Staff Report to the New York State Senate Select Committee on Budget and Tax Reform

on

Modernizing New York State's Telecommunication Taxes

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Based on testimony from a roundtable meeting in Albany on August 12, 2009

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Executive Summary

New York State's telecommunications tax system is long overdue for an upgrade. The last time it received a major overhaul was nearly 15 years ago — after an appellate court ruled that the state's Utilities Tax discriminated against interstate and foreign commerce.

The 1995 reforms, which among other things created a new excise tax for telecommunications services, came amid a period of dramatic change in the telecommunications industry. It was the year, for example, Time Warner Cable premiered in Rochester a voice service delivered over its cable television network.

Since then, telephone companies too have ventured out of their traditional market and started providing video services. Despite this cross-pollination of services, New York tax policy continues to treat these providers separately.

Many of New York's telecommunications taxes stem from an era when telephone service was a regulated monopoly, and most of the industry's newcomers face fewer taxes partly because they have fallen outside of this traditional framework. But as these new technologies and competitors emerged, the Legislature attempted to "level the playing field" by expanding the monopoly-era taxes.

The playing field instead became more complicated and inequitable. Today the complexity has become so problematic that in the state budget passed earlier this year, the Senate directed the Department of Taxation and Finance and the Public Service Commission to do a full accounting of the state's telecommunications taxes. They are expected to issue a report on their findings by October 1.

In anticipation of this report, the Senate Select Committee on Budget and Tax Reform, which is chaired by Senator Liz Krueger, convened on August 12 a roundtable on modernizing New York's telecommunications taxes. At the Albany meeting, the Select Committee discussed the issue with several tax experts representing telephone, wireless, cable television and satellite television service companies.

Key findings and conclusions from the roundtable's discussions are detailed in this staff report to the Select Committee. They include:

Telecom Evolution=Tax Inequity: Disparate treatments in New York's telecommunications tax system largely stem from lawmakers' endeavors to "level the playing field" by expanding the monopolistic-era practices to unregulated utilities and newer technologies.[1] Key inequities identified by state and industry representatives included:

- Cable companies do not pay property taxes on network equipment on private property, while telecoms' similarly-sited equipment is subject to taxation.
- Traditional telecoms are exempt from paying property taxes on electronic attachments connected to cables in public rights-of-way, while cable companies are required to pay taxes on this similarly-sited equipment.

[1] Testimony from Scott Mackey, partner with Kimbell Sherman Ellis LLP. Albany roundtable, Aug. 12, 2009.

- The New York State Office of Real Property Services requires cable companies to provide less extensive data on their networks, compared to what is required of traditional telecoms.
- Purchases of equipment for cable television networks are subject to a sales tax while equipment purchased for traditional telecom networks are not subject to the tax.
- Voice over Internet Protocol (VoIP) and wireless telephone service providers are not required to contribute to the Targeted Accessibility Fund of New York (TAF) while landline telephone companies are subject to that fee.
- E-911 fees are not collected on prepaid wireless phone cards while a $1.20 monthly state surcharge is levied on customers' postpaid wireless communications bills.
- Traditional telecoms offering both video and voice services are required to pay the PSC the Section 18-A assessment for telephone-related regulation and the Section 217 assessment fee for television-related regulation while some cable companies engaged in the same activates are only subject to the latter.
- Direct broadcast satellite providers do not pay the PSC the Section 217 assessment fee that cable and telecom companies pay when they provide video services.
- Direct broadcast satellite providers are not required to pay the video franchise fees both cable and traditional telephone companies pay to local governments when providing multichannel video programming services in their communities.

Tax Policy vs. State Goals: New York's telecommunications tax policy runs counter to the goals of the state's economic development and regulatory policies. High tax rates, unequal tax treatments and heavy administrative burdens threaten investment in broadband networks, which are crucial to attracting and maintaining businesses. By creating a tax structure that is more onerous on regulated utilities, the state is inadvertently steering New Yorkers toward non-regulated utilities that are not subject to the consumer protection provisions in the Telephone Fair Practice Act.

Local Concerns/Federal Considerations: Telecommunications taxes and fees represent a vital component of local governments' revenue — totaling almost $900 million in 1998. But industry representatives warned this revenue is not sustainable due to trends steering consumers toward services and providers that are not taxed. Any state attempts to simplify or equalize the telecommunications tax system would impact local governments significantly. Along with these local concerns, there are several federal telecommunications-related laws which lawmakers need to consider when looking to reform the tax system. They include The Cable Act of 1984, The Telecommunications Act of 1996, The Federal Internet Tax Freedom Act (1998) and The Federal Mobile Telecommunications Sourcing Act (2000).

Solutions & State Models: The telecommunications industry is largely in agreement that taxes should be based on the type of service — not the means through which it is delivered. There is also a consensus that functionally-equivalent services should be taxed the same way. In recent years, several states have overhauled their telecommunications tax system, and roundtable participants singled out Virginia's 2007 reform as being the most comprehensive and equitable. The cable industry came out in favor of reforms enacted by Virginia, Massachusetts, Ohio, North Carolina and Tennessee, but satellite companies have challenged most of these measures with lawsuits. Twenty-three other states have opted to modernize their telecommunication taxes by adopting the definitions in the Streamlined Sales and Use Tax Agreement, a collaborative project of the National Governors' Association and National Conference of State Legislatures intended to simplify states' sales tax systems.

In conclusion, the Select Committee intends to explore further ways to create a simpler telecommunications tax system that uniformly imposes taxes based on the types of services rather than on their means of delivery. The telecommunications tax matrix that the New York State Department of Taxation and Finance is expected to issue by Oct. 1 will be crucial to understanding and improving the system, and the Select Committee looks forward to reviewing its findings.

Introduction

Almost 15 years have passed since New York State last gave its telecommunications tax system a major overhaul. To usher in this reform, it took an appellate court ruling that said an access charge deduction under a section of the state's Utilities Tax discriminated against interstate and foreign commerce.

Under the 1993 court ruling, New York could have been forced into providing long-distance phone companies with up to $100 million in refunds and reducing their taxes by $34 million annually. Instead, four major long-distance companies reached a settlement with the state under which they agreed to forego $54 million in refund claims in return for the enactment of corrective legislation.[2]

Very simply, the reform the Legislature passed two years later excluded long distance companies from having to pay an additional franchise tax under Section 184 of Article 9 of the Tax Law. It also created a new excise tax on telecommunications, developed a new allocation method for receipts from telecommunications services and directed the Department of Taxation and Finance (Tax and Finance) to evaluate the reforms and recommend ways to modernize New York's telecommunications tax system.[3]

That was 1995, amid a revolution in the telecom industry. It was the same year Amazon.com was launched as an online bookstore and eBay was founded in a San Jose living room. The term "blog" hadn't even been coined yet.

It was also the year AT&T Corp. announced plans to undergo its second major breakup in about a dozen years. Time Warner Inc. reached a deal to acquire Turner Broadcasting System, strengthening its position as the world's largest communications company. And perhaps most importantly — at least in regard to telecommunications taxation dynamics — Time Warner Cable made Rochester the first city in the nation to have voice services delivered over a cable television system.[4]

Clearly much has changed in the telecommunications industry since then. Unfortunately, much in New York's telecommunications tax system hasn't changed. And much of the change that has come only continued the age-old practice of cobbling one layer of taxes upon another until it is nothing but a complex system riddled with inconsistencies and inequities.

The complexity has become so problematic that in the state budget passed earlier this year, the Senate directed the Department of Taxation and Finance and the Public Service Commission (PSC) to do a full accounting of the New York's telecommunications taxes. They are expected to issue a report on their findings by October 1. This will be the third major report on telecommunications taxes lawmakers have ordered since the reforms of 1995.

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[2] New York State Department of Taxation and Finance, "Summary of 1995-96 Tax Provisions."
[3] Ibid.
[4] The New York Times, "A Telephone Role By Time Warner." By Edmund Andrews. Section A, page 1 of New York edition. May 18, 2004.

It is a complexity with implications that go beyond giving the state's tax policy the appearance of a Gordian knot. It also results in higher tax rates and overly-burdensome administrative requirements.

According to a 2004 Study and Report on Telecommunications Taxation by the Council for State Taxation, the national average effective rate of state and local transaction (consumer) taxes for telecommunications services was 14.17 percent. In New York that figure was approximately 19 percent. Not making the situation any simpler are the 588 taxing jurisdictions statewide that impose taxes on telecommunications services, requiring service providers to file over 5,600 tax returns annually.[5]

"What now complicates the subject tremendously [is] now cable … wireless and traditional telephone companies are in the same business. But we're still viewed as separate industries. We all provide similar services and we have all these different tax structures that are not matching up equally," said Robert Puckett, president of the New York State Telecommunications Association.

In its 1997 report evaluating the telecommunications tax reforms from two years earlier, Tax and Finance said, "Although important changes were made with the 1995 telecommunications legislation, the current system results in some taxpayer inequities. Forthcoming competitive changes within the industry will exacerbate these inequities."

Recognizing that the competitive changes Tax and Finance referred to have come about and that the inequities within the industry have worsened, the Senate Select Committee on Budget and Tax Reform on August 12 held a roundtable on modernizing the state's telecommunications taxes. The six-member, bi-partisan committee chaired by Senator Liz Krueger asked tax experts from around the country to identify unequal tax treatments applied to telecoms and to offer solutions that could carry New York's telecommunications tax policy well into the 21st century.

At the Albany meeting, the Select Committee discussed the issue with several tax experts representing the interests of the providers of telephone, wireless, cable television and satellite television servicers. Representatives from the state Office of Real Property Services (ORPS) and Tax and Finance also either participated in or attended the meeting.[6]

The Select Committee staff's key findings and conclusions from the roundtable are detailed in this report.

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[5] Testimony from Stephen Kranz, partner of Sutherland Asbill & Brenna LLP. Albany roundtable, Aug. 12, 2009.

[6] Roundtable participants included: Stephen Kranz of Sutherland Asbill & Brennan LLP, Jeremy Kudon of Orrick & Herrington LLP (for DirecTV and DISH network), Scott Mackey of Kimbell Sherman Ellis LLP (for Verizon/Verizon Wireless/AT&T/Sprint/T-Mobile), Victor Mallison and Matthew Riordan of Office of Real Property Services, Louis Manuta of the Public Utility Law Project of New York, Scott Olson of Cooper Erving and Savage LLP (for the New York State Wireless Association), Robert Puckett of the New York State Telecommunications Association and Eric Tresh of Sutherland Asbill & Brennan (for the Cable Telecommunications Association of New York.

Telecom Evolution=Tax Inequity

By 2008, it became obvious that New York tax policy treated telecommunications service providers not only differently, but unequally as well. It actually became a marketing tool.

Enter Sir Charge, the derby-donning man with a British accent who starred in Time Warner Cable advertisements promoting the cable company's home phone service. The ads claimed Time Warner phone bills feature far fewer taxes and fees than those for the cable company's local telephone service competitor. The seemingly aristocratic character introduces himself in one ad saying, "I'm Sir Charge. I pop up all over your Verizon phone bill. Peek-a-boo!" The ad ends with the voiceover of a woman encouraging viewers to call a Time Warner hotline and "[S]ay goodbye to Verizon and to Sir Charge."

By last June, Cablevision too was highlighting lower taxes and fees on its cable television-Internet access-phone service package called Optimum Triple Play, compared to Verizon's similar FiOS Triple Package. According to an ad mailed to Verizon customers, a monthly subscription to the Optimum package carries up to $2.11 in taxes and fees while that figure for the FiOS package is up to $15.44.

"Marketing campaigns shouldn't be based on the differences in taxes that one provider pays versus another … [W]hen it gets to that point, where to the public your marketing campaign is based on these tax and surcharge differences, we think that certainly points to a need to address the issue," said Puckett at the telecommunications association.

The cable industry acknowledged that there are inequities built into New York's telecommunications system, but most of its complaints related to the taxation of direct broadcast satellite (DBS) providers. It also acknowledged that these different tax treatments create unfair competitive advantages.

"[C]onsumers may choose one functionally-equivalent service over another based on the aggregate taxes and fees on their invoices," said Eric Tresh, a partner at Sutherland Asbill & Brennan LLP who at the roundtable represented the Cable Telecommunications Association of New York.

Even the satellite industry chimed in on the Sir Charge debate: "No one should be able to base an entire advertising campaign … on the disparity between the taxes and surcharges paid by two providers of the same landline telephone service," said Jeremy Kudon, a senior associate at Orrick & Herrington LLP who represented DISH Network and DirecTV at the roundtable.

Needless to say, the cable industry's lower-tax-touting ads irked their competitor telecoms that largely pay taxes under New York's Utilities Tax, which is established under Article 9 of the Tax Law. Cable companies, having first appeared on the video service provider scene in the early 1970s, used newer technologies and were subjected to New York's Corporate Franchise Tax. The Corporate Franchise Tax is the main tax for general businesses and is established under Article 9-A of the Tax Law.

Inherent to this 9/9-A split are a host of differing taxes businesses must pay. For example, and perhaps most significantly, Article 9 taxpayers are taxed on a gross receipts basis. Meanwhile Article 9-A taxpayers are primarily subject to a net income tax.

In its 1997 report, one of Tax and Finance's chief recommendations for improving New York's telecommunications taxes was a unilateral movement toward net income taxation for telecoms. Citing increased competition, the agency said, "Recent changes in the telecommunications industry make it essential to reexamine the current corporate tax structure as it applies to telecommunications companies." However, Tax and Finance said it was "premature" to pursue this net income tax switch.[7]

A dozen years later, the gross receipts basis for taxation has taken a back seat to the myriad of unequal tax treatments that have emerged or worsened as Article 9 telecoms ventured deeper into the tradition service territory of Article 9-A cable companies, and vice-versa.

Tresh said the net income tax/gross receipts issue is less pressing now because all voice service providers — from landline telephone companies to cable-owned VoIPs — pay taxes under Article 9. In these cases, some subsidiary service providers pay taxes under an article different from what their parent companies pay when providing different services.

"I'm not sure I have a real take on that — whether the distinction between 9 and 9-A ought to be carried forward — but there is parity between these providers," said Tresh.

However, there are several disparate tax treatments that exist between telecoms and cable companies offering voice services, and they do not all fall in favor of the latter.

Landline/Wireless/Cable (Voice)

Whether they are being used to transmit telephone conversations, television programs or e-mails, telecommunications networks remain asset-heavy. Service providers roll out thousands of miles of wires and cable and erect an array of other equipment to make communication transmissions possible. But even at a time when both cable and traditional telephone companies are laying similar fiber-optic lines across their state to support voice, video and Internet services, the equipment used in their networks are taxed differently. For example:

- **Cable companies do not pay property taxes on network equipment on private property, while telecoms' similarly-sited equipment is subject to that taxation.[8]** In 1985, the Legislature amended a section of the Real Property Tax Law to exclude certain cable television equipment from the definition of "real property." This equipment, when

[7] New York State Department of Taxation and Finance, "Improving New York State's Telecommunications Taxes: Final Report and Recommendations." January 1997.

[8] Testimony of Victor Mallison, deputy executive director of the New York State Office of Real Property Services. Albany roundtable, Aug. 12, 2009

sited on privately-owned land, was classified as personal property and deemed tax exempt.[9]

Cable companies received this property tax exemption after the broadcasting industry obtained an exclusion for its equipment from the Real Property Tax Law "appurtenance" exemption. The 1985 act created parity between the competing cable and broadcasting industries, according to Tresh.

"[W]hile it was designed to create parity between the competing cable and broadcasting industries, it failed to anticipate the future of the entire communications industry and created huge a advantage for the cable industry," Verizon Director of New York Government Affairs David Lamendola said of the 1985 act.

This disparity is exacerbated by the valuation and assessment practices for telecoms' network equipment on private property. ORPS annually values cable and telecommunications companies' network property in public rights-of-away, minimizing the impacts of lags in local government assessment updates or mandated cyclical reassessments. However, Lamendola said this is not the case with telecoms' equipment on private property, which local assessors value and assess, often infrequently. During the period between reassessments, the value used for telecoms' initial assessment stays on the tax roll and is equalized by an equalization rate that reflects trends in the traditional real estate market. But this market, which predominately includes residential homes, "is completely foreign to declining market value trends and depreciation experienced by telephone plant investment."

"There is a huge disparity that favors the cable industry and the impact is reflected in over-assessment, the cost of administrative and legal appeal challenges, expert appraisal resources and legal representation," Lamendola said. " … In Verizon's case alone, this disparity is an inequity equal of $60 [million] to $70 [million] annually in property tax the cable industry completely avoids."

- **Traditional telephone companies are exempt from paying property taxes on electronic attachments connected to cables in public rights-of-way, while cable companies are required to pay taxes on this similarly-sited equipment.[10]** In 1987, the Legislature eliminated the property tax on most central office and station equipment. At the time, very little of this equipment was housed indoors. But by 1995 technological

[9] New York State Department of Taxation and Finance, "Local Telecommunications Taxes and Fees in New York State." January 2001.
[10] Mallison.

advancements made it more practical for some of this equipment to be placed in streets, highways and waterways. Lawmakers that year passed legislation (S.1736-A/A.5280-A) that exempted telephone company's central office and station equipment — namely the circuit packs located on fiber-optic cable routes —from the tax.[11]

"It does create an inequity in the way we access value in the properties," said Victor Mallison, the deputy executive director at ORPS. Lamendola at Verizon said, "[T]he disparity should not exist and … the cable industry should be treated similarly."

- **ORPS requires cable companies to furnish it with less extensive data on their networks, compared to what is required of traditional telephone companies.** The discrepancies in the amount of detail ORPS requires of cable and telephone companies stems from the former emerging as "mom-and-pop" enterprises and the latter being regulated monopolies.[12]

  "The reality is there are differences in how we collect data at this point in time, with much of it having to do with the data collected by the companies themselves," Mallison said.

  Verizon attests that the reporting differences result in more than a disparity in assessment and valuation; it also creates inequitable administrative costs associated with annual compliance obligations, addressing issues with inventory discrepancies, management of bill payments and processing and the tracking of factors to judge the fairness of assessments and the merits of pursuing assessment appeals.

  "ORPS either needs to have a mandate of finding a common inventory or developing a factor to 'level' the inventory collected to be similar in the valuation process of similar typical mile reproduction cost new estimates," Lamedola said.

  Tresh said the cable industry would "support any effort to decrease reporting requirements." Lamendola added, "[P]arity should and must not result in greater taxation of either the cable or telecommunications industry."

- **Purchases of equipment for cable television networks are subject to a sales tax while equipment purchased for traditional telecom networks are not subject to the tax.** The exemption on telecommunications and Internet equipment took effect in 2000. It applies to tangible personal property used directly and predominantly in the receiving,

[11] Justification cited for S.1736-A.
[12] Mallison.

initiating, amplifying, processing, transmitting, re-transmitting, switching, or monitoring of telecommunications services for sale or Internet access services for sale. In 2006, the most recent year for which data is available, the exemption yielded $78 million in foregone tax revenues.[13] Networks built by traditional telecoms and cable companies now have a dual nature; they are capable of delivering both voice and video services. Because most of traditional telecoms' networks are devoted to voice service, they largely take advantage of this exemption. But cable companies, whose networks remain largely devoted to video services, rarely claim this exemption, according to Tresh.

The cable television industry previously received a similar sales tax exemption on machinery and equipment for upgrading to digital television and applicable services. This exemption applied to purchases from September 2000 to September 2003. A sales tax exemption for television broadcasting machinery and equipment also took effect in September 2000.

While Tresh assured the Select Committee there is parity between cable-owned VoIP and traditional telecoms because they pay the same taxes under Article 9, Puckett noted they are not all subject to the same fees. For example:

- **VoIP and wireless telephone service providers are not required to contribute to the Targeted Accessibility Fund of New York (TAF) while landline telephone companies are subject to that fee**. The PSC established TAF in 1998 as a way to ensure certain programs were funded by telecoms. Programs supported by TAF funds include Lifeline, Enhanced E-911, public interest pay phones and the Telecommunications Relay System. In 2006, the Federal Communications Commission (FCC) expanded Universal Service Fund (USF) contribution requirements to VoIP service providers. Some of the federal funds streamlined through the USF go toward TAF programs, such as Lifeline, but VoIP and wireless providers do not contribute to it on a state level.

  Lou Manuta, a senior attorney for the Public Utility Law Project of New York (PULP), noted that Time Warner Cable does make voluntary contributions to TAF. Recent years have also seen the FCC make VoIP services providers comply with the federal wiretapping Communications Assistance for Law Enforcement Act of 1994, offer E-911 access and connect to relay services for the deaf. Wireless providers are subject these requirements as well.[14]

[13] New York State Department of Taxation and Finance, "Annual Report on New York State Tax Expenditures." 2009-2010.
[14] Testimony from Louis Manuta, senior attorney for the Public Utility Law Project of New York, Albany roundtable, Aug. 12, 2009.

"Without declaring VoIP to be a telecom service, the FCC has already begun to bring VoIP under the telecom umbrella," Manuta said. "We believe the time is right for New York to begin taxing and assessing all similar service providers similarly, since there should be no impediments on the federal or local levels."

The PSC is currently reviewing TAF, and Tresh said the Legislature should await the agency's recommendations. He noted that VoIP customers are not eligible for TAF funds and VoIP providers cannot be reimbursed from the federal USF, meaning they would receive less on TAF than traditional telecoms.

Verizon disagreed that TAF funds need to be extended to VoIP and wireless providers. Lamendola noted that wireless customers already pay a $1.50 monthly in state and local E-911 fees while landline customers pay up to 35 centers per line (except in New York City, where the fee is capped at $1).

- **E-911 fees are not collected on prepaid wireless phone cards while a $1.20 monthly surcharge is levied on customers' postpaid wireless communications bills.** Even though prepaid wireless customers use New York's 911 system, the state lacks the mechanisms to collect the E-911 fee from them. A handful of states, such as Maine, Texas and Louisiana, have recently enacted legislation creating such mechanisms. The National Conference of State Legislatures has established a model for the collection of this fee based on either a flat rate or a percentage rate.

  In New York, Assemblyman David Koon recently introduced legislation (A.8830-A) proposing to impose a 3 percent surcharge on the retail purchase of any prepaid wireless communications service for the state's 911 and emergency communications system.

Landline/Cable/Satellite (Video)

New York's playing field for multichannel video programming distributors was contentious enough when it was just cable and satellite companies offering pay-TV services. But, as always, technological advancements changed the dynamic of the industry.

Around 2005, both Verizon and AT&T began rolling out fiber-optic television services in select cities across the nation. By January 2006, Verizon brought its new pay-TV service to New York, beginning on Long Island and expanding it to almost 160 municipalities statewide as of last August.

When traditional telecoms ventured into New York's video service territory, the tax inequities they experienced with cable companies on the voice front were further complicated. Fees continue to be problematic for both traditional telecoms and cable companies, but their grievances do not fall on the same ones. For example:

- **Traditional telecoms offering both video and voice services are required to pay the PSC the Section 18-A assessment for telephone-related regulation and the Section 217 assessment fee for television-related regulation while some cable companies providing both services are only subject to the latter**. Telecoms regulated by Public Service Commission are required to pay this fee, which funds the agency and is so-named because it stems from Section 18-A of the Public Service Law. The 217 fee stems from the Legislature's decision to merge the Commission on Cable Television into the PSC. The merger, which took effect in 1996, granted regulatory authority over cable television in the PSC and Department of Public Service.

  Telecoms' outcry over disparities involving 18-A grew louder earlier this year when Governor David Paterson proposed in his 2009-2010 Executive Budget raising the fee from 0.33 percent to 1 percent of utilities' intrastate revenues. Governor Paterson also proposed creating an additional temporary 1 percent conservation assessment. The Legislature approved both measures. Although, "[i]n recognition of the competitive nature of the telecommunications industry," telecoms were exempted from this temporary assessment.[15]

  Some cable company affiliates that provide voice services do pay the 18-A assessment. These affiliates largely include competitive local exchange carriers. Tresh said uncertainly concerning the 18-A assessment has compelled some cable-owned VoIPs, such as Time Warner Cable's affiliate, to pay the fee while others have decided not to pay it.

- **Direct broadcast satellite providers do not pay the PSC the Section 217 assessment fee that cable and telecom companies pay when they provide video services.** Satellite television service providers fall outside the PSC's jurisdiction; therefore exempting them from the television-related regulatory fee.

- **Direct broadcast satellite providers are not required to pay the video franchise fees both cable and traditional telephone companies pay to local governments when they operate in their communities.** Tresh traced satellite companies' scant taxation to misinterpretations of the U.S. Telecommunications Act of 1996. Section 602(a) of the law prohibits local governments from imposing local taxes on satellite television service providers, essentially saving them from having to file hundreds of thousands of tax returns to municipalities nationwide. However, the law includes a clause that allows

[15] New York State Division of Budget, "2009-10 Enacted Budget Financial Plan." April 2009.

> states to impose taxes on satellite companies and distribute some or all of the tax revenue to local governments.
>
> "In practice, what Congress intended as merely administrative relief has translated into a substantial competitive advantage for DBS providers, effectively denying consumers a tax neutral choice of video service providers," Tresh said.

Meanwhile, the satellite industry viewed the issue differently. Kudon, the representative for DirecTV and DISH Network, acknowledged that other video service providers pay more in state and local taxes than what the satellite industry pays. Actually, when pressed by Select Committee Chairwoman Liz Krueger to identify what his industry pays in taxes, Kudon replied saying, "Nothing." However, he said other providers' heavier tax burdens are largely based on "objective criteria," namely the value of property they own in the state.

"When it comes to pay-TV service, we believe New York's current tax structure is fair and reasonable. Pay-TV is not subject to the 'differing tax treatments' that plague other telecommunications services. To the contrary, all providers are treated exactly the same: New York does not impose state or local sales tax on pay-TV — regardless of the provider," said Kudon.

Kudon also stressed that franchise fees are not taxes, and that the former are not applicable to satellite companies in the same way they are to cable and telephone companies. Some states have been hit with satellite industry lawsuits for allegedly replacing cable franchise fees with taxes imposed on all video service providers. To highlight the difference between taxes and fees, Kudon noted:

- Local governments do not impose franchise fees the way they impose taxes.
- Telephone and cable companies pay these franchise fees in return for a direct benefit—a property right—that they alone, enjoy.
- The property rights that phone and cable companies buy with franchise fees are highly valuable.
- The franchise agreements that are negotiated at arm's length between cable and local governments look nothing like tax codes.[16]

"The bottom line is that franchise fees do not look anything like taxes," Kudon said.

[16] Kudon.

Tax Policy vs. State Goals

The Time Warner Cable character Sir Charge rather glibly underscored some of the cable industry's alleged tax advantages over traditional telecoms. However, the repercussions of such inequities in New York's tax system reach beyond the industry and its services. Ultimately it is a situation that pits the state's tax policy against the goals of its regulatory and economic development policies.

While not wholly attributing recent industry trends to tax inequities, traditional telecom representatives said that unequal treatments do impact consumer habits and discourage investment in infrastructure. Together they make the telecom tax policy a threat to the state's economic development policy. Puckett noted that Verizon lost almost $1 billion in New York in 2007. Since 2000, according to PSC data, Verizon has lost 43 percent of market share as measured by access lines.[17]

"As you increase administrative burdens and increase taxes, you're going to have less and less money for network expansion buildout and enhancement. The carriers don't want that. There are areas that are not covered. They just don't have basic coverage in a lot of areas," said Scott Olson, a member of Cooper Erving & Savage LLP who represented the New York State Wireless Association at the roundtable.

Mackey warned that burdensome taxes and administrative requirements could curtail telecoms' ability to invest in broadband networks, which are widely viewed as crucial economic development tools. In 2008, the industry invested about $50 billion in communications networks. He said an overhaul of the state's telecommunications tax system "can improve New York's ability to attract new investment in communications networks that will make New York's economy more productive and create new jobs."

From a state tax revenue perspective, the trend away from landline telephone service providers actually has some benefits. The 2009-10 Executive Budget projected All Funds receipts under Article 9 to increase as consumers continue to cancel their land lines and use wireless services as their primary form of communication. The Executive Budget noted: "Customers' wireless bills on average are higher than comparable bills for land lines, driving telecommunications tax receipts higher."[18] Corporations and Utilities tax revenue collections totaled $742.78 million in fiscal year 2008, up 9.6 percent from the previous year.[19]

However, the revenue perks related to this revenue shift are not shared with local governments. The detrimental aspects this shift poses to local government revenues will be examined in the next section, "Local Concerns/Federal Considerations."

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[17] Testimony from Robert Puckett, president of the New York State Telecommunications Association, Albany rountable, Aug. 12, 2009.

[18] `New York State Division of the Budget, "2009-10 Executive Budget: Economic and Revenue Outlook." December 2008.

[19] New York State Department of taxation and Finance, "Monthly Goss and Net Tax Collections." March 2009 and March 2008.

The trends away from landline telecoms, whether promulgated by tax policy or not, are also undermining an important aspect of New York's regulatory policy. The trends are actually steering New Yorkers to unregulated service providers not subject to certain consumer protection requirements.

Under the Telephone Fair Practice Act (TPFA), which is established under Part 609 of the PSC's regulations, landline telephone customers can go to the PSC with complaints concerning provider billing or service quality for resolution. However, cable, wireless and VoIP service providers are not subject to the act, so the PSC cannot assist their customers in resolving problems. PULP believes TPFA should apply to all providers of intrastate telecommunications services.[20]

"Because of disparity in the tax treatments, it's sort of an incentive for people to leave the regulated, taxed utility and go to the non-regulated, non-taxed utility … Cablevision is now the largest local telephone provider on Long Island. Well, all of those customers who have switched over to Cablevision no longer are protected by the customer protections of TPFA," said Manuta.

[20] Manuta.

Local Concerns/Federal Considerations

Local Government Standpoint

Trends shifting consumers away from tax-paying, regulated telecommunications service providers also threaten to upend local governments' traditional relationship with the industry. A 2001 survey by Tax and Finance found the industry remitted $894 million in taxes and fees to local governments in 1998.[21]

Over two-thirds of those remitted revenues stemmed from local sales taxes and real property taxes. Cable television franchise fees accounted for $101 million and local gross receipts taxes and New York City's own set of corporate and excise taxes on telecommunications companies accounted for $81.7 million.

When Tax and Finance conducted its 2001 survey, New York had over 3,500 separate taxing units including counties, cities, towns, villages, school districts, and other special districts. Fifty-seven cities and 349 villages imposed a gross receipts tax on telecoms.[22] To alleviate the administrative burdens telecoms face in having to file separate tax returns to each of these taxing jurisdictions, some tax experts at the roundtable suggested creating a centralized collection system, particularly for cable franchise fees.

Commenting on such proposals, Mallison from ORPS said: "The argument of the local government might be that you're taking away their opportunity to set their own rate … If we administer this centrally, obviously there's going to be a higher cost to the state."

However, in the nine years since the Legislature ordered the above-noted study, the dynamic by which traditional telecom and cable companies remit these taxes and fees has started to change. Increasingly, New Yorkers are receiving telecommunications services from so-called "remote sellers," who lack a taxable presence in the state.

"While the localities don't like going through the change or giving up sovereignty of their tax rates and conduct their own audits, the threat to their tax base is the shift in the way services are provided," Kranz said.

One scenario illustrating this shift is when a cellular phone user — who is also connected to a wireless fidelity or "WiFi" signal —uses a VoIP service provider to make a free long-distance phone call. This practice, Kranz said, results in a shift "away from the service providers who are charging tax and remitting it to the local government to service providers who no longer have a nexus with the local governments and will not be collecting their tax."

"The only way to address that is to truly simplify the tax structure — communications taxes generally and sales taxes in particular— and get remote sellers to collect the tax," Kranz said.

Federal Government Standpoint

[21] New York State Department of Taxation and Finance, "Local Telecommunications taxes and Fees in New York State." January 2001.
[22] Ibid.

When looking to address concerns involving remote sellers, centralized tax structures and other issues, lawmakers will need to be conscious of several federal laws that draw the parameters around which states can act. Key federal laws and the limitations they put on state telecommunications tax policy include[23]:

- **The Cable Act of 1984**: Outlines what state and local taxes can be imposed on cable television service providers. The law prohibits state and local governments from imposing multiple and discriminatory taxes on these companies.
- **The Telecommunications Act of 1996**: Prohibits local governments from imposing taxes and fees on satellite television services. However, states are permitted to impose such taxes and remit some or all of their revenues to local governments.
- **The Federal Internet Tax Freedom Act (1998)**: Prohibits states from imposing multiple and discriminatory taxes on electronic commerce and new taxes on Internet access service.
- **The Federal Mobile Telecommunications Sourcing Act (2000)**: States that mobile telecommunications are taxed or "sourced" to customers' primary place of use.

Other federal legislation either being considered in Congress or expected to be reintroduced soon include:

- **Sales Tax Fairness and Simplification Act (H.R.3396 and S.034 in 2007)**: Proposes to enable states that have adopted the Streamlined Sales and Use Tax Agreement to require remote sellers to collect and remit sales and use taxes. This legislation is expected to soon be reintroduced in Congress. [24]
- **State Video Tax Fairness Act of 2009 (H.R.1019)**: Proposes to prohibit states from imposing discriminatory taxes on providers of multichannel video programming services, such as Internet protocol technology, direct broadcast satellite and cable television. A tax would be deemed discriminatory if its net tax rate is higher for one means of multichannel video programming service than the net tax rate imposed on another means for the same service.[25]
- **The Mobile Wireless Tax Fairness Act of 2009 (S.1192)**: Proposes to temporarily prohibit state and local governments from imposing new discriminatory taxes on mobile wireless communications services, providers or property. The act would impose a five-year moratorium on new mobile phone taxes.

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[23] Tresh.
[24] Kranz.
[25] Kudon

Solutions & State Models

Uniformity and competitive neutrality. Telephone, cable and satellite companies all claim to favor these qualities when it comes to the taxation of telecommunications services. But often there is not uniformity within the industry on how to achieve uniform taxation.

"A fundamental tenant of sound tax policy is that consumers should be provided with a tax-neutral choice. This requires that functionally-equivalent services be taxed the same," said Tresh. By "functionally-equivalent services" Tresh meant video, voice or data services. How or who delivers them is secondary.

Manuta echoed this position saying, "There should be no unevenness in taxation that tilts the playing field for providers using different technological platforms to provide the same type of service."

On top of the demand for a uniform and neutral tax policy, industry representatives at the roundtable also said New York needs to reduce telecoms' administrative burdens and reduce the high effect tax rates levied on their services.

"Any attempt at modernization should seek to eliminate this discrimination by reducing the rate and number of taxes imposed on telecommunications services," said Kranz.

Whatever course New York takes to address the inequities built into its telecommunications tax system, Mackey suggested using the National Conference of State Legislatures' ("NCSL") Communications Service Tax Reform principals to guide the state's reform efforts. The NCSL issued this resolution in 2004, saying that under a uniform and competitively neutral system, "industry-specific telecommunications taxes are no longer justified." [26]

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[26] Key points in the NCSL resolution which the organization's executive committee adopted in 2007, include:

- **Tax Efficiency:** State and local taxes and fees imposed on communications services should be substantially simplified and modernized to minimize confusion and ease the burden of administration on taxpayers and governments.
- **Competitive Neutrality:** State and local transaction taxes and fees imposed on communications services should be applied uniformly and in a competitively neutral manner upon all providers of communication services, without regard to the historic classification or regulatory treatment of the entity.
- **Tax Equity:** Under a uniform, competitively neutral system, industry-specific telecommunications taxes are no longer justified.
- **Tax Fairness:** With the blurring of distinctions between various services and technologies, state and local governments must strive to set tax burdens on communications services, property and providers that are no greater than those tax burdens imposed on other competitive services and the general business community.
- **Local Government Impacts**: States need to include provisions to mitigate potential local government revenue impacts associated with communication tax reform.
- **Economic Development:** States need to simplify, reform and modernize state and local telecommunications tax systems to foster competition, encourage economic development,

For about a third of the 50 states, modernizing their telecommunications taxes is not an issue because they have long levied on the industry taxes similar to those applied to general businesses. These states lack the discriminatory taxes that have failed to keep pace with industry technology.[27]

However, several states with industry-specific taxes have recently attempted to modernize them. The below chart, prepared by the Select Committee staff, details some reforms:

Recent State Telecommunications Tax Reforms

State	Year of Reform	Key Reforms	Fiscal Impacts	Steps to Conform New York State to Reforms
Florida **Telecom Tax Simplification/ Centralized Tax Collection**	**2001**	The reform merged seven local and state telecom taxes into two taxes, establishing a streamlined tax filing system for Florida telecoms. The two new taxes are a State Communications Services Tax and a Local Communications Services Tax. Under the new structure, the Florida Department of Revenue collects all telecom taxes for local governments. Telecoms file single monthly returns with single payments to that agency, which remits the local portion of the tax to local governments.	The reform was intended to be revenue neutral. Communications Services Tax collections: FY2002: $2.04 billion. FY2008: $2.52 billion.	1. Consolidate several state and local taxes levied on telecoms, such as a state sales tax, gross receipts tax, video franchise fees and telecom franchise fees. 2. Create a streamlined tax return filing and collection system, under which the state collects and remits local jurisdictions' portion of the tax.

reduce impediments to entry, and ensure access to advanced communications infrastructure and services throughout the states.

- **State Sovereignty:** NCSL will continue to oppose any federal action, other than prohibition of taxes on Internet access, or oversight role which preempts the sovereign and Constitutional right of the states to determine their own tax policies in all areas, including telecommunications and communication services.

[27] Ibid.

Ohio **Satellite Tax/ Uniform Telecom Tax**	**2003 and 2005**	A budget bill imposed a sales tax on satellite television services. A separate reform shifted local telephone companies' liability from under the public utilities excise tax to the corporation franchise tax and municipal income tax. Local telephone companies' assessment rates on tangible personal property were phased down to the general business rate level.	Satellite Sales Tax revenues: $18.5 million (estimated) in 2005. $36 million in 2008. Telecommunications reclassification: FY 2004 $65.9 million estimated revenue increase. FY2005: $30 million estimated revenue increase.	1. Eliminate the excise tax on receipts that telecoms pay under Article 9 and subject them to a net income tax under or comparable to Article 9-A. 2. Align personal property assessment rates for Article 9 telecoms with rates applied to general businesses. 3. Create a satellite sales tax.
Massachusetts **Satellite Excise Tax**	**2009**	The budgetary measure imposed an excise tax on satellite broadcast service providers' gross revenues. Another provision eliminated property tax exemptions for telephone poles and wires, and it authorized municipalities to tax them.	Estimated revenue increase of $25 million for each provision.	1. Impose an excise tax on satellite broadcast service providers' gross revenues.
Virginia **Uniform Telecom Tax**	**2007**	The reform replaced Virginia's utility-based tax system and cable franchise fees with a new state-administered system to which all communications services are subject. This creates a new article of taxation to which all telecoms are subject	Before Virginia lawmakers expanded the new telecom tax to cable and satellite television services, initial projections showed the reforms resulting in a $34 million in fewer collections. The expansion of the tax was designed to offeset this loss.	1. Create a new article of tax with a flat rate levied on all communications services. The rate should be comparable to the state's retail sales tax rate. 2. Eliminate local cable franchise fees and establish a central collection system under which the state collects all telecom taxes and disburses to municipalities rebates equal to their share of taxes under the old system.

Kentucky **Telecom Excise Tax/Centralized Tax Collection**	**2006**	The measure created new taxes on video service providers designed to replace local franchise fees on those services. It levied a new communications excise tax on the sales price of multichannel video programming services. Revenues generated by the new taxes are deposited into a Gross Revenue and Excise Tax Fund. Those funds are distributed to local governments, which are in turn prohibited from levying franchise fees on multichannel video service providers.	FY 2006: $13.9 million estimated in new General Fund revenues. FY2008: $35.6 million estimated in General Fund revenues. (Figures do not include funds collected for and remitted to local jurisdictions).	1. Eliminate local video franchise fees and replace them with a new excise tax on multichannel video programming services. 2. Create a Gross Revenue and Excise Tax Fund into which revenues from the new telecom tax are deposited. 3. Establish procedures for the state to remit municipalities' portion of the new excise tax.
North Carolina **Telecom Sales Tax/Centralized Tax Collection**	**2006**	The measure brought telecom and cable and satellite television services under North Carolina's general state sales tax.The new telecom sales tax replaced the local cable franchise fee. The state redistributes revenues generated by the new telecom tax to local governments.	The new tax on satellite television services generated $13.2 million more revenues in FY2005, compared to the previous fiscal year.	1. Eliminate local cable franchise fees 2. Eliminate the sales tax exemption on cable television services and impose a sales tax on satellite broadcast television services. 3. Establish a mechanism for the state to collect and remit to municipalities their potion of the new sales taxes.
Maine **Uniform Telecom Tax/State Universal Service Expansion**	**2003-2009**	The state shifted several services from its 5 percent sales tax and placed them under a newly-created service provider tax set at the same rate. It is collected by landline, wireless and Voice Over Internet Protocol (VOIP) service providers. The tax is also imposed on extended cable and satellite television services. Established state universal service surcharges for Lifeline, schools and libraries and broadband. Levied a flat fee on wireless telephone prepaid cards for E-911 services. Postpaid wireless communications contracts are subject to a similar fee.	Service Provider Tax revenues: Cable/Satellite: $7.5 million in 2005 $8.7 million in 2008. Telecommunications: $37.9 million in 2005 $40.2 million in 2008.	1. Create a new article of tax that imposes a service provider tax levied on cable television, satellite television, landline, wire and VOIP telecommunications service providers. The new tax's rate should be equal to the sales tax rate. 2. Establish state universal service surcharges imposed on all voice service providers for Lifeline, schools and libraries and broadband networks. 3. Impose an E-911 fee on wireless telephone prepaid card purchases.

Tennessee **Competitive Cable and Video Service Act**	**2007**	The act established a state-issued certificate of franchise authority meant to replace local cable franchise fees. Holders of the certificates can be subject to a franchise fee set by local governments but not to exceed 5 percent of gross revenues. Slightly different privilege tax rates were also imposed on cable and satellite television companies.	Net impact of franchise fee restructuring: $12.5 million increase in state expenditures. $2.3 million decrease in local government revenues. Eighteen percent of the new tax is redistributed to local governments to offset the loss of franchise fee revenues.	1. Eliminate local cable franchise fees. 2. Create a state-issued certificate of franchise authority. 3. Create privilege taxes imposed on cable and satellite companies.

Virginia's telecommunications tax reform model emerged as the most popular among participants at the roundtable, or at least it was viewed as the most comprehensive individual state effort. State reform models favored by the cable industry included Massachusetts, Ohio, Virginia, North Carolina and Tennessee.

In explaining the benefits of these reform strategies benefits, Tresh frequently spoke of them as equalizing, simplifying or narrowing the gap between the tax and fee burdens borne by cable and satellite television companies and their customers.

However, Kudon said most of the state models mentioned favorably by Tresh failed to fulfill the satellite industry's core taxation requirement: "If we're all going to be taxed, we're all going to be taxed the same."

The satellite industry has challenged most of the cable industry's favored state models with lawsuits. For example, DirecTV and EchoStar Satellite sued Ohio over its 2005 reform. Tresh viewed this measure's 5 percent tax on satellite television service providers as "approximately equal to the franchise fees imposed on cable video service." But DirecTV and EchoStar called the tax unlawfully discriminatory because it is not applied to the cable industry.

States, such as North Carolina and Tennessee, have established special taxes for video service providers while also eliminating cable franchise fees. These reforms have also met lawsuits from the satellite industry.

"[T]he tax should be imposed equally on all pay providers. It certainly should not be used to offset the franchise fees that cable companies pay to local towns and cities as 'rent' to access the public rights of way necessary to deliver their video programming to subscribers," Kudon said.

Regarding the above-noted reform measures, Mackey said "states have taken a bad situation and made it marginally better." A far better reform strategy, in Kranz's view, is outlined in the Streamlined Sales and Use Tax Agreement (Streamlined Agreement).

In 1999, the National Governor's Association and National Conference of State Legislatures joined forces to draw a blueprint states could use to simplify and modernize their sales and use tax administration. They formed the Streamlined Sales Tax Governing Board, which was tasked with finding solutions to the issued raised in the U.S. Supreme Court's 1992 decision in *Bellas Hess v. Illinois and Quill Corp. v. North Dakota.* The court ruled that state cannot require sellers to collect tax on sales if they lack a physical presence in the state. The court said the existing system is too complicated for states to mandate sales tax collections on remote sellers.

Twenty-three of the 45 states that impose sales taxes have adopted the Streamlined Agreement.[28] Although it primarily addresses sales and use tax issues, it also contains definitions for telecommunications services and sourcing matters. While these definitions are important to establishing a uniform method for levying sales taxes on telecommunications service providers, Tresh said the Streamlined Agreement does not resolve problems concerning the gross receipts and other taxes and regulatory fees levied on those companies.

"The agreement improves sales tax administration for main street and remote sellers through tax law simplifications, more efficient administrative procedures and the utilization of emerging technologies. The agreement eases the sales tax burden on businesses by adopting uniform definitions," Kranz said.

In recent years in Congress, Massachusetts Representative William Delahunt and Wyoming Senator Michael Enzi have introduced a bill that would allow states that have adopted the Streamlined Agreement to require remote sellers to collect sales taxes. Kranz called the remote seller provision the "carrot" Congress is using to get states to simplify their tax systems. The legislation, also known as The Sales Tax Fairness and Simplification Act, is expected to be reintroduced soon in Congress.[29]

[28] States that have adopted the Streamlined Sales and Use Tax Agreement include Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin and Wyoming.

[29] Kranz.

Conclusion

Over the past 25 years, New York's attempt to make its tax policy catch up with the technological advancements of various voice, video and data service providers has created more problems than it has sought to resolve. The Select Committee believes a tax structure based more on the type of service than on the type of provider would not only bring the state's telecommunications tax policy up to speed but also better prepare it for the myriad of changes expected to play out in the industry throughout the 21st century.

As speakers at the roundtable made abundantly clear, the telecommunications tax structure has become almost inordinately complex. Crucial to simplifying the system will be the findings of Tax and Finance's telecommunications tax matrix, which is due by Oct. 1. The Select Committee plans to use this report to explore what steps would be necessary to achieve the following:

- The implementation of a streamlined tax system that utilizes universally-accepted definitions and ultimately reduces administrative burden.
- The development of a more standardized method for imposing real property taxes on traditional telecoms and cable television companies.
- The creation of a uniform and competitively-neutral tax structure for multichannel video programming services.

With this report in hand, the Select Committee can better explore ways to establish a simplified and more equitable tax structure.

Advisory: The Select Committee staff acknowledges that this report does not provide a full review of the disparate treatments in New York's telecommunications tax system. A more thorough review of the system will be possible after Tax and Finance issues its telecommunications tax report by October 1. The purpose of the August 12 roundtable and this report was to identify the inequities industry representatives viewed as the most egregious or pressing and to discuss ways to remedy them.

About the Select Committee on Budget and Tax Reform

On February 5, 2009, the New York State Senate adopted Senate Resolution No. 315, which created the Select Committee on Budget and Tax Reform. Since then, the six-member, bi-partisan committee chaired by Senator Liz Krueger has sought to look at New York State's entire tax structure. It aims to determine what aspects of it are working smoothly and where there are inequities and complications that must be rectified.

The Select Committee embarked on this mission initially by holding a public hearing on March 12, 2009 to explore progressive changes to the state's personal income tax (PIT) system From this hearing in Albany, the Select Committee noted how PIT rate reductions in the 1990s and earlier part of this decade resulted in a greater tax burden shift to property taxes. Given this trend — coupled with the elimination of the Middle Class STAR Rebate Check Program in the 2009-2010 budget — Senator Krueger introduced legislation (S.4239) proposing to establish a middle-class circuit breaker tax credit that would be phased in over four years. The bill would provide tax relief to households with an adjusted gross income of less than $250,000 annually, broadening the reach of the state's existing circuit breaker program.

Given the state's economic and fiscal crises, the Select Committee then turned its attention to New York's business and banking taxes. It held public hearings on April 30, 2009 in Rochester and May 21, 2009 in New York City to evaluate the equitability of the state's business and banking tax structures and their effectiveness to foster economic growth statewide. After hearing about the varying tax treatments imposed on businesses by the state and New York City, Senator Krueger sponsored legislation (S.50047/A.8867) that would align the two tax structures. Both the Senate and Assembly in June passed this legislation, which the governor signed into law on July 10.

After hearing about widespread inequities in New York's telecommunications tax system during last winter's budget discussions, Senator Krueger turned the Select Committee's attention to this issue. It held on August 12 a roundtable on modernizing New York's telecommunications taxes.

The Select Committee's members also include Senators Neil Breslin, Kenneth LaValle, Kevin Parker, Bill Perkins and Michael Ranzenhofer. Select Committee staff includes Executive Director Michael Lefebvre, Principal Analyst Richard Mereday and Administrator James Schlett.