NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 571 (Second Edition) **REVISED NOTE**

SHORT TITLE: Simplify Taxes on Telecommunications

SPONSOR(S):

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available (X)**

($ Millions)

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund					
Interstate & New Rate (4.5%)	**(2.1)**	**(5.3)**	**(5.3)**	**(5.3)**	**(5.3)**
Prepaid Phone Cards	*** See Assumptions and Methodology ***				
Coin Telephones	**$0.3**	**$1.2**	**$1.2**	**$1.2**	**$1.2**
Call Centers	*** See Assumptions and Methodology ***				
TOTAL	**(1.8)**	**(4.1)**	**(4.1)**	**(4.1)**	**(4.1)**

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Dept. of Revenue and most municipalities.

EFFECTIVE DATE: The bill is effective January 1, 2002 and applies to taxable services reflected on bills dated on or after January 1, 2002.

BILL SUMMARY: This bill attempts to simplify the collection of telecommunications taxes by (1) combining multiple tax rates into one uniform rate equal to 4.5%, (2) broadening the tax base by eliminating exemptions for interstate calls and telephone membership corporations, (3) taxing prepaid phone cards at the point of sale instead of at the point of use, (4) adjusting the tax on the gross receipts from pay phones, (5) setting a call center tax cap of $50,000 a year, and (6) eliminating the current 3.09% franchise tax distribution to municipalities and replacing it with a distribution of 18.26% of the new revenue total (less the previous freeze amount).

BACKGROUND: Under current law telecommunication is taxed in a variety of ways, depending on the type of call. As the chart below suggests most local calls are subject to a 3% sales tax and a 3.22% franchise tax. Toll calls and intrastate calls are subject to a 6.5% sales tax and no franchise tax. Interstate and pay telephone calls are exempt.

Type of Call	State Sales Tax	State Franchise Tax
Most Local	3.00%	3.22%
Local Coin Pay Phone	0%	0%
Toll	6.50%	0%
Intrastate	6.50%	0%
Interstate	0%	0%

The North Carolina Department of Revenue reports the following telecommunications revenue streams.

Fiscal year	Utility Sales Tax Collections			Franchise Tax	Total Collections
	3% (Estimated)	6.5%	Total	3.22%	
1996-97	$62,900,000	$49,317,345	$112,217,345	$63,520,237	$175,737,582
1997-98	68,800,000	57,966,199	126,766,199	71,263,562	198,029,761
1998-99	76,400,000	55,287,550	131,687,550	79,658,103	211,345,653
1999-00	84,422,000	61,000,000	145,422,000	90,331,697	235,753,697

This suggests that for 1999-00, the most recent year for which data is available, North Carolina revenue collections on telecommunications were $235.8 million. This translates into a telecommunications tax base of $3.74 billion.

ASSUMPTIONS AND METHODOLOGY: The bill makes several changes that have a fiscal impact.

Interstate Calls

Under existing law, interstate telephone calls are exempt from state tax. Previously it was believed that taxing this type of call was prohibited by federal law. However, in Goldberg v. Sweet the US Supreme Court ruled that interstate calls can be taxed by state governments. The bill makes these interstate calls taxable.

The first attempt to develop a fiscal estimate on taxing interstate calls failed when telecommunications companies serving North Carolina refused to answer a survey sent out jointly by the Department of Revenue and the Fiscal Research Division of the General Assembly. The telecommunications companies feared that answering the survey would reveal valuable market data. They also stated that this information was not available from their parent companies.

Lacking industry data, Fiscal Research turned to data from other states. In 1997 New York began taxing interstate calls and reported that tax base separately for one year. That state reported an interstate and international telephone tax base of $5.3 billion. Adjusting for the difference in statewide personal income in New York and North Carolina, and deducting for international calls in New York, suggests a potential North Carolina base of $1.5 billion for 1999-00.

In May 2001 Fiscal and Tax Research discovered that Mississippi had recently instituted a new tax on interstate telecommunications. This state's experience suggested that earlier estimates based on New York data might have been too optimistic. While some of their lower revenue numbers can be attributed to collection problems related to multiple tax rates and sourcing problems (which are eliminated by the bill) the much lower actual collection numbers suggested an adjustment was needed. These adjustments are included in the new base estimates and are responsible for the bill becoming a net loss to the state.

New Tax Rate

The combined data on current collections and the potential interstate base suggests a total telecommunications tax base of approximately $5.83 billion (4.25 + 1.58). A 4.5% gross receipts tax on that base would yield $262.45 million ($5.83 billion X 4.5%). Once the payment to municipalities is deducted ($63.90 million) approximately $198.56 million remains for the state in 2001-02. When compared to the current estimated existing tax revenue this portion of the bill creates a $4.9 million revenue loss. This number is adjusted for the effective date and grown by 8%. No growth is included in the last three fiscal year estimates as the future of telecommunications rates and structure is very unclear.

Prepaid Phone Cards

The bill subjects prepaid phone cards to the general state and local sales tax at the point of sale. As of 1999, 28 states and the District of Columbia taxed prepaid calling cards with the point of sale method. Currently, North Carolina taxes the phone cards when used by the consumer. Since the Department of Revenue does not track the tax paid on the use of calling cards, it is difficult to determine the revenue impact of the change in tax methods. The firm Atlantic-ACM estimated that the 1998 U.S. retail market for prepaid calling cards was $3.2 billion. If North Carolina's market share is equal to its share of the US population (2.8%), then $89.6 million in calling cards were sold in North Carolina in 1998. If used for interstate calls, the state would not have received any tax. If used for intrastate calls, then those minutes would have been taxed at 6.5%. The state receives no tax on cards that are lost or not fully utilized for the full face value of the card. At a minimum, tax at the point of sale should be a break-even or a positive gain for the state. If the 1998 sales had been taxed at the point of sale, the state would have earned $4,032,000 from a 4.5% sales tax and local governments would have earned $1,792,000 from the 2% local sales tax.

Coin Operated Phones

The bill includes in taxable gross receipts the customer access line charges billed to pay phone companies. The North Carolina Utilities Commission Public Staff estimates that there are approximately 44,000 pay phones in the state. According to the North Carolina Payphone Association, the average access line charge is between $45 and $50 a month. Assuming $50 a month for 44,000 pay phones, then the taxable receipts equal $26.4 million. If a 4.5% tax rate is imposed on $26.4 million in receipts, then the General Fund will earn $1,188,000 from the line charges.

Call Centers
The legislation caps the telecommunications tax liability of call centers at $50,000 annually. The cap applies to a user that purchases interstate telecommunications services that originate outside North Carolina but terminate in the state, and has a direct pay certificate issued by the Department of Revenue. According to the Telecommunications Industry Association, at the national level these centers are most often associated with financial institutions (21.0%), followed by telecommunications companies (12.8%), manufacturers (12.5%), and transportation (9.2%). However, no reliable information is available to Fiscal Research on the amount of calls made by these centers or the tax loss associated with a cap.

City Distribution
Currently cities receive 3.09% of the 3.22% gross receipts tax assessed on calls made within their city limits. The legislation replaces this allocation with a 24.4% share of the total receipts from the new 4.5% tax. The revenue is not available to a city incorporated after January 1, 2000 unless it is eligible to receive Powell Bill funds and have a majority of its streets open to the public. The bill also modifies the distribution formula to cities. Under the bill cities incorporated before January 1, 2001 receive revenue based on the proportion of the franchise tax they received in the same quarter in 2001. Newer cities receive an allocation based on population.

According to the Department of Revenue, in FY 1999-00 North Carolina municipalities received $47.0 million in franchise tax revenue ($57.5 million in franchise tax less a $10.5 million holdback). This equates to approximately 24.4% of the collections estimated under the new tax. By shifting from the franchise tax to a proportion of the new gross receipts tax, Tax Research estimates that the cities would gain approximately $120,000 statewide in the first full year under the new system.

Note: The annual growth rates in federal telecommunication excise tax receipts generated by the Joint Congressional Committee on Taxation are used throughout the analysis. The annual growth rates and projections for 1998-2007 are as follows:

Year	Growth
1998	7.49%
1999	7.12%
2000	6.39%
2001	6.39%
2002	6.61%
2003	6.51%
2004	6.62%
2005	6.21%
2006	6.22%
2007	5.98%

The FY 2001-02 estimates have been adjusted to account for the effective date.

NOTE: HB 231, passed by both chambers, changes the uniform rate from 4.5% to 6.0%. The rate language in HB 231 supersedes the rate in this bill, although the reforms in this bill remain intact.

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