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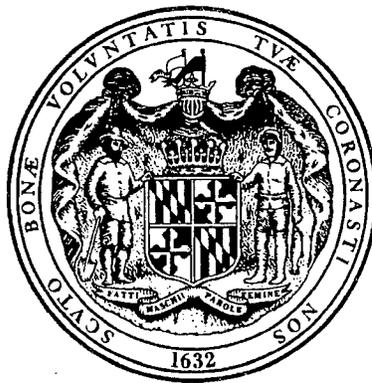
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Taxation of Telecommunications and Cable Television in Maryland

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August 25, 1995

The Honorable Barbara A. Hoffman, Chairman
Senate Budget and Taxation Committee

Delegate Sheila E. Hixson, Chairman
House Committee on Ways and Means

Members of the Senate Budget and Taxation Committee
Members of the House Committee on Ways and Means

Ladies and Gentlemen:

This report was presented in a series of briefings to the Task Force on Telecommunication Taxes during the 1994 Interim. It includes a brief discussion of developments in the telecommunications industry and an overview of the taxation and regulation of the industry in the state. The current structure of taxes on this industry and its consumers is analyzed, as are possible alternatives. Also included is a description of the taxation and regulation of cable television companies in Maryland.

This report was prepared by analysts David F. Roose, Michael J. Sanderson, and Stephen M. Ports, under the guidance of Douglas R. Mann. The Department of Fiscal Services appreciates the cooperation received from industry representatives, state agencies, and all other interested parties.

Sincerely,

A handwritten signature in black ink, appearing to read "William S. Ratchford, II".

William S. Ratchford, II
Director

TAXATION OF TELECOMMUNICATIONS AND CABLE TELEVISION IN MARYLAND

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Taxation of Telecommunications and Cable Television in Maryland

I. Origin and Purpose of Study

The General Assembly considered legislation during the 1994 Session that would have reduced the assessment ratio of operating property of telecommunications companies from 100% to 40% (House Bill 1496). This legislation was amended to require a comprehensive study of the entirety of telecommunications taxes in Maryland by a Task Force on Telecommunication Taxes. The amended bill passed both houses and was signed into law by the governor (Chapter 680). This report, analyzing the taxes telecommunications companies pay in Maryland as well as possible alternatives, was prepared by the Department of Fiscal Services to assist the Task Force in its work.

II. Overview of the Telecommunications Industry: Past, Present and Future

The telecommunications industry has undergone a significant evolution over the last several decades. This change is most evident in the transformation of long distance service from a well-regulated monopoly to a fairly competitive though still regulated industry. Significant changes have occurred in the local service market as well, due in large part to the shakeup in the long distance market. Although the local service market is still somewhat monopolistic, it is dramatically different from that of several decades ago, and it is still evolving.

Changes in the telecommunications industry have had many effects on state economies and governments. Effective public policy response to these changes requires an understanding of the evolution of the industry as well as the impending changes in the industry.

Monopoly

American Telephone and Telegraph (AT&T) held a monopoly on virtually all aspects of telecommunications through the first half of this century. Other firms were prohibited from providing telecommunications services, even to the point of not being allowed to manufacture and connect non-AT&T equipment to phone jacks. The monopoly was complete.

AT&T was able to maintain its monopoly position in part because the provision of telephone service was, in economic terms, a natural monopoly. A natural monopoly exists in a market if the most efficient quantity can be produced by one firm. One indicator that a natural monopoly exists is if the fixed costs of an industry are high relative to the marginal costs.

The fixed costs of telecommunications were very high as the industry was developing. Poles and wire were very expensive to erect and maintain. Once the infrastructure was established, however, it was very inexpensive to add a customer to the system. This condition held true for both local and long-distance telephone service.

In part because it was a natural monopoly, and in part because regulation would enhance AT&T's monopoly position, long-distance service was regulated at the federal level by the Interstate Commerce Commission (ICC) in 1910. The ICC controlled entry to the market, as well as minimum and maximum rates. In 1934 regulation of the long-distance market was transferred to the newly created Federal Communications Commission (FCC). Intra-state service was primarily regulated by the states.

For the first two-thirds of this century, this arrangement worked well. Because the long-distance and local markets were natural monopolies, there was no incentive for other firms to challenge the existing order. Consumer worries of monopolistic practices were minimized because of the regulation. American Telephone and Telegraph was satisfied with the

arrangement because its market position was assured, as were its returns. Any costs of regulation could be passed on to its customers.

Divestiture

Primarily due to technological advances, the existence of a natural monopoly in the long-distance market came into question. A series of events beginning in the late 1960s led to the breakup of the AT&T monopoly. The breakup has had far-reaching consequences which have not entirely played themselves out.

The FCC in 1968 allowed companies other than AT&T to be connected to long-distance lines. The next year, the FCC allowed Microwave Communications Incorporated (MCI) to enter the Chicago-St. Louis private line service market (private line service is a circuit which allows long-distance, full-time access between two or more points). This decision further stimulated the appetite of non-AT&T firms for access to the long-distance market.

The FCC's Specialized Common Carrier decision in 1971 allowed free entry into the private line service market (PLS) anywhere in the country to any firm without the lengthy petition process. Four years later, MCI introduced its Execunet service, a message toll service ("regular" long-distance). The FCC ruled that it had only opened the PLS market, and demanded that MCI discontinue this service. The courts ruled, however, that provision of long-distance service was not limited to AT&T.

AT&T's role as the telephone company ended in 1982, when Judge Harold Greene decided an antitrust case brought against AT&T by the United States Government. This case was filed in 1974 by the Justice Department, though AT&T's hold on the telecommunications market had at that point been under assault for some time.

Although competition was increasing in the telecommunications market, the Department of Justice's antitrust case against AT&T forced AT&T to sever its connections with the twenty-two local operating companies. AT&T retained Western Electric, its manufacturing division, Bell Labs, its research and development division, and its long-distance operations. As a result of divestiture, AT&T was no longer operating in any monopoly markets.

Currently, the long-distance market is a competitive one. In Maryland in 1993, there were 57 companies providing long-distance service. Most of these companies were re-sellers, or companies which purchase excess capacity in volume from facility-based long-distance companies (AT&T, MCI, etc.) and resell it at retail prices to consumers. Consumers, both business and residential, have a wide variety of choices when it comes to their long-distance provider.

Local Telephone Service

The long-distance market has grown from one company several decades ago to several major players and scores of aspiring firms today. Clearly, competition is a major factor in that market. The case is not so clear-cut, however, for local telephone service. While the divestiture agreement created seven local companies where before there was essentially one, the "Baby Bells" provide local service in strictly defined geographical areas. From the perspective of local telephone service, some contend there is still a monopoly structure in this market.

This conclusion may be incorrect. There are increasing signs of competition in the local service market. Montgomery Cable has received a great deal of press for its plans to provide what amounts to local phone service in Montgomery County through its cable network, in competition with Bell Atlantic (Montgomery Cable is a subsidiary of Southwestern Bell). Cable companies are not the only businesses looking into such possibilities. Already, MFS Communications Inc. has received permission to provide local telephone service in the Baltimore area. In addition, cellular companies also provide local service, though they are not regulated by the State.

Several technologies are developing which could further increase the intensity of competition in this market. In the near future, personnel communications services (PCS) may be providing something similar to local telephone service, but much more sophisticated. PCS are expected to be able to transmit data as well as voice. These wireless communications systems will enable an individual to use one phone number and be reached at any time, in any place. Another potential application of new technology is the use of cable to transmit on-line electronic data. Technological developments are rapidly eroding the Baby Bells' preeminence in the communications market.

While the potential for competition in the "pure" local telephone service market is increasing, Baby Bells are active in other markets which are competitive to some degree or other. The Baby Bells have long competed in the markets for Yellow Pages and telephone equipment. All of the Baby Bells compete in the cellular communications market, serving about half of the nation's cellular customers. Local phone companies are not standing idly by while cable companies and others encroach on their primary product. Technology which will allow video signals to be sent over telephone lines is advancing. This will open up video-on-demand and interactive video services to the Baby Bells. While anything approaching total competition in these markets may still be years off, all indications are that this is the direction the market is headed.

Conclusions

The evolution of the telecommunications market has several distinct long-reaching effects on Maryland's government and economy. The gross receipts tax alone resulted in more than \$45 million for the general fund in fiscal year 1993. The fiscal year 1994 assessed property tax base for telecommunications companies was over \$2.7 billion, representing approximately \$78

million in revenue for local governments. In a time of fiscal austerity, these are rather large numbers. As always, potential changes to the tax structure must be made with an eye towards the effect on revenues.

Equally important, the effects of any changes to the tax structure must be examined for their impact on telecommunications firms. An indication of the importance of a strong telecommunications presence to the State's economy lies in the very reason this study has been undertaken--technological change in the industry. High technology firms and advanced telecommunications systems have a symbiotic relationship. If Maryland wishes to pursue an economic development strategy in which high technology firms play a large role, it seems reasonable to ensure that telecommunications firms are not placed at a competitive disadvantage by locating in Maryland.

III. The Current Structure of Telecommunications Taxation in Maryland

The State of Maryland, like most states, maintains a dual regulatory and taxation structure, treating "utilities" differently than other businesses. In short, Maryland regulates utilities via the Public Service Commission (PSC), and taxes them through a Gross Receipts Tax. This specific treatment arises from the long-held standard that these companies operate essentially as monopolies in the provision of their services, and that it is in the best interest of the public to regulate the services and prices of such natural monopolies.

Telecommunications companies are, for the most part, treated as "utilities" by the state. For purposes of this report, the discussion of telecommunications companies will focus on two groups: providers of local telephone service, and providers of long distance telephone services. Other types of companies that provide similar services (such as cellular carriers, paging systems, and others) are generally neither regulated nor taxed under public service company laws. Additionally, companies that operate in more than one field (such as a "baby bell" company that has different divisions to provide local telephone service and cellular service) are treated "unit-by-unit" as either a regulated public service company or as a non-regulated company, as appropriate to the services provided. Appendix 2 shows the tax and regulatory treatment of companies facing various degrees of regulation by the state.

Gross Receipts Tax

Generally, public service companies in Maryland pay a 2% Public Service Franchise Tax as their primary state tax. The tax, also known as the gross receipts tax, applies to all revenues associated with the functions that are directly regulated by the PSC. It is a source of approximately \$138 million in revenue to the state's general fund, about \$45 million of which is derived from telecommunications companies.

There are two underlying rationale behind the imposition of a gross receipts-based tax for utilities rather than the more traditional profit-based income tax placed on most corporations. First, the rate-setting authority granted to the PSC allows the gross receipts tax to be passed on directly to the final customers, in the form of higher service rates (which are calculated based on the cost of inputs, and can be adjusted to reflect a simple 2% tax). Second, for a company that has its rate of return established by the PSC, "profits" may not be the most effective measurement of "ability to pay" taxes, and the use of a tax based on overall activity (such as gross receipts) may be a better indication of the company's use of government resources as well.

The tax base of "gross receipts" is defined in Section 8-401 of the Tax-General Article as including:

gross or total earnings and total receipts;

the full amount of approved and applicable federal and State tariff charges for telephone lifeline service without the discount provided under the Public Service Commission Law; and

gross charges from the sale of long distance that originates or terminates in the State and for which a charge is made to a service address located in the state, regardless of where the amount is billed or paid.

"Gross receipts" do not include:

revenue derived from an activity other than a regulated "public service" function (i.e. electric, gas, oil pipeline, telegraph, or telephone);

net uncollectible revenue; and

receipts from a sale of a service or product that is intended for resale and will ultimately be subject to the gross receipts tax.

In 1992, the General Assembly made a significant change to the application of the gross receipts tax to interstate long distance carriers. The apportionment method for interstate service was changed from a method of using "circuit mileage" to determine the state for taxation to a "billed revenue" method that uses the billing site of an interstate call as the taxable site. This method seems more able to accommodate future technological developments, and also generated a significant revenue increase to the State of Maryland.

Other State Taxes

In addition to the Public Service Franchise Tax, telecommunications companies in Maryland pay several additional taxes on their operations in the state.

Corporate Income Tax. For local telephone service providers, the state's 7% corporate income tax is applied to net income derived from functions that are not subjected to the gross receipts tax (such as billing and collection services, Yellow Pages, access charges, and telephone services for resale). Long distance companies also pay the corporate income tax, although they cannot deduct their gross receipts tax base in the taxable income calculation.

Sales Tax. The 5% state sales tax applies to the purchase of capital and other equipment used to provide telephone services. Telephone companies must collect the sales tax on specialized telephone services such as answering services and "custom calling features" like speed dialing, call waiting, etc. The sales tax also applies to service charges for cellular telephones and "beepers."

Property Taxes

Among local taxes paid by telecommunications companies, by far the most significant is the property tax. With nearly \$3 billion in assessable tax base in Maryland associated with the telecommunications industry, the property tax is of great significance to both the industry and the local governments, which rely heavily on property tax revenues.

Most corporations have their property assessed by the State Department of Assessments and Taxation, with a division between real and personal property. Real property is assessed at 40% of "market value," while personal property is assessed at full value. Real property is taxed by the state at 21 cents per \$100 of assessed value. Both real and, in most cases, personal property are taxed by the local governments at the locally-set tax rate.

The procedure for "utilities," including telecommunications companies (specifically the property used to provide services that are regulated and taxed otherwise as public services) is different. All property used in the provision of public services (whether land, buildings, or equipment) is categorized as "operating property" and classified as operating real property or operating personal property. Whether it is classified as real or personal, all operating property is assessed at 100% of full value, rather than the 40% that would otherwise apply to improvements to land (land is assessed at 40% of value). The property is then treated and taxed as any other class of personal property--taxed at the rate set by the local government.

Other Local Taxes

Some local governments in Maryland have established a local excise tax on telecommunications services. Those local jurisdictions are detailed below:

Anne Arundel: 8% excise tax
Baltimore City: 12% excise tax
Baltimore County: 8% excise tax
Montgomery: \$1.25 per residential or business line,
\$.125 per centrex access line

The excise taxes are levied on local telephone service only.

IV. Analysis of the Gross Receipts, Corporate Income and Sales Tax Structures

This section analyzes the current tax structure using the following criteria: revenue sufficiency; equity; simplicity and ease of administration; and competitiveness and market neutrality. The criteria are often used in tax policy analysis to assess tax structures and alternatives. Section IV explains several alternatives to the current tax structure, and analyzes them using the above concepts.

Revenue Sufficiency

The revenue generated by a tax is obviously one of the most important considerations of tax policy. In addition to the amount of revenue, the stability of the revenue stream is also important. Taxes on telecommunications, while not one of the major sources of State revenue, do generate millions of dollars for the State. If any changes are made to the tax structure, they should be made with an awareness of the revenue effects. In this era of tight budgets, the loss of even a few million dollars can be a problem. Also, an impairment of revenue stability from year to year can be a problem.

The current structure of taxes (excluding property taxes) levied on telecommunications services and firms produced about \$96 million for the State in tax year 1993. This total includes:

- ◆ the gross receipts tax revenue, levied on local and long-distance telephone service providers;
- ◆ the sales taxes paid by local and long-distance companies on equipment;
- ◆ the sales tax revenue from cellular phone services;
- ◆ the sales tax revenue from miscellaneous phone services; and
- ◆ the corporate income taxes paid by local, long-distance and cellular providers.

The revenue total is broken down as follows:

1993 Telecommunications Revenues

(Millions of \$)

Gross Receipts	\$45.1
Sales Tax on Equipment	18.3
Corporate Income Tax	13.6
Sales Tax on Cellular Service*	13.5
Miscellaneous Sales Tax	6.0
TOTAL	\$96.5

* Fiscal 1994 data

Source: Department of Assessments and Taxation,
Office of the Comptroller, Survey of
Telecommunications Firms

These revenues are all credited to the general fund, with the exception of a portion of the corporate income tax revenues which are credited to the Transportation Trust Fund.

Several comparisons help to put these figures in context. Of the approximately \$6.5 billion in general fund revenue collected in calendar year 1993, the taxes from telecommunications firms and services (excluding the property tax) amounted to 1.5%. The gross receipts tax revenues from telecommunications companies was just over one-third of total gross receipts revenues, while corporate income taxes from these sources amounted to about 6% of total corporate income tax revenue. Just over 2% of sales tax revenue came from these sources.

Whether revenue from these taxes is "sufficient" is difficult to determine. Several methods could be used to try to determine whether the State is receiving enough revenue from these sources, or is overburdening the industry with taxes. Ideally, the tax burden faced by a company or industry would be equivalent to its consumption of public resources such as public safety, roads, and the like. If an industry consumes a relatively large portion of public resources, its tax burden should be relatively heavier than that for an industry which consumes a small amount of public resources.

As one indication of the telecommunication industry's consumption of public goods, the payroll and employment of the telecommunications industry in the State can be compared to total payroll and employment. The average annual payroll of telecommunications firms was 1.7% of the total payroll in the State in 1993, while telecommunications companies provided

1.0% of the jobs in the State. One could infer from these statistics that the tax burden on telecommunications is not unreasonable.

In addition to revenue, the stability of the revenue stream is also of importance. Some components of the telecommunications tax structure are relatively stable and predictable, while others vary greatly from year to year. As the table below indicates, growth in the revenue stream has been rather stable in the 1990s, with the exception of 1992. In this year, the apportionment of gross receipts for long-distance companies was altered from a circuit mileage method to a billed revenue method, which resulted in a significant revenue change. The gross receipts tax revenue from telecommunications companies has been growing more slowly in the 1990s than in previous years, in part because the market is saturated, and rates are not increasing significantly. Despite this slower growth, revenues remain rather predictable from one year to the next, as do revenues from the sales tax on equipment used by telecommunications firms.

Average Annual Revenue Change, 1975-1993

<u>Tax</u>	<u>1975- 80</u>	<u>1980- 85</u>	<u>1985- 89</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Telecom. Gross Receipts	9.7%	3.5%	11.9%	4.3%	3.4%	11.8%	7.9%
Sales Tax on Equipment	NA	NA	NA	-4.5%	3.9%	-0.2%	-2.6%
Income Tax	NA	NA	NA	67.5%	16.4%	44.3%	20.7%
TOTAL				5.8%	5.0%	12.2%	7.2%
General Fund	12.5%	8.0%	9.3%	4.7%	7.8%	0.5%	4.9%

Source: Department of Assessments and Taxation, 1993 Report of the Spending Affordability Committee, Survey of Telecommunications Firms

Corporate income tax revenues, on the other hand, are not particularly stable. The wide variance from one year to the next is due to several factors, including the ability to carry losses forward and backward. In any given year, sixty percent of all corporations incur no corporate income tax liability. Thus, for the small universe of telecommunications companies, corporate income tax revenues could change substantially from one year to the next. The variance of these revenues does not have a significant effect on the variance of the entire revenue stream, however, since these revenues account for less than 15% of the total.

Although the question of whether the telecommunications industry is being taxed "enough" is essentially a policy question for the legislature to address, available indicators suggest that this industry is not overburdened by the current structure of taxation. The current system also

provides a reasonably stable revenue stream, primarily because of the emphasis on taxation of gross receipts of these companies, rather than profits.

Equity

One very significant consideration in the tax treatment of a diverse industry as telecommunications is equity. With an increasing number of services being provided, and an increasingly complex and competitive network of service providers, the fair treatment of the corporations and their consumers is of significant importance.

Horizontal Equity

Horizontal equity is concerned with taxpayers in similar circumstances being treated similarly by the tax system. In the telecommunications area, there are two considerations of horizontal equity: fair treatment of companies providing telecommunications services, and fair treatment of the consumers of different telecommunications services. In each case, a tax system is considered equitable (in terms of horizontal equity) if individuals or corporations that are in identical or similar circumstances (for example, providing or using the same types of services) shoulder the same or comparable tax burdens.

Local Telephone Carriers and Long Distance Carriers

In the provision of telephone service, both local and long distance have traditionally been treated as "utilities" by the state of Maryland. The tax treatment of these two facets of telephone service were subject primarily to the 2% gross receipts tax, and exempted from the corporate income taxes except on their secondary, "competitive" functions. In 1992, this equal treatment was altered, and long distance telephone service was subjected to the 7% corporate income tax, in addition to the 2% gross receipts tax. In short, the tax burden on long distance carriers and their customers (to the extent that this gets passed along in higher rates) is higher than that on local telephone service.

This unequal treatment may or may not represent inequitable treatment between these two facets of the broader telecommunication industry. To the extent that local and long distance service are both facets of an increasingly competitive industry, then this differential treatment (taxing profits of long distance providers but not local providers) may be a basic inequity. But to the extent that the provision of the two services are different enough to be considered entirely separate industries (i.e. they do not compete directly for customers, etc.) then the differential treatment may be a matter of relative policy-making, rather than a judgement of equity.

Local Telephone Carriers and Cellular Telephone Carriers

The tax treatment of local telephone service and cellular telephone service differs dramatically. Cellular telephone carriers are treated essentially as an ordinary "competitive"

business, subjected to the corporate income tax. However, the service they provide has been included as a "taxable service" under the state sales tax law. So, these two tax differences apply a different tax burden on both the companies and their consumers than is applied to local telephone.

Without question, the tax burden on cellular telephone is higher. The 5% sales tax and 2% gross receipts tax are comparable in their application-- they are both separately stated items on the consumer's ultimate bill. Therefore, the question of "who ultimately pays the tax" is moot, since the taxes are similar in application, and the main difference is the significantly higher rate of the sales tax, which applies to cellular telephone service only. With the addition of the corporate income tax on profits of cellular companies, this further adds to the disparate tax treatment of these two industries.

Again, the evaluation of this difference lies in the judgement of the similarity or difference of these two services. To the extent that people may choose between making calls by their stationary local telephone provider or their mobile cellular telephone provider, the industries may be considered comparable and competitive, and the tax difference may be a genuine inequity. However, to the extent that cellular service acts primarily as a supplement to consumers of local service (virtually all of whom are likely to be consumers of stationary phone service as well), then the two services may be viewed as substantially different, and the tax differences may be warranted by policy objectives other than horizontal equity (*see below, under vertical equity*).

Companies Providing Similar Services

One area that the Maryland tax system does not appear to raise questions is the tax treatment of different companies providing identical services. Each of the services being discussed (local telephone, long distance, and cellular telephone) are treated identically within their own classifications. Specifically, the taxes that are levied on overall activity (gross receipts tax or sales tax) are applied on all such activity, and the taxes on corporate profits (corporate income tax) are levied at a flat rate on all net income. In short, competitors that provide identical services are subjected to equitable tax burdens, and their consumers presumably face the equivalent pass-through of those taxes.

Vertical Equity

Vertical equity is concerned with the treatment of individuals or companies with different "ability to pay," and that the tax burden is fairly distributed on that basis. Specifically, a tax is considered to be progressive if the relative burden increases as ability to pay increases. A tax that fails to fit this model, and falls more heavily on those with lower ability to pay is considered regressive, and generally undesirable. In the telecommunications field, there are again two levels of consideration: telecommunications companies and their customers. The companies can be evaluated on the taxes they pay relative to their overall activity (and perhaps their draw of

government services) or on their level of corporate profits. Individuals are generally gauged based on their income level as the measure of their ability to pay taxes.

Gross Receipts Tax

The gross receipts tax applies to the overall level of business activity, and therefore applies proportionally to all the companies who pay it (when measured against that determination of ability to pay). However, since the tax does not separately address corporate profits, it fails to capture that facet of corporate vertical equity, and in an arena of increased competition (where profitability may be an increasingly appropriate means to tax) this may be an important shortcoming.

On consumers, the gross receipts tax is a flat tax applied on all consumption of telephone services per se. In short, the distribution of the tax mirrors the use of telephone services among people of different income levels. This distribution is generally regressive, as is detailed in the chart below:

Incidence of the Gross Receipts Tax							
Household Income Class (thousands)	\$5-10	\$10-15	\$15-20	\$20-30	\$30-40	\$40-50	> \$50
Expenditures on Telephone Services	\$376	\$473	\$514	\$532	\$587	\$631	\$767
Implied Gross Receipts Tax Paid	\$7.52	\$9.46	\$10.28	\$10.64	\$11.75	\$12.62	\$15.34
GR Tax as % of Income	0.10%	0.08%	0.06%	0.04%	0.03%	0.03%	0.02%

Source: Bureau of Labor Statistics, 1992 Consumer Expenditure Survey

Corporate Income Tax

The corporate income tax, applied to long distance telecommunications companies and to cellular telephone companies, is levied on net income, or corporate profit. To the extent that profits are the best representation of a competitive company's "ability to pay," the corporate income tax is a proportional representation of that measure.

Consumers feel the pressure of corporate income taxes only to the extent that the companies are able to pass through their tax burden in higher rates. In a competitive environment (the only area where the corporate income tax is applied), this ability is likely limited due to the nature of

a competitive market. Any burden that does fall to the consumer is likely to be less regressive than local telephone services, as long distance or cellular service do not have the "necessity" characteristic that is associated with basic local phone service.

Sales Tax

The sales tax, which is selectively applied to specific services in the state of Maryland, primarily affects users of cellular or mobile telephone service. Since the tax is passed directly on to the consumer, the primary concern is the vertical equity affect on the ultimate user of the service. While concrete data is unavailable to refine our understanding of the demographics of cellular telephone use, general intuition suggests that cellular telephone use is more highly concentrated among higher-income people than is ordinary local or long distance telephone service. With this assumption, we can state that the sales tax on cellular telephone is less regressive than the gross receipts tax as currently applied to all other telephone service.

Simplicity and Ease of Administration

The Gross Receipts Tax is, by its very nature, a rather straightforward tax to calculate, administer, and apply. The tax is simply applied at a flat 2% rate on virtually all revenues associated with providing public services, such as local or long distance telephone service. Were the Gross Receipts Tax the only method of taxation on the industry, the tax structure could be readily categorized as quite simple to administer and comply with.

However, the telecommunications industry is becoming increasingly diversified. As a result, companies providing telephone service are in most cases also involved in other corporate functions that may not be included under the domain of the Gross Receipts Tax. In these instances, the companies must then separate their functions into "regulated" and "non-regulated" functions, which then determines the tax treatment of those receipts and/or profits (via the gross receipts tax and/or corporate income tax). The state administrative agencies then must ensure that the corporate separation of functions between regulated and non-regulated is accurate and appropriate for the various methods of taxation.

Even with the necessary separation of functions for most telecommunications companies, the current tax structure seems to present no significant administrative burdens to either the payers or to the state.

In the future, however, this fairly simple tax structure may become increasingly difficult to manage. As the distinctions between the different segments of this evolving market dissolve, more and more companies can be expected to be providing telecommunications-type services. These companies may increasingly become hybridized--maintaining characteristics of public service companies for some functions, but remaining akin to a competitive business for others. It seems possible that as cellular telephones, personal communications services, expanded cable television services, and other products become more readily available, the companies providing

these services may become entangled in a bookkeeping web, having to appropriately categorize all of their functions as subject to the various taxes applied in the industries. Similarly, the state's revenue agencies may encounter similar problems in monitoring compliance with these laws.

Apportionment

One specific issue arising in the administration of taxes on interstate businesses is interstate apportionment. Companies doing business in multiple states must apportion their functions among the different states for tax purposes. The method of apportionment depends upon the type of business and the type of tax involved. In the realm of telecommunications, it is primarily long distance telephone providers that are affected by this issue.

Interstate long distance carriers currently apportion the gross receipts tax based on the "billed revenue" apportionment method. This method subjects a long distance phone call to taxes in Maryland if the call either originates or terminates in Maryland, and the call is charged to a Maryland address. This method of apportionment was adopted by Maryland in 1992, and reflects a general trend of states' apportioning this service by billing location rather than the use of "circuit mileage," which was commonly used in the past.

Also in 1992, long distance telephone providers were made fully taxable under the corporate income tax as well as the gross receipts tax. As a result of this, these companies must already apportion their income among the states they serve for purposes of the states' various taxes on profits or net income. Maryland, like many other states, treats the delivery of long distance telephone as a "service" industry, and taxes it on a fairly straightforward "one-factor" apportionment based on the location of the service delivery. Essentially, this method of apportioning the corporate income tax closely mirrors the method used for the gross receipts tax.

As the telecommunications industry grows and becomes more multi-faceted, it stands to reason that apportionment may become an ongoing issue for many states' tax systems, including Maryland's. Continued diversification of the nature of the companies doing business in telecommunications in multiple states may lead to confusing apportionment issues. Especially to the extent that the function of providing long distance service becomes one facet of a corporation that is taxed as a more traditional corporation (with a three-factor apportionment method based on property, sales, and payroll), the administrative issue of apportionment becomes more complicated.

Competitiveness and Market Neutrality

The notion of competitiveness is related to both equity and market neutrality. Ideally, regulatory and tax policy will increase competitiveness. It has long been recognized as a general rule that market competition, within limits, yields the best outcome for consumers (low prices, efficient distribution of resources, quality goods, etc.). The telecommunications industry has been an exception to this rule in the past, primarily because the industry was a natural monopoly.

The evolution of the market, however, has seen the erosion of this natural monopoly. The tax structure should complement this development, and enhance the competitive nature of the market. At the very least, taxes should not impede the development of a strong competition between both the traditional telecommunications companies and their differently regulated competitors.

The above ideal implies that the tax structure should not distort the market. Market neutrality requires that the tax structure not provide incentives for economic agents to alter their actions. In other words, producers and consumers should act the same in the presence of taxes as they would in the absence of taxes. A goal for telecommunications taxes should therefore be to find the tax structure that interferes least in the workings of the market.

These concepts relate to the idea of horizontal equity, described earlier. If a tax distorts market decisions, it may very well result in horizontal inequity, a market advantage given to one segment of the industry. The current tax structure imposes a greater burden on cellular communications than land-based telecommunications (the 5% sales tax and corporate income tax against the 2% gross receipts tax). Consumers are given an incentive to do something they would not in the absence of taxation. They will use cellular less because of the tax (they are making inefficient decisions). In turn, cellular companies are placed at a competitive disadvantage. Resources, including investments and profits among others, are not provided to cellular companies in efficient amounts.

Distortion of economic decisions appears in the broader market as well. Because the gross receipts tax results in a tax burden even if a company operates at a loss, the tax burden on traditional telecommunications firms could be very high in any given year, relative to all other firms. The high tax burden could lead to a higher investment of resources in other industries than if the tax burden were the same. These inter-industry distortions, which can arise due to the different tax structure imposed on the telecommunications industry, could be eliminated if the tax structures were made more similar.

Taxes can only be perfectly neutral if they are placed on goods with inelastic demand, or demand which does not vary in response to price changes. While telecommunications services do not exhibit perfectly inelastic demand, they are very inelastic relative to other goods.¹ Therefore, from the broad perspective, taxes on telecommunications (especially local service) impose only minimal losses of efficiency, or market distortions. Within the industry, however, these taxes may cause a shifting of resources.

¹This may not be true if one considers non-common carrier communications. Many private businesses, as well as governments, have found it economical to bypass the public means of communications. When bypass is considered, local service is relatively more elastic for those with the means to bypass (i.e., businesses).

The current tax structure is not neutral within the industry. It gives consumers and producers alike incentives to perform actions they would not in the absence of taxes. Consumers are given reason to purchase services they would otherwise not. Producers are induced to direct resources away from the uses most economically efficient. Obviously, one way to rectify these distortions is to bring the taxation of traditional telecommunications more in line with the taxation of other forms of telecommunications as well as other industries.

V. Analysis of Current Property Tax Structure

Introduction

Property assessment and taxation in Maryland is an important component of the state and local tax structure, and has significant effects on the telecommunications industry. In Maryland, the Maryland Department of Assessments and Taxation is charged with the classification and assessment of property, and the assessed value of property is then subject to the various tax rates imposed by the state and local governments. This paper will focus on how Maryland's laws and practices in assessing and taxing property affect the telecommunications industry.

Legislative Background

House Bill 1496 from the 1994 Session was ultimately enacted to create the Task Force on Telecommunications Taxation. This bill, however, was introduced and originally passed by the House of Delegates as legislation to alter the property tax treatment of long distance telecommunications companies. The bill as introduced would, in short, have eliminated the practice of valuing the real property components of long distance companies' operating property at 100% of value instead of 40%, treating it more like the property of a non-regulated company. This legislation would have carried a significant fiscal loss to local governments, and was amended by the House of Delegates to create a local option tax credit to grant the same tax benefit to the long distance carriers (in a county which authorized the tax credit) without altering the assessment process. Finally, the legislation was again altered by the Senate, to replace the actual tax changes with a Task Force to investigate more broadly the issues involved with the taxation of telecommunications companies, both with property taxes and other corporate taxes. This modified legislation was finally adopted and enacted as Chapter 680 of the Acts of 1994.

Method of Assessment

In Maryland, property of telecommunications companies, both those providing local and long distance services, is assessed as public utility property. The procedure for assessing public utility property varies somewhat from the procedure for assessing property of other, non-regulated companies. This procedure is outlined below.

Stages of Assessment

In general, the assessment process falls into three stages: appraisal, allocation, and apportionment. In each of these stages, there are components of the process used for public utilities (including telecommunications companies) that vary from the treatment of other, non-regulated companies.

Appraisal

For a public utility, the appraisal process begins with examination of the utility's entire operations as a whole. This is because of the unit valuation method, which considers the value of the property of the entire utility, and then divides that value among the appropriate jurisdictions. The appraisal process usually involves one or more of the following basic methods of assessment:

Cost Method. The cost method involves evaluating the original cost of the actual property involved, and allowing an appropriate depreciation for years in service, etc.

Income Method. The income method involves evaluating the income stream generated by the property, and calculating the net present value of that income stream to generate a current value of the property.

Comparable Sale Method. The comparable sale method involves investigating other actual sales of properties which may be comparable to the property for appraisal, and using that data to approximate the actual market sale value of the property at hand.

Appraising the value of a typical telecommunications company can involve all three of the methods described above. Specifically, however, the cost and income methods are most directly applicable to a telecommunications company appraisal, since the actual sale of such a large interest is both an infrequent and unique sort of transaction. Therefore, most of the focus is likely to fall on the replacement cost and income generation of the property.

As mentioned previously, telecommunications companies and other utilities are assessed using the unit valuation method. In essence, this means that the complete operation of the company is evaluated for its value in its entirety.

The use of the unit valuation method of appraisal is generally common for states conducting assessments of utility property. In all, 37 states conduct their utility property appraisals in this manner. The guiding rationale for performing a unit assessment is that the physical property of a utility has more relevance if placed in the context of an operating utility system. For example, the value of a series of telephone wires or cables that crosses one county may be quite different when viewed by itself, as compared to its value when viewed as part of a network of wires and cables that provides comprehensive service to an entire region. Specifically, the income method of assessment would lose a great deal of its merit if the unit method of assessment were not used.

Allocation

For the purposes of property tax assessment, allocation is the process of dividing the value of a company's property among the various states in which it operates. In general, allocation of telecommunications property is conducted using a formula that includes both the location of the

actual property and the source of operating income. This formula is again in general conformity with the allocation method by other states employing the unit valuation method.

One issue that may be raised regarding the current method of allocation is that it contrasts with the parallel methods of allocating other taxes, such as the gross receipts tax and the corporate income tax. Specifically, the gross receipts tax is divided among the states according to the "billed revenue" method of apportionment, which taxes a call in Maryland 100% if the call was either initiated or terminated in Maryland, and was charged to a Maryland address. Further, the income tax could be apportioned on a single-factor apportionment, based on the point of service. The result, however, is that the combined method of allocation used for the property tax assessment may result in a greater or lesser portion of a certain company's "operations" being considered to be in Maryland than would another method of interstate allocation. It should be noted, however, that the method of interstate allocation used by Maryland is very much in line with those employed by other states, and is generally not a point of contention from within or outside the industry.

Apportionment

In the context of property assessment, apportionment means the division of a company's property among the various local jurisdictions for purposes of taxation.

In general, the apportionment of a telecommunications company or other utility's property is conducted according to the county-by-county breakdown of the actual location of the physical plant and property that is reported on regulatory forms submitted to the State Department of Assessments and Taxation. The reported location of the property is used to develop a "ratio" for each locality, which is then applied to the appropriate Maryland taxable base (as determined from the allocation previously).

As a whole, this method of apportionment of the taxable base among the counties, coupled with the broader application of the unit valuation method, generates an impact on local tax bases rather similar to what would be created by a more straightforward method of "bricks and mortar" assessment. For example, if a large capital complex is constructed in a certain county, that county's share of the company's operating property would increase significantly, resulting in an increase in their local tax base. This increased tax base would be similar to the increase that would be expected from the simple addition of a new capital facility under more traditional valuation methods.

Classification

Perhaps the most fiscally significant issue involved with property tax assessment and taxation is the issue of classification. Maryland maintains several classifications of property which impacts the ultimate taxation of that property under either real or personal property taxes.

Real vs. Personal Property

In Maryland, real and personal property are assessed and taxed differently. Real property is assessed at 40% of cash value, and is then taxed by both the state (at the statewide rate of 21 cents) and local governments (at the local tax rate). By contrast, personal property of corporations is assessed at 100% of cash value, and is then only taxed by the local governments. The state property tax does not apply to personal property (i.e., the rate is actually zero).

Through a classification system that has evolved over a number of years, operating property of utilities (excluding land) had traditionally been categorized as a subset of personal property. This classification prevailed whether or not the property at hand was a building or another fixture which would otherwise have been considered real property. As a result, all operating property (except land) of a utility, including a telecommunications company, had been assessed and taxed on its full cash value.

While this system of differential classification was eliminated in 1993, the net effect remains the same. Currently, the operating property of utilities, including telecommunications companies, is assessed at 100%, whether it is actually real or personal property.

This method of classification creates a disparity between the treatment of regulated utilities that provide telecommunications services and non-regulated companies that may also provide services which compete with telecommunications services *per se*. With a potentially equipment-intensive service such as telecommunications, this tax difference could be of major fiscal significance. The projected fiscal impact of a policy change to equalize the effective taxation of telecommunications companies with other, non-regulated companies is detailed in Policy Option 6 in Section VI of this report.

History

The status of property classification that creates this system of valuation and taxation has evolved over a number of years. Some of the important point in this history are detailed below:

1957 - The case of *Sears, Roebuck & Company v. State Tax Commission* (214 Md. 550) of Maryland struck down the existing system of assessment, which assessed real property at ratios varying from 25% to 60% (based on inflationary adjustments), while personal property was assessed at cost or market value.

1958 - The General Assembly enacted Chapter 73 of the Acts of 1958, which provided for separate classification of real estate and personal property. This legislation also made a clear statement of legislative intent to assess real property with a depreciation allowed for inflation, while personal property is assessed at full cash value. In this legislation, the operating property of utilities was explicitly categorized as a subclass of personal property.

1959 - *National Can Corporation v. State Tax Commission* (220 Md. 418) upheld the constitutionality of the 1958 enactment, thereby reaffirming the legitimacy of the multi-classified system of assessments.

1983 - The General Assembly enacted legislation repealing the state's property tax on personal property, but maintained the tax on the real component of "operating property" of utilities.

1993 - The General Assembly enacted legislation further clarifying the laws regarding the assessment and classification of utility property, codifying the practices of the State Department of Assessments and Taxation which assess all operating property of utilities at 100%, even though there are "real" and "personal" components of that property. This enactment did, however, reclassify the operating property into "real" and "personal" components.

VI. Policy Options and Analysis

The options presented in this section are not an exhaustive list of the alternative tax structures for telecommunications available to Maryland. Many of these options could be modified in various ways which could have a significant impact on the analyses. Each option is analyzed in the context of the same criteria that was used for assessing the current tax structure. The revenue impact boxes estimate the revenues which would have been received in 1992 and 1993 if these alternatives had been in effect, and estimate their revenue impact through 1999. *Appendix I* presents a summary of these options along with respective advantages and disadvantages.

Policy Option #1

Extend the Corporate Income Tax to Local Telephone Service Providers

Description

In 1992, partially as recognition that the long distance telecommunications industry had become increasingly competitive, the General Assembly extended the Corporate Income Tax to interstate long distance carriers. This tax is levied at 7% of net income, which is in addition to the 2% gross receipts tax.

In response to the increasingly complicated nature of the industry, one response would be to extend this tax treatment to all participants in the telecommunications field. This would continue the gross receipts tax as a method of taxing both local and long distance telephone providers, and would provide an equitable "profit-based" tax on those companies that operate for a profit.

Revenue Impact (\$ in millions)

Tax Year	<i>1992E</i>	<i>1993E</i>	<i>1994E</i>	<i>1995E</i>	<i>1996E</i>	<i>1997E</i>	<i>1998E</i>	<i>1999E</i>
Net Effect	14.2	14.4	14.7	15.0	15.3	15.6	15.9	16.2

Source: Survey of Telecommunications Firms

Revenue Sufficiency

With the application of the corporate income tax onto local telephone providers, the state would receive a significant increase in tax revenue from a net income stream which is currently untapped. Additionally, the net income of local telephone providers is a fairly predictable number, since their rates are approved by the Public Service Commission based on rate-of-return calculations. Therefore, this option would yield a significant increase in fairly stable revenues.

Were the heavy regulatory oversight and rate-setting authority of the Public Service Commission eliminated (as a result of increasing competition in the local telephone marketplace), the revenue stream of this option would become significantly less predictable, as the local telephone service providers establish their own rates of return based upon market conditions.

Fairness and Equity

Extending the corporate income tax to local telephone providers would establish an identical tax structure for local and long distance providers. However, there would remain significant differences between the treatment of these traditional telephone service providers and the treatment of their more indirect competitors - cellular services, cable television, etc.

From the individual perspective, a corporate income tax may be a more progressive tax than a tax which is passed on directly to the consumer. To the extent that the corporate income tax is borne by the shareholders of a corporation (an assumption which may be particularly germane to a regulated corporation, which needs approval to pass on their costs in higher rates), this tax would ultimately fall on people who own stock of the corporation. Since stock ownership is distributed increasingly among higher income persons, this incidence of a corporate income tax may be significantly more progressive than the other main taxes in this industry.

Competitiveness

As the provision of local telephone service increasingly becomes an arena for competition rather than monopoly, the corporate income tax may be a more appropriate vehicle for the state's primary taxation. As a more competitive environment evolves in this industry, the continued imposition of the gross receipts tax may be inappropriate, especially if the provision of local telephone service becomes a direct competition between regulated and non-regulated companies. But after the pass-through gross receipts tax, the profit-based corporate income tax would treat all entries into the market by the same means.

Economic Market Neutrality

The corporate income tax is levied on net income only, so this addition would only affect a company that actually generates profits from its operations. This taxation based on "ability to pay" may avoid some competitive concerns. However, allowing cellular telephone and other non-regulated services to escape the regulatory burden of the Public Service Commission may continue a competitive disadvantage to those regulated companies still subject to the gross receipts tax.

From the consumer's point of view, the corporate income tax on local telephone providers could add to the cost of service. Presumably, the PSC would recognize corporate tax liabilities as "costs" for the purposes of rate-setting calculations, and rates would increase in order to maintain current rates of return. Therefore, this new tax would cause increased rates, which

could tend to drive some users to either reduce their consumption or become more likely to use alternative goods such as cellular services, etc. On balance, the new tax could increase total market distortion by driving rates up further, but may reduce relative distortion by reducing tax disparities among competing firms.

Simplicity and Ease of Administration

Since the number of providers of local telephone service is currently quite limited, an extension of the corporate income tax to these providers would not present significant administrative duties for the state. Most local telephone service providers already pay the corporate income tax on other, non-regulated functions under current law, so the procedural and logistical impediments should be few. As the market may grow in the future, this may change somewhat, but the degree of this potential difficulty is indeterminate.

Compliance with corporate income tax laws should not present a significant problem to the local service providers, as such financial information is already maintained for regulatory purposes under current law.

Policy Option #2

Repeal the Gross Receipts Tax on Telecommunications Companies and Apply the Corporate Income Tax Fully

Description

Repeal the 2% tax on gross receipts tax on long distance and local providers and apply the 7% corporate income tax to net taxable income of local telecommunications companies.

Revenue Impact (\$ in millions)

Tax Year	<i>1992E</i>	<i>1993E</i>	<i>1994E</i>	<i>1995E</i>	<i>1996E</i>	<i>1997E</i>	<i>1998E</i>	<i>1999E</i>
Repeal GRT	(41.8)	(45.1)	(46.1)	(47.4)	(49.0)	(50.9)	(52.7)	(54.6)
Income Tax	14.2	14.4	14.7	15.0	15.3	15.6	15.9	16.2
Net Effect	(17.1)	(14.7)	(31.4)	(32.4)	(33.7)	(35.3)	(36.8)	(38.4)

Source: Department of Assessments and Taxation, Survey of Telecommunications Firms
Estimates by the Department of Fiscal Services

Revenue Sufficiency

This policy, despite the inherent difficulty in estimating corporate income tax revenues, would almost certainly result in reduced revenues in the short term, and a less stable revenue stream. Since a much greater reliance would be placed on the corporate income tax, the year-to-year predictability of revenues would diminish.

The gross receipts tax base for the telecommunications industry appears to be levelling off. The corporate income tax base may be growing, however. If firms are increasing returns through a lowering of costs rather than rate increases, revenues from corporate income taxes would increase faster than gross receipts revenues from the same companies. This implies that at some point in the future, the net revenue effect of this policy change could be zero or positive. However, this is hard to predict with any degree of certainty.

If the implementation of this tax structure were coupled with a relaxing of the regulatory burden, it is possible that rates of return of the regulated companies could increase. This would lead to a faster increase in corporate income tax revenues, as the base expands. Alternatively, increasing competition could lead to a diminished rate of return, lowering corporate income tax revenues and increasing the revenue loss attributable to this policy option.

Fairness and Equity

Although the State would suffer what could be a significant revenue loss, this option would enhance vertical equity in the present. As the gross receipts tax is regressive, its repeal would make the current tax structure less regressive. Further, this option would decrease the regressivity of the telecommunications tax structure as long as cellular use is concentrated in the upper income classes. However, the fairness of taxing cellular service under the sales tax but not traditional local service could be questioned, especially as cellular becomes less and less perceived as a luxury service.

In addition, it seems likely that the imposition of the corporate income tax will shift some of the tax burden from consumers to stockholders. The corporate income tax cannot be passed onto consumers as easily as the gross receipts tax can. Assuming that stockholders are wealthier than consumers on average, this tax structure would lessen the degree of regressivity.

Competitiveness and Market Neutrality

This policy option reflects the changes in the industry which have increased and will continue to increase the degree of competition in the market. This policy would not only put the traditional telecommunications firms on more equal footing with cellular providers and other direct competitors in terms of the tax burden being based on ability to pay, but it would also level the playing field between these firms and others who are becoming more direct competitors, such as cable television and information technology firms.

All firms in the communications field, whether telephone, cable television, wireless communications or anything else, would primarily face income tax liability. These firms' tax liability would depend on their profitability, and be unaffected by their regulatory status. From the corporate perspective, this option makes the tax structure more neutral.

Note that the uneven application of the sales tax across these segments of the industry lessens the attractiveness to consumers of the taxed services relative to the untaxed services. This tilt would be exacerbated by the repeal of the gross receipts tax, leaving these services untaxed at the consumer end, while the other services face the 5% sales tax burden. To the extent taxes affect consumption decisions, this outcome seems likely to mute the coming increase in demand for cellular service and sway market share to traditional telecommunications. From this perspective, this structure may be less neutral than the current system.

Simplicity and Ease of Administration

This policy option should be relatively easy for the affected firms to comply with. They already must file income tax returns, and the minimal administrative burden of the gross receipts tax would be eliminated. Similarly, the Office of the Comptroller should have no difficulty with this change since they must already process these income tax returns. The Department of Assessments and Taxation would have one less tax to administer.

Policy Option #3

Repeal the Gross Receipts Tax for Long Distance Providers

Description

In 1992, the corporate income tax was applied to long distance telecommunications companies, partly in recognition of the fact that the market was becoming more competitive. This option represents another step towards recognizing this competition by eliminating the gross receipts tax on long distance companies.

Revenue Impact (\$ in millions)

Tax Year	<u>1992E</u>	<u>1993E</u>	<u>1994E</u>	<u>1995E</u>	<u>1996E</u>	<u>1997E</u>	<u>1998E</u>	<u>1999E</u>
Net Effect	(17.8)	(21.1)	(21.4)	(22.3)	(23.4)	(24.6)	(25.8)	(27.0)

Source: Department of Assessments and Taxation
Estimates by the Department of Fiscal Services

Revenue Sufficiency

Because the corporate income tax is already applied fully to the gross receipts of long distance companies, there would be no offsetting increase in income tax revenues from this policy. In addition to a substantial drop in revenues, this option would reduce the stability of the revenue stream, since a relatively stable source of revenue is eliminated and revenue from long-distance providers would come solely from the corporate income tax.

Fairness and Equity

This alternative lessens the tax burden on customers of long distance providers by eliminating a source of double taxation. Assuming that long distance service consumption increases with income, a lowering of this tax burden will increase the regressivity of the entire tax structure.

Competitiveness and Market Neutrality

This policy option reflects the idea that the long distance market has achieved competitive status. The last remnants of unique taxation are removed from the industry. This option prospectively levels the playing field between long distance companies and potential competitors (i.e., computer and satellite based communications companies who would not fall under the gross receipts tax).

By eliminating the gross receipts tax, a market distortion would be rectified. Changing the price of long distance service is one of the more significant distortions introduced by telecommunications taxation, as consumers respond more to price changes for long distance than for local service. In the big picture, however, this distortion is not likely to be noticeable.

Simplicity and Ease of Administration

The repeal of the gross receipts tax will remove a minor paperwork burden for long distance companies. A large part of the administrative burden of the gross receipts tax will be removed from the Department of Assessments and Taxation, as all but a handful of telecommunications companies would not have to pay the gross receipts tax (local service providers--Bell Atlantic, Armstrong, MFS Communications, and perhaps several others in coming years--would still pay the gross receipts tax).

Policy Option #4

Repeal the Gross Receipts Tax and Apply the State Sales Tax to All Telephone Services

Description

This option eliminates the 2% gross receipts tax and replaces the revenue with a 5% sales tax on all telephone services. Note that selected telephone services are already under the sales tax. As a result of this policy, the gross receipts of local service providers that were formerly taxed by the gross receipts tax would fall under the corporate income tax.

Revenue Impact (\$ in millions)

Tax Year	<i>1992E</i>	<i>1993E</i>	<i>1994E</i>	<i>1995E</i>	<i>1996E</i>	<i>1997E</i>	<i>1998E</i>	<i>1999E</i>
Repeal GR	(41.8)	(45.1)	(46.1)	(47.4)	(49.0)	(50.9)	(52.7)	(54.6)
Sales Tax	90.7	99.1	101.3	104.2	107.7	111.9	115.9	120.1
Income Tax	14.2	14.4	14.7	15.0	15.3	15.6	15.9	16.2
Net Effect	63.1	68.4	69.9	71.8	74.0	76.6	79.1	81.6

Source: Department of Assessments and Taxation, Survey of Telecommunications Firms
Estimates by the Department of Fiscal Services

Revenue Sufficiency

This policy option results in a large revenue surplus over the current revenue stream, primarily because a 2% tax is replaced with a 5% tax, although government and non-profit entities would be exempt from paying the sales tax. These agencies represent over 25% of the local market, but probably not more than 5% of the long-distance market. This tax structure would provide a stable source of revenue, as telephone use does not vary dramatically from year to year.

The above revenue estimates assume that all telephone calls currently resulting in revenue from Maryland for the telephone companies can be captured in the sales tax base. If these calls are not entirely included in the base, the revenue impact will be smaller than that indicated above.

Fairness and Equity

This option does not fare well from a vertical equity standpoint. Since expenditures on telephone services do not increase significantly as income increases, this tax structure would be regressive. This option does have the benefit of treating all telecommunications services

similarly.

One potential drawback to this option stems from the view that consumer "necessities" such as groceries, medicine and residential utilities should not be subject to the sales tax. This service is thought to be a necessity, as the presence of the State's telephone lifeline service program indicates. There are at least two different ways to approach this problem (see Policy Options #4a and #4b).

Competitiveness and Market Neutrality

This policy option is intended to update the tax structure to reflect the increasing competition in the telecommunications market. All the taxes which would be levied on these services and producers are those levied on participants in competitive markets. There would be no more selective taxes. As new technologies become more prevalent, the definition of the sales tax base may require adjustment to maintain this result.

This approach would truly place all major current players in the telecommunications market on a level playing field. They would all face the same taxes; all economic decisions would be made in the face of the same tax burdens. While there may be some minor imperfections related to taxation of cable television and local taxes on telecommunications services, this approach is a significant step towards market neutrality.

Note that the application of the sales tax to business telephone service may violate the principle of applying the sales tax to the end consumer. In addition, applying the sales tax to telephone services raises the question of how to treat expenditures by phone companies for the equipment used to produce their service. This could be exempted from the sales tax as manufacturing equipment. Such an exemption would lower the revenue estimates above by approximately \$18 million per year.

Simplicity and Ease of Administration

Complying with and administering this option should be relatively simple for both the industry and the government. Rather than a 2% gross receipts tax separately billed to the customer, a 5% sales tax would be billed. The only complication is that government and non-profit agencies would be exempt from paying the tax. On the administration side, sales tax accounts already exist for local telephone service providers, though new ones would have to be created for long-distance providers. The Department of Assessments and Taxation would be relieved of the collection of the gross receipts tax.

Policy Option #4a

Repeal the Gross Receipts Tax and Apply the State Sales Tax to Long Distance Service Only

Description

This variation eliminates the gross receipts tax and applies the 5% State sales tax to long distance service only. This alternative would not alter revenues from the corporate income tax, since the tax base includes receipts taxed by the gross receipts tax.

Revenue Impact (\$ in millions)

Tax Year	<u>1992E</u>	<u>1993E</u>	<u>1994E</u>	<u>1995E</u>	<u>1996E</u>	<u>1997E</u>	<u>1998E</u>	<u>1999E</u>
Repeal GR	(41.8)	(45.1)	(46.1)	(47.4)	(49.0)	(50.9)	(52.7)	(54.6)
Sales Tax	42.9	50.0	51.8	54.0	56.6	59.5	62.4	65.5
Income Tax	14.2	14.4	14.7	15.0	15.3	15.6	15.9	16.2
Net Effect	15.3	19.3	20.4	21.6	22.9	24.2	25.6	27.1

Source: Department of Assessments and Taxation, Survey of Telecommunications Firms
Estimates by the Department of Fiscal Services

Revenue Sufficiency

This tax structure would prove very stable and would provide an increased revenue stream, as long as any new long-distance technologies were included in the sales tax base, and barring any dramatic decrease in long-distance rates. Again, government and non-profit agencies would be exempt from the tax, though they are assumed to represent only 5% of long-distance business revenues.

There would be no additional revenue increase from the corporate income tax, as the gross receipts of long-distance telecommunications are already subject to the income tax.

Fairness and Equity

This tax structure would be regressive, though the burden imposed on taxpayers would obviously be less than that imposed by applying the sales tax to all telecommunications services. The benefit to this alternative is that what many view as a necessity--local telephone service--would be untaxed at the consumer level. This may help to mitigate the regressivity somewhat.

Competitiveness and Market Neutrality

This policy option does not resolve the disparate taxation of local and cellular service. Moreover, it opens a new disparity between land-based local and long-distance service, although this disparity may not be a problem, as local service is not competing with long-distance service.

Note that the application of the sales tax to business telephone service may violate the principle of applying the sales tax to the end consumer. In addition, applying the sales tax to telephone services raises the question of how to treat expenditures by phone companies for the equipment used to produce their service. This could be exempted from the sales tax as manufacturing equipment. Such an exemption would lower the revenue estimates above by approximately \$18 million per year.

Policy Option #4b

Repeal the Gross Receipts Tax and Apply the State Sales Tax to Telecommunications Services With an Exemption for "Basic Residential Service"

Description

This variation on Policy Option #4 repeals the 2% gross receipts tax and applies the 5% sales tax to all telecommunications services, but it allows an exemption for "basic residential service." Basic residential service is defined for purposes of this analysis as the limited per call service provided by Bell Atlantic, although other definitions could be substituted. The cost of this service ranges from \$9.52 to \$11.17. For the purposes of this estimate, the \$3.50 federal subscriber line charge has been included in the definition.

Revenue Impact (\$ in millions)

Tax Year	<u>1992E</u>	<u>1993E</u>	<u>1994E</u>	<u>1995E</u>	<u>1996E</u>	<u>1997E</u>	<u>1998E</u>	<u>1999E</u>
Repeal GR	(41.8)	(45.1)	(46.1)	(47.4)	(49.0)	(50.9)	(52.7)	(54.6)
Sales Tax	62.6	70.6	72.2	74.6	77.6	81.2	84.7	88.3
Income Tax	14.2	14.4	14.7	15.0	15.3	15.6	15.9	16.2
Net Effect	35.0	39.9	40.8	42.2	43.9	45.9	47.9	49.9

Source: Department of Assessments and Taxation, Survey of Telecommunications Firms
Estimates by the Department of Fiscal Services

Revenue Sufficiency

This tax structure would prove very stable and would provide an increased revenue stream. The exemption costs the general fund an estimated \$27.2 million in fiscal 1995, and is estimated to grow at 1.8%, although it could grow faster if rates for basic services increase.

Fairness and Equity

This tax structure attempts to alleviate the regressivity of a flat rate tax on telecommunications services by exempting the "necessary" part of that service. The tax is placed on the "luxury" portion of local service, which is assumed to be consumed by those with a greater ability to pay.

Competitiveness and Market Neutrality

This policy option presents a balance between levelling the playing field and avoiding the full impact of the regressivity of the sales tax. By applying the sales tax and eliminating the gross receipts tax, telecommunications firms are treated as all other firms. With the exception of the exemption for basic services, local service would be taxed identically to cellular service. As long as developing technologies were added to the sales tax base, the playing field would remain level.

Since all firms would face the same tax burden, this structure is relatively neutral where the investment of resources is concerned. As most tax structures do, this tax structure does impose some market distortions. These distortions, however, would be minimal and would affect all companies in the same manner.

Note that the application of the sales tax to business telephone service may violate the principle of applying the sales tax to the end consumer. In addition, applying the sales tax to telephone services raises the question of how to treat expenditures by phone companies for the equipment used to produce their service. This could be exempted from the sales tax as manufacturing equipment. Such an exemption would lower the revenue estimates above by approximately \$18 million per year.

Policy Option #5a

Repeal the Sales Tax on Cellular and Portable Telephone Services

Description

In 1992, the 5% state sales tax was extended to include several specific services, including cellular telephone services. This tax could be rescinded in recognition of the increasingly direct competition of cellular telephone services with local telephone carriers.

Revenue Impact (\$ in millions)

Tax Year	1992E	1993E	1994E	1995E	1996E	1997E	1998E	1999E
Net Effect	(7.8)	(10.3)	(13.5)	(17.7)	(23.3)	(30.6)	(40.2)	(52.8)

Source: Office of the Comptroller
Estimates by the Department of Fiscal Services

Revenue Sufficiency

Clearly, the simple elimination of the sales tax on cellular telephone service would result in a significant reduction in the revenue stream generated by the state from the broadly-defined telecommunications industry. Unless this option were combined with one or more other policy changes that generated a revenue increase, the resulting policy change would carry a significant fiscal burden to the state.

Fairness and Equity

In terms of vertical equity, this policy option is likely to be a step away from progressivity in the tax structure. While the concrete data is not yet available to support this argument, it seems reasonable to assume that most users of cellular telephone technologies are of middle- to upper-income groups. In this sense, a tax on cellular telephone service may actually be a progressive tax, or at least would largely mitigate the generally regressive nature of sales tax incidence. Therefore, eliminating the tax on cellular telephone service would be akin to granting tax relief for higher income persons over lower income persons.

Competitiveness and Market Neutrality

This policy option specifically identifies the increasingly direct competition between cellular telephone service and local (stationary) telephone service. In this sense, eliminating the sales tax on cellular service would be a step towards leveling the playing field between these two competing facets of the greater industry. Further, the elimination of the highest-rate tax (the 5% sales tax) on this market would also reduce the overall distortion of consumer choices.

Competition between cellular telephone providers and local telephone providers would continue to be slanted, however, by the imposition of the 2% gross receipts tax and the ongoing regulatory role of the Public Service Commission. The elimination of the sales tax on cellular phone services is one step towards full competition, but not the only one.

Simplicity and Ease of Administration

The application of the sales tax does not pose significant problems for the Office of the Comptroller, especially since the number of providers is very limited (two, and perhaps one or two more in the near future). The sales tax calculation and collection, after initial costs, is unlikely to be a large burden for the service providers. Nonetheless, the elimination of the tax would reduce one step in the bookkeeping and processing of both parties.

Policy Option #5b

Reduce the Sales Tax on Cellular and Portable Telephone Services From 5% to 2%

Description

In 1992, the 5% state sales tax was extended to include several specific services, including cellular telephone services. This tax could be altered in recognition of the increasingly direct competition of cellular telephone services with local telephone carriers, reducing it to 2% to match the 2% gross receipts tax paid by local service providers.

Revenue Impact (\$ in millions)

Tax Year	<u>1992E</u>	<u>1993E</u>	<u>1994E</u>	<u>1995E</u>	<u>1996E</u>	<u>1997E</u>	<u>1998E</u>	<u>1999E</u>
Repeal ST	(7.8)	(10.3)	(13.5)	(17.7)	(23.3)	(30.6)	(40.2)	(52.8)
Apply GR	3.1	4.1	5.4	7.1	9.3	12.2	16.1	21.1
Net Effect	(4.7)	(6.2)	(8.1)	(10.6)	(14.0)	(18.4)	(24.1)	(31.7)

Source: Office of the Comptroller, Cellular Telecommunications Industry Association
Estimates by the Department of Fiscal Services

Revenue Sufficiency

Reducing the sales tax on cellular telephone service to 2% would result in a significant reduction in the revenue stream generated by the State from the broadly-defined telecommunications industry. Unless this option were combined with one or more other policy changes that generated a revenue increase, the resulting policy change would carry a fiscal burden to the State.

Fairness and Equity

In terms of vertical equity, this policy option is likely to be a step away from progressivity in the tax structure. While the concrete data is not yet available to support this argument, it seems reasonable to assume that most users of cellular telephone technologies are of middle- to upper-income groups. In this sense, a tax on cellular telephone service may actually be a progressive tax, or at least would largely mitigate the generally regressive nature of sales tax incidence. Therefore, reducing the tax on cellular telephone service would be akin to granting a tax break for higher income persons over lower income persons.

Competitiveness and Market Neutrality

This policy option specifically identifies the increasingly direct competition between cellular telephone service and local (stationary) telephone service. In this sense, equalizing the amount of tax on the two services would be a step towards levelling the playing field between these two competing facets of the greater industry. Further, the reduction of the highest-rate tax (the 5% sales tax) on the cellular market would reduce the overall market distortion.

Simplicity and Ease of Administration

The application of the sales tax does not pose significant problems for the Office of the Comptroller, especially since the number of providers is very limited (two), although the maintenance of a separate sales tax rate will increase the complexity somewhat. The sales tax calculation and collection, after initial costs, may not be a large burden for the service providers. With a separate tax rate, bookkeeping procedures would be made more difficult for the providers as they would have to separate sales of equipment (still subject to the 5% sales tax) from the sales of service (subject to the new 2% sales tax). In general, this represents a step away from the simple system of a uniform rate for the sales tax, although the precedent has been set with a different sales tax rate on rental cars.

Policy Option #6

Reduce Assessment of Real Property to 40% of Appraised Value

Description

Operating property of utilities, whether real or personal, is assessed at 100% of the value of the property (land is assessed at 40%). This differs from the treatment of all other businesses, which pay property taxes on only 40% of the value of all real property. This option would reduce the assessment on all real property of telecommunications companies to 40% of value. Alternatively, the assessment of long-distance companies only could be reduced to 40%, as proposed by House Bill 1496 of the 1994 Session of the General Assembly.

Revenue Impact (\$ in millions)

Tax Year	<u>1992E</u>	<u>1993E</u>	<u>1994E</u>	<u>1995E</u>	<u>1996E</u>	<u>1997E</u>	<u>1998E</u>	<u>1999E</u>
Net Effect	(2.1)	(2.1)	(2.2)	(2.3)	(2.3)	(2.4)	(2.5)	(2.6)

Source: Department of Assessments and Taxation
Estimates by the Department of Fiscal Services

See page 47 for revenue impact on local governments.

Revenue Sufficiency

This policy option would result in a slight revenue loss for the state and a rather significant revenue loss for local governments. The state loss is less than one percent of state property tax revenues, which are dedicated to the annuity bond fund for debt service payments.

The revenue loss for local governments totals an estimated \$29.6 million. Of course, those jurisdictions with a greater concentration of telecommunications property will face a greater share of this loss. Those jurisdictions are generally the wealthier jurisdictions in the state. The revenue loss ranges from 0.15% of total revenue (Montgomery County) to 0.76% of total revenue (Kent County). The four jurisdictions with the largest losses (Baltimore City, Baltimore, Prince George's and Montgomery Counties) would account for almost 60% of the total loss.

Fairness and Equity

This change would be neutral with respect to vertical equity. The property tax burden ultimately paid by consumers would be reduced proportionally, although the relative burden of this tax among income classes would be unchanged. Within a given county, the property tax on telecommunications property would remain regressive.

Competitiveness and Market Neutrality

In some respects this change represents a step toward market neutrality and increases competitiveness, although in one significant respect it represents a further distortion in the market. The reduction in the assessment would place telecommunications companies on equal footing with potential competitors who are not taxed as utilities. On the other hand, it creates a difference in the taxation of telecommunications companies and other regulated utilities. Whether this difference is justified primarily depends on the state of competition in the other regulated markets *vis-a-vis* that in the telecommunications market.

VII. The Taxation of the Cable Television Industry in Maryland

Background

Cable television, or community antenna television (CATV), was first developed in 1948 to improve reception of broadcast signals for subscribers located far from local television stations, or where local television reception was non-existent, inadequate, or limited due to topographical barriers. The technology used to operate cable television systems consists of electronic signals that are received through microwave and satellite earth stations. Signals are processed using coaxial trunk lines, feeder cables, and drop cables. Drop cables run from the main line located in the public right-of-way into the customer's residence where it is connected to a converter box.

At present, there are 11,217 systems nationwide which provide cable service to approximately 55.1 million basic subscriber customers (See Table 1). In Maryland, there are 46 systems which provide cable service to approximately 338 communities and over one million customers. This is an indication that the systems in Maryland are generally larger than the systems in the rest of the nation.

Regulation of the Cable Television Industry

A historical analysis of the cable industry reveals that cable operators were regulated initially by the local governments to ensure proper usage of public property and right-of-ways where cable operators needed to install cable. As the industry grew, the Federal Communications Commission (FCC), along with state governments, assumed some of the regulation responsibilities and developed stringent rules on the cable operators.

The first cable operators were mostly local businessmen. Initially, the FCC and the state governments chose not to regulate the cable industry. The local governments accepted the responsibility as the regulatory authority since the cable operators needed permission to use public property and rights-of-way to install cables. However, in 1966 the FCC exercised its regulatory authority by virtue of the Communications Act of 1934 and a Supreme Court decision upholding this authority. The FCC assumed responsibilities for the regulation of inter-relationships among cable operators, television broadcasters, the telephone industry, and the owners of programs televised through the cable service.

In 1972, the FCC issued cable rules which eased its regulatory authority by recognizing the necessity of regulation at the local government level. State and local governments were given the authority to grant franchises and regulate the construction and physical operation of cable systems. However, the FCC continued to specify rules and regulations concerning technical standards, minimum system capacities, channel access, copyright protection, and the importation of distant signals.

The 1984 Cable Act

The Federal Cable Communications Policy Act of 1984 (1984 Cable Act), the first national cable policy in 50 years, was initiated to:

- ◆ determine and clarify the responsibilities of the regulating authorities of cable companies (the FCC, the states, and the local communities);
- ◆ provide standards in the establishment of a cable company as a franchise;
- ◆ assure that cable companies would provide a diversity of information sources and services to the public; and
- ◆ promote competition within the cable industry.

The 1984 Cable Act defined a cable system as "a facility, consisting of a set of closed transmission paths and associated signal generation, reception, and control equipment that is designed to provide cable service which includes video programming and which is provided to multiple subscribers within a community."

The 1984 Cable Act allowed the FCC to regulate certain aspects of cable, and state, or local governments to regulate others. The FCC regulates technical standards for system operators, while the state or local governments grant franchise agreements to cable companies. The 1984 Cable Act provided franchise renewal provisions and deregulated the basic rates charged by cable operators as of December 29, 1986 in most communities.

Franchises, the authorization to construct a cable system over public right-of-way through easements and to operate a cable system, are awarded generally by local communities; however, some states grant franchises. The franchising authority is allowed to award one or more franchises within its jurisdiction. Cable companies compete to win a franchise which will be awarded for a period which is determined by the local government (generally 10 or 15 years).

The intent behind allowing the local communities to award franchises to prospective cable companies and to periodically test the quality of the system for compliance is that the local authority can better match a cable company's services with the needs of the community. In addition, the local communities control the public right-of-way in their community.

The cable operator charges a fee for the installation of the hardware and a monthly charge for the basic cable service. In addition, charges for premium or special programming are assessed to the subscriber. These rates are not regulated by the franchise agreement or the franchising authority. The FCC ruled that effective January 29, 1986, federal agencies, state governments, or local governments were disallowed from regulating the rates for basic cable service provided by any cable operator unless there is no competition for a service franchise

within a certain jurisdiction. Between December 1986 and October 1988 the average monthly rate for the lowest priced basic services increased by 29% from \$11.23 to \$14.48.

The FCC provides that effective competition exists if residents of a community can receive 3 or more over-the-air broadcast signals using their own antenna as a alternative to cable service. The U.S. General Accounting Office (GAO) estimated that 3% of the cable systems remained regulated as of October 1988 compared to over 60% in December 1986, prior to the deregulation rule. A cable system which is not subject to effective competition is restricted from increasing its rates by more than 5% per year.

A summary of other provisions of the Cable Communications Section of the Federal Law pertaining to franchising are presented in *Appendix 4*.

The Cable Television Consumer Protection and Competition Act of 1992

In 1992, the General Accounting Office found that, since the implementation of the 1984 Cable Act, the average monthly rate for basic cable service increased by 40% or more for 28% of subscribers. The average monthly rate increased by 29% while the average number of channels increased from 24 to 30 and monthly cable rates increased almost three times as much as the Consumer Price Index over the prior 6 years. In addition, Congress found that most cable subscribers had no opportunity to select between competing cable systems.

In response to consumer complaints regarding escalating cable rates and poor service, Congress passed the Cable Television Consumer Protection and Competition Act of 1992. The bill requires regulation of cable rates wherever cable systems are not subject to "effective competition" as defined by the Act and enforced by the FCC.

In order to regulate rates, a state or local jurisdiction must be certified by the FCC. According to the National Council on State Legislatures, as of March of 1994, only 25% of the local franchising authorities were certified by the FCC to regulate rates. The 1992 Act is expected to subject at least 95% of all cable systems to rate regulation.

The 1992 Act requires that rates charged by cable operator for basic service to be regulated, unless one of the following conditions are met:

- ◆ fewer than 30% of households in the service area are subscribers;
- ◆ at least 2 sources of competing multi-channel video programs are available to 50% of the households and at least 15% subscribe to them; or
- ◆ a competing multi-channel video broadcast system operated by the local franchise authority offers services to at least 50% of the households.

In general, local franchising authorities may regulate the rates for basic service which includes most over-the-air television broadcasting, and educational or governmental access channels. The FCC regulates the cable programming service tier, which includes channels like ESPN and CNN. Pay-per-channels including HBO and Showtime are currently unregulated. The Act also prohibits franchising authorities from unreasonably granting exclusive franchises to cable operators and encourages municipalities to operate their own cable systems.

Cable Television Systems

The number of cable systems and subscribers has significantly increased with new technological advances. Table 1 shows the growth of cable systems nationwide from 1952 to 1994 from the standpoint of operating systems and total subscribers. There are 46 systems in Maryland that provide cable service to 338 communities and over one million customers.

Table 1
Estimated Growth of the Cable Industry - Nationwide
1952 - 1994

<u>Year</u>	<u>Operating Systems</u>	<u>Total Subscribers</u>
1952	70	14,000
1957	500	350,000
1962	800	850,000
1967	1,700	2,100,000
1972	2,841	6,000,000
1977	3,832	11,900,000
1982	4,825	21,000,000
1987	7,900	41,000,000
1988	8,500	44,000,000
1989	9,050	47,500,000
1990	9,575	50,000,000
1991	10,704	51,000,000
1992	11,035	53,000,000
1993	11,108	54,200,000
1994	11,217	55,100,000

Source: TV & Cable Factbook No. 62 (1994 Edition)

This table reveals that the number of cable systems nationwide grew from 70 serving 14,000 customers in 1952 to 800 serving 850,000 customers in 1962. In 1962, new technology increased the potential channel capacity and reception was improved. This new technology permitted the importation of additional broadcast signals via microwave links from television stations in distant cities. New technological break-throughs and increased popularity of cable resulted in a major expansion of the industry from an estimated 1,000 cable systems in 1972 serving over 6 million customers to 11,200 cable systems in 1994 serving an estimated 55.1 million customers. In 1972, Home Box Office (HBO) was the first premium cable service offered and Showtime began as a premium cable service in 1978.

Approximately 46 companies provide cable service in Maryland. A cable operator can provide service to a county, to portions of a county, or to a municipality within the county. *Appendix 5* shows the cable operators in Maryland and the counties that they serve.

Channels Offered

Viewers can receive more than 80 channels with a television set that provides UHF and VHF channels. According to the TV & Cable Factbook No. 62 (1994 Edition), of the 11,160 cable systems nationwide, 6,364, or 57%, of the systems offer 30-53 channels, 1,306, or 11%, offer 54 or more channels, and 11% offer 20-29 channels.

The basic cable service is a service tier which retransmits local television broadcast signals. Special channels, on other service tiers, are called pay cable service. The basic cable service subscriber pays an extra fee over and above the basic service charge for pay cable service. Table 2 lists most of the basic services and pay services that are provided through satellite national services, non satellite-fed services and regional services. Each cable operator determines which basic service channels will be offered and which pay service channels will be available for an extra charge.

**Table 2
Most Popular Basic and Pay Service Channels**

Basic Service	Pay Service
Cable News Network (CNN)	The Move Channel (TMC)
C-Span	Home Box Office (HBO)
ESPN	The Disney Channel
The Family Channel	Showtime
Lifetime	Cinemax
Music TV (MTV)	

(Table 2 continued)

The Nashville Network
Nickelodeon
Superstation (TBS)
USA Network
The Sci-Fi Channel

Price of Cable Service

The U.S. General Accounting Office conducted nationwide surveys of cable television rates and services between 1986 and 1991. The purpose of the surveys were to evaluate the cable rate deregulation provisions of the 1984 Cable Act due to the overwhelming concern about the increases in cable rates between 1986 and 1991.

According to the GAO report issued in July 1991, the average number of basic channels offered increased from 24 in December 1986 to 30 in April 1991, thereby increasing the average monthly charge per channel from \$0.47 to \$0.58. The average charge for the most popular basic service increased by 26%, from \$11.71 in December 1986 to \$18.84 in April 1991, and the average overall monthly revenue to cable operators per subscriber increased by 32% from \$21.78 in December 1986 to \$28.76 in April 1991.

Revenue Growth

Table 3 shows that the total revenue received by cable operators has increased significantly from \$20 million in 1955 to \$17.8 billion in 1990. Between 1984 and 1990, total cable revenue went from \$7.8 billion to 17.7 billion, a 125% increase.

Table 3
Revenue Growth of Cable
Television, Nationwide

(Millions of \$)

1955 - 1995

<u>Year</u>	<u>Total Revenue*</u>	<u>Basic Service</u>
1955	20	20
1965	95	95
1975	804	774
1980	2,603	1,668
1984	7,892	3,696
1985	9,305	4,522
1986	10,520	5,341
1987	12,374	6,778
1988	13,979	7,883
1989	15,933	9,322
1990	17,784	10,074

*Total includes installation revenue

Source: Statistical Abstract of the U.S. 1992
(112th Edition), U.S. Department of
Commerce, Bureau of the Census.

Other States

There are a variety of ways in which states play a role in the regulation of cable. Most states, like Maryland, Virginia, and the District of Columbia do not regulate cable at the state level; their local jurisdictions regulate this industry. Several states either (1) play a support role for the local governments which have the regulatory authority over cable; or (2) provide for the regulation of cable by passing specific laws concerning cable service. Some states work through independent offices and some provide support through their Public Service Commission. The number of states that regulate cable has not changed significantly since 1974.

Under the Cable Television Consumer Protection and Competition Act of 1992, a state may not regulate rates unless it passes a law making it a certifiable franchising authority. According to the National Council on State Legislatures (NCSL) the following ten states regulate cable television through their public service commission or a separate cable board with varying degrees of shared state and local government authority:

Alaska	Connecticut
Delaware	Hawaii
Massachusetts	New Jersey
New York	Rhode Island
Vermont	West Virginia

Several states impose a sales tax on cable television services in addition to the assessment of other taxes on cable operators. The states listed below subject cable television services to the state sales taxation as of 1989:

Arizona	4%	Mississippi	6%
Connecticut	7.5%	Nebraska	4%
Florida	6%	North Dakota	5.5%
Hawaii	4%	Rhode Island	6%
Indiana	5%	South Dakota	4%
Iowa	4%	Tennessee	5.5%
Kansas	4%	Texas	6%
Maine	5%	Vermont	4%
Minnesota	6%	Wisconsin	5%

Average Rate: 5%

Most communities across the country impose a 3%-5% franchise fee on cable services. In addition, some states impose a utility tax.

Appendix 6 shows cable penetration in the United States by state.

Taxation Analysis

In Maryland, cable companies are subject to property taxes, franchise fees, and the traditional corporate income tax. The property tax, a business tax, is not directed only at cable systems, while the franchise fee is assessed only to cable operators for the privilege of holding a cable franchise in a jurisdiction. Cable subscribers in Maryland are not subject to a sales tax.

Franchises and Franchise Fees

Generally, a local government or county will award one franchise to serve its jurisdiction. However, in Maryland, large urban counties have several franchises. These counties have split

their county into regions with each region awarding a franchise. Many incorporated towns and municipalities have utilized their authority to franchise cable companies independent of their respective county.

A cable franchise fee is assessed by the local or state government to the cable company. The fee is paid yearly, based on a percentage of revenue, not to exceed 5%. The cost of the fee is passed on to the subscribers and permitted to be itemized on the subscribers bill. The rationale for collecting this fee is to charge the cable operators for the costs of regulation. The fee is the payment for the privilege of using the public right-of-way. Initially, the 1984 Cable Act provided that the franchising authorities were allowed to charge not more than 3% of the franchisee's gross revenues per year; however, the FCC subsequently ruled that the franchise fees paid by a cable operator may not exceed 5% of the franchisee's gross revenues derived for any 12 month period. The franchise fee may be passed on to the subscriber and specified as a separate item on the bill.

In Maryland, counties/municipalities assess either a 2%, 3%, or 5% fee. *Appendix 7* shows the total amount of franchise fees paid to each county and municipality in FY 1993. Overall, more than \$19 million in franchise fee revenue was collected in FY 1993--less than 8% of the total revenue went to municipalities enforcing their franchising authority. Of the municipalities, Ocean City collected \$360,000 in franchise fees which represented roughly 30% of all municipal cable TV franchise fee collections. Montgomery County collected more than \$5.5 million in cable TV franchise fees which exceeds the collections of any other county.

Property Taxes

The property tax is assessed by the county and/or municipality. See *Appendix 8* for the rates charged by the counties. The state assesses a property tax on real property at a rate of \$0.21 per \$100 of the assessed value; however, the state does not assess a personal property tax.

Appendix 8 also shows that almost \$5.25 million was paid by cable operators to the counties for property taxes in FY 1994--\$5.1 million of which was attributable to county personal property tax payments. Frederick, Kent, Queen Anne's and Talbot counties exempt cable operators from the personal property tax. Real property taxes paid to the counties and the state for the 1994 were \$129,052 and \$7,626, respectively.

Maryland uses the cost less depreciation method to assess real property tax. The property's full cash value is depreciated at varying rates depending on the class of property (an average of 10% depreciation per year; electric cable is depreciated at a 20% rate each year). Cable companies depreciate the box located at the customer's residence, drop cable and the cost of capital labor from installing cable.

Drop cable, which is currently taxable to the cable operator, is the cable that runs from the main line located in the public right-of-way into the customer's residence where it is connected

to a converter box. The drop cable is located on the private property of the customer and is not removed if a customer cancels the service.

Labor costs of installing a cable system, aerial or buried, is subject to the personal property tax. Buried cables require more labor than aerial systems and, therefore, have a higher value for tax purposes.

Taxation of Other Services

In 1992, the General Assembly passed legislation permitting the imposition of a 5% sales tax on pay-per-view and video rental. These services are not subject to the 10% entertainment tax.

Issues

Competition by Telephone Companies

Telephone operators are potential competitors to cable operators since telephone systems can carry the same electronic data transmission as cable systems. New technology will allow telephone companies to wire homes with fiber optics used for telephone lines. Fiber optics "can carry more voice, data, and images than copper, in a smaller, lighter cable, for longer distances, with immunity from electromagnetic or radio interference." Long distance carriers have been laying fiber optic cable for several years which allow them to use telephones as remote channel selectors for cable TV.

In the 1984 Act, Congress imposed restrictions on the use of telephone lines for video transmission. These restrictions were established to prevent telephone companies from impeding the development phases and growth of the cable industry. The restrictions were initiated to prevent: (1) cross-subsidization of non-regulated telephone company cable television activities with resources committed to the regulated sector; and (2) telephone companies from using their money power, basic exchange, as leverage to exert dominance in the cable services market.

However, in 1992 the FCC imposed the video dialtone rule which permits telephone companies to provide a range of video services by capitalizing on existing telephone infrastructure and compete with cable companies in the video delivery arena. This ruling is currently being challenged in the courts by cable companies, consumers and assorted interest groups.

To date, the FCC has received about 25 applications; however, only one application has been approved (Bell Atlantic in New Jersey). Some of the applications are for a full range of cable services and some are for a video on demand format. Video on demand permits the subscriber to utilize a pay-per-view service via their respective telephone company. *Appendix 9* provides a listing of most of the companies filing with the FCC for cable TV and video services,

the proposed location of the services, and the type of services for which the company has applied.

If such services are approved and able to withstand a prospective court challenge, it is unknown as to how these services will be taxed. The FCC or Congress will probably make a ruling as to whether franchise fees would apply to telephone companies delivering cable TV and video services through telephone lines.

Use of Direct Broadcasting Satellites (DBS)

A new technology known as Direct Broadcasting Satellite (DBS) will also compete with cable TV companies in the near future. Direct Broadcasting Satellite systems are small satellite dishes that can receive direct transmissions from a satellite to the home. The customer will have the ability to receive about 300 channels of movies, sports and satellite networks, including some that are not offered by many cable companies. The DBS systems can not carry local broadcast stations.

The equipment package includes a decoder, dish, remote unit and connecting cables. The equipment package costs anywhere from \$700 to \$900 and installation costs roughly \$150 to \$200. Currently, there are 3 companies offering this satellite service--DirecTV, United States Satellite Broadcasting and PrimeStar (a cable company). The basic package, which allows customers to choose over 40 channels costs between \$22 and \$30 per month. Other channels can be selected for an additional cost and pay-per-view is also available.

Direct Broadcasting Satellites can provide near video on demand and the picture and sound quality is generally better than provided by cable companies. As this technology becomes more popular, the cable TV industry will lose subscribers to DBS. In addition, since franchise fees are not imposed on DBS services, counties and municipalities could lose franchise fee revenues unless tax law changes are made on the federal or state level.

VIII. Summary and Conclusions

The current telecommunications tax structure has worked reasonably well for Maryland and the industry. These taxes raise a substantial amount of revenue for the State, over \$92 million in tax year 1993, and the counties received approximately \$74 million from the property tax. Moreover, these revenue sources are rather stable from year to year. While these taxes are regressive on the whole, they do not consume a significant amount of any but the poorest household's income. The greatest drawback of the status quo is the effect of these taxes on market efficiency. The industry has become more competitive. Not only are the local and long distance markets becoming more competitive, but the regulated telecommunications firms are increasingly being challenged by those outside the regulatory and tax structures they operate under. These developments in the industry, resulting in increased competition in the long distance market and potential competition in the local market, have perhaps made the alteration of the tax structure appropriate.

Several policy options have been presented in this paper. One point all have in common is that they attempt to level the playing field to some degree for all players in this and related industries. The various approaches can result in more or less revenue for the State, more or less regressivity in the tax structure, and a more or less neutral system of taxation. But they all try to make the tax structure more amenable to the industry which has undergone radical change over the past several decades and will change even more radically over the coming years.

**TAXATION OF TELECOMMUNICATIONS
AND CABLE TELEVISION
IN MARYLAND**

APPENDICES

SUMMARY OF POLICY OPTIONS

Option	Revenue Effect (\$ millions)			Advantages	Disadvantages
	FY 95	FY 96	FY 97		
#1 - Extend the Corporate Income Tax to Local Telephone Service Providers	15	15.3	15.6	<ul style="list-style-type: none"> » Creates significant, fairly stable revenue stream to the state » Equalizes treatment of two facets of "traditional" telephone service - local and long distance providers would be subjected to identical taxes 	<ul style="list-style-type: none"> » Increases overall tax burden on industry, increasing overall market distortion » May cause rate increases in local phone service, which would have a regressive burden on phone users
#2 - Repeal Gross Receipts Tax On All Telecommunications Companies and Apply the Corporate Income Tax Fully	(32.4)	(33.7)	(35.3)	<ul style="list-style-type: none"> » Vertical equity enhanced by the repeal of a regressive tax and the shifting of some of the tax burden from consumers to stockholders » Increases market neutrality of tax structure by reducing overall tax burden 	<ul style="list-style-type: none"> » Less stable revenue stream » Emphasizes disparate sales tax treatment between mobile phone service and traditional phone service
#3 - Repeal the Gross Receipts Tax On Long Distance Providers	(22.3)	(23.4)	(24.6)	<ul style="list-style-type: none"> » Lessens tax burden by eliminating a source of double taxation » Levels the playing field between long distance companies and potential competitors » Reduces market distortions, although this is not likely to be noticeable 	<ul style="list-style-type: none"> » Increases regressivity by repealing a tax less regressive than the entire tax structure » Less stable revenue stream
#4 - Repeal Gross Receipts Tax and Apply the State Sales Tax To All Telephone Services	71.8	74.0	76.6	<ul style="list-style-type: none"> » Treats all telephone services similarly (i.e. sales tax but no gross receipts tax) » Eliminates "target" taxation of telephone services as utility-type service with special gross receipts tax, instead categorized them as taxable services similar to their competitor industries 	<ul style="list-style-type: none"> » May be difficulty in capturing appropriate tax base » Increases regressivity of tax structure » Taxation of business (not end user?) and equipment used to produce phone services could be problematic » Would have to ensure future technological developments are captured in the tax base to maintain advantages

<p>#4a - Repeal Gross Receipts Tax and Apply Sales Tax to Long Distance Only</p>	<table border="1"> <tr> <td>21.6</td> <td>22.9</td> <td>24.2</td> </tr> </table> <p>Revenue Stability: No Effect</p>	21.6	22.9	24.2	<ul style="list-style-type: none"> » Stable revenue stream » Mitigates regressivity of Option #4, (although more regressive than current tax structure) 	<ul style="list-style-type: none"> » Opens new tax disparity between land-based local telecommunications and long distance telecommunications » Local and mobile phone services treated similarly
21.6	22.9	24.2				
<p>#4b - Repeal the Gross Receipts Tax and Apply the Sales Tax to Telecommunications Services With an Exemption for "Local Basic Service"</p>	<table border="1"> <tr> <td>42.2</td> <td>43.9</td> <td>45.9</td> </tr> </table> <p>Revenue Stability: No Effect</p>	42.2	43.9	45.9	<ul style="list-style-type: none"> » Exemption enhances equity of sales taxation on local service, thought by many to be a necessity 	<ul style="list-style-type: none"> » Local and mobile phone services treated similarly » Again, would have to ensure future technological developments are captured in the tax base to maintain advantages
42.2	43.9	45.9				
<p>#5a - Remove Sales Tax From Cellular and Other Mobile Phone Services</p>	<table border="1"> <tr> <td>(17.7)</td> <td>(23.3)</td> <td>(30.6)</td> </tr> </table> <p>Revenue Stability: No Effect</p>	(17.7)	(23.3)	(30.6)	<ul style="list-style-type: none"> » Eliminates current taxation advantage for cellular services over traditional local service providers (5% sales tax vs. 2% gross receipts tax) » Increases market neutrality of tax structure by reducing overall tax burden 	<ul style="list-style-type: none"> » Would increase regressivity in tax system, by eliminating one tax that generally has progressive incidence (or nearly so) » Would place regulated local service providers at relative disadvantage to cellular service providers (2% gross receipts tax vs. no GRT or sales tax)
(17.7)	(23.3)	(30.6)				
<p>#5b - Reduce the Sales Tax On Cellular and Other Mobile Phone Services From 5% to 2%</p>	<table border="1"> <tr> <td>(10.6)</td> <td>(14.0)</td> <td>(18.4)</td> </tr> </table> <p>Revenue Stability: No Effect</p>	(10.6)	(14.0)	(18.4)	<ul style="list-style-type: none"> » Eliminates current tax advantage of traditional local service providers over cellular service providers (5% sales tax vs. 2% gross receipts tax) » Increases market neutrality of tax structure by reducing overall tax burden 	<ul style="list-style-type: none"> » Would increase regressivity in tax system, by reducing rate of tax that generally has progressive incidence (or nearly so) » Would create some new administrative burden for companies collecting sales taxes at two different rates, and for state to administer separately
(10.6)	(14.0)	(18.4)				
<p>#6 - Reduce Assessment Ratio from 100% to 40%</p>	<p>For long-distance companies only:</p> <p>For all telecommunications:</p>	<p>\$2.0 million local revenue loss</p> <p>\$29.6 million local revenue loss</p>	<p>\$150,000 state revenue loss</p> <p>\$2.2 million state revenue loss</p>			

Appendix 2

Regulation and Taxation of Telecommunications Industry

	Fully Regulated Monopoly or Utility	Local Telephone Service Company	Long Distance Telephone Service Company	Cellular Telephone Service Carrier	Non-Regulated Competitive Company
REGULATION					
State Regulatory Authority	Public Service Commission	Public Service Commission	Public Service Commission	No State Regulatory Overseer: Regulation is at federal level by FCC	No Regulatory Overseer
Regulatory Role	<u>Full Oversight:</u> rate-setting, level of service, financial auditing, general oversight Regulations can be superseded by federal actions	<u>Full Oversight:</u> rate-setting, level of service, financial auditing, general oversight Regulations can be superseded by federal actions.	<u>Limited Oversight:</u> companies must file with PSC to do business, but no direct oversight of finances or operations Regulatory role applies only to intra-state service - interstate regulated at Federal level by the FCC	No State regulation	None
STATE TAXES					
Public Service Company Franchise Tax	Tax is 2% of gross receipts from regulated functions	Tax is 2% of gross receipts from regulated functions	Tax is 2% of gross receipts from regulated functions	Not applicable	Not applicable
Corporate Income Tax	Tax is 7% of net income, applied only to functions other than public services	Tax is 7% of net income, applied only to functions other than public services	Tax is 7% of net income, applied to all functions incl those taxed by GRT	Tax is 7% of net income from all sources	Tax is 7% of net income from all sources
Sales Tax	Most "public services" are not subject to the state sales tax	Custom calling features (speed dialing, call waiting and answering services are subject to 5% tax	Generally, no sales tax on any services provided by long dist companies	5% sales tax applies to sale of equipment and service charges	Tax is 5%, collected on retail sales of goods and taxable services
LOCAL TAXES					
Property Tax (Assessment)	All property used in provision of "public services" is classified as "operating property" and assessed at 100% of full value, except land	All property used in provision of telephone services is classified as "operating property" and assessed at 100% of full value, except land	All property used in provision of telephone services is classified as "operating property" and assessed at 100% of full value, except land	Real property assessed at 40% of value, personal property at 100%	Real property assessed at 40% of value, personal property at 100%
Property Taxes Levied	State tax of \$0.21 levied on operating real property Only local taxes levied on operating personal property	State tax of \$0.21 levied on operating real property Only local taxes levied on operating personal property	State tax of \$0.21 levied on operating real property Only local taxes levied on operating personal property	State tax of \$0.21 levied on real property Local taxes apply to both real & personal property	State tax of \$0.21 levied on real property Local taxes apply to both real & personal property
Local Excise Taxes	Taxes and tax rates vary by jurisdiction, and by type of service	Some counties have tax on telephone service: (AA, Balt City, Balt Co., Mont)	Local governments have no authority to levy excise or sales taxes	Local governments have no authority to levy excise or sales taxes	Generally, locals may not levy local excise or sales taxes

STATE TAXATION OF TELECOMMUNICATIONS

	Gross Receipts Tax		Sales Tax		Corporate Income Tax		Notes
	Rate	Tax Base	Rate	Tax Base	Rate	Comments	
AL			6.7%	Intrastate	5.00%		(a) A gross earnings tax, levied only on local nonprofit telephone cooperatives in Alaska.
AK	1.0% - 2.0%	Intrastate (a)			1.0% - 9.4%		
AZ			5.0%	Intrastate	9.30%		(b) A consumer's tax is imposed on intrastate services at 4.25% of sales price. Residential consumers are exempt. Transmitters, miles of wire are also taxed.
AR			4.5%	Intra & Interstate MTS	1.0% - 6.5%		
CA			0.5% - 0.75%	Intrastate MTS & WATS, 800 Svc	9.30%		
CO			3.0%	Intrastate	5.00%		
CT			6.0%	Intra & Interstate	11.30%	20% surcharge, effective rate of 13.8%	(c) Gross receipts tax applies only to operating revenue. Gross receipts are deductible for the corporate income tax.
DE	(b)		4.25% (j)	Intrastate	8.70%		
DC	10.00%	Intra & Interstate	6.0%	Local, Cellular, Coin, "900"	10.25%		
FL	2.25%	Intra & Interstate	7.0%	Intra & Interstate	5.50%	Alternative minimum rate of 3.3%	
GA			4.0%	Local	6.00%		(d) The gross receipts tax applies only to local telecommunications services. Intrastate toll and private services pay a 6.5% sales tax in lieu of a combined 3% sales tax and a 3.22% gross receipts tax.
HI			4.0%	Interstate	4.4% - 6.4%		
ID					8.00%		
IL			5.0%	Intra & Interstate (Special Excise Tax)	7.30%	Combined (g)	
IN	0.3% - 1.2%	Intrastate	5.0%	Intrastate	7.90%	Tax due is greater of GRT or Corp. Inc. Tax	
IA			5.0%	Intrastate	6.0% - 12.0%		(e) Requirement repealed, but phone companies may pay the gross receipts tax in lieu of the corporate income tax and property tax.
KS			4.9%	Intrastate & Part of Interstate	4.50%		
KY			6.0%	Intrastate	4.0% - 8.25%	Graduated	
LA			3.0%	Intrastate	4.0% - 8.0%	Graduated	
ME			6.0%	Intrastate	3.5% - 8.93%		(f) If the corporate income tax falls below a minimum level, an alternate tax based on gross receipts is imposed (1.2% in 1990, falling to 0.5% of gross receipt in 1996).
MD	2.00%	Intra & Interstate (c)	5.0%	Cellular, "900", Answering Services	7.00%	Gross receipts are excluded from income tax for LEC	
MA			5.0%	Intra & Interstate	6.50%		
MI			6.0%	Intra & Interstate	2.35%	Single business tax	
MN			6.5%	Intra & Interstate	9.80%	Alternative minimum tax	
MS			7.0%	Intrastate	3.0% - 5.0%	Graduated	(g) This tax is a business and occupation tax imposed on all corporations.
MO			4.2%	Intrastate	6.25%	50% federal deduction allowed	
MT	1.80%	Intrastate			4.48% - 7.81%		(h) Gross income does not include income from goods or services subject to competition.
NE			5.0%	Intrastate	5.17% - 7.24%		
NV							
NH			6.0%	Intra & Interstate	8.00%		
NJ	5.00%	Intrastate	6.0%	Intra & Interstate & Yellow Pages Adv.		GRT in lieu of corp. inc. tax	(i) This tax is to be repealed in 1996.
NM			4.25% & 5.0% (k)	Intra & Part of Interstate	4.8% - 7.6%		
NY	4.90%	Intra & Interstate	4.0%	Intrastate		Gross receipts & franchise taxes in lieu of income tax	(j) Consumers tax.
NC	3.22%	Local Exchange Svc. (d)	3.0% & 6.5% (l)	Local & Interstate	7.75%		
ND			5.0%	Intrastate	3.0% - 10.5%		(k) Intrastate taxed at 5.0%, interstate taxed at 4.25%.
OH	4.75%	Intrastate	5.0%	Interstate MTS (m)	5.21% - 9.12%	Not applicable to services taxed by GRT	
OK			4.5%	Intra & Interstate	6.00%		(l) 3% rate applies to local services. See note (d).
OR					6.60%		
PA	5.00%	Intrastate	6.0%	Intra & Interstate (n)	12.25%		(m) Does not apply to services taxed under the gross receipts tax. Sales tax is imposed on intra and interstate telecommunications.
RI	5.00%	Intra & Interstate	7.0%	Intra & Interstate & International			
SC	0.30%	Intrastate	5.0%	Local	5.00%		
SD	5.00%	Intra & Interstate	4.0%	Intrastate			(n) Residential basic & subscriber line charges exempt.
TN			6.0%	Intra & Interstate MTS	6.00%		
TX			6.3%	Intra & Interstate	4.50%	Higher of surplus or capital	
UT			4.9%	Intrastate	5.00%		(o) Telecommunications systems are subject to a 3.5% sales tax.
VT	2.25% - 5.25% (c)	Intra & Interstate			5.5% - 8.25%	Not applicable to companies taxed by GRT	
VA	(f)			(e)	6.00%		
WA	0.00471% (g)	Intra & Interstate	6.5%	Intra & Interstate (p)			(p) Residential basic local exchange exempt.
WV	4.00% (h)	Intra & Interstate			9.00%		
WI	5.75% - 5.8% (i)	Intra & Interstate	5.0%	Intra & Interstate	7.90%		(q) Rate is composed of a 2.5% tax on personal property plus a tax on net income, currently 4.8%.
WY			4.0%	Intrastate			

SUMMARY OF OTHER PROVISIONS OF THE 1984 CABLE ACT

- I. provides that a franchising authority may establish requirements with respect to the designation or use of channel capacity for public, educational, or governmental use;
- II. requires the establishment of three types of access channels (channels used other than for the retransmission of the signals of television stations) which are:
 - public access channels which are available to the general public on a first come basis -- they may not present commercial advertising, political advertising, or obscene/indecent material;
 - education access channels which are used by local educational authorities for instructional/educational purposes--the same restrictions apply to education access as for public access;
 - local government access channels which are used by local governments and are not restricted; and
 - leased access channels which are available to the public on a leased basis--advertising is permitted on these channels;
- III. specifies how many channels a cable operator is required to designate for commercial used by persons unaffiliated with the operator;
- IV. disallows a person to be a cable operator if the person owns or controls the license of a television broadcast station that covers any portion of the community served by the operator's cable system;
- V. disallows a telephone common carrier to provide video programming transmitted by a cable system directly to subscribers in its telephone area and disallows cable ownership by telephone companies in the same areas as they provide telephone service except where cable operators are unwilling to provide the service, such as in rural areas.
- VI. allows any federal agency, state, or franchising authority to prohibit discrimination among customers of basic cable service;
- VII. provides that a franchising authority may prohibit a cable operator from presenting obscene material or services unprotected by the Constitution of the U.S.; and
- VIII. specifies that the FCC may establish technical standards relating to the facilities and equipment of cable systems.

**Cable Operators in Maryland
1994**

<u>Cable Operators</u>	<u>County Served</u>
Alpha Satellite Cable System	Somerset
American Cable	St. Mary's
Antietam Cable TV	Washington
Cable TV Montgomery	Montgomery and Prince George's
Cecilton CATV	Cecil and Kent
Clearview CATV	Harford
Comcast Cablevision of Maryland, Inc.	Baltimore, Harford
CMA Cablevision	Allegany, Garrett, Washington, Frederick
Easton Cable Company	Talbot
Falcon Cable	Kent, Queen Anne's, Somerset and Talbot
Flight Systems Cablevision	Baltimore City
G.S Communications, Inc.	Carroll
Harold's TV	Garrett
Howard Cable Television, Inc.	Howard
Jones Intercable, Inc.	Anne Arundel
Jones Intercable, Inc. of Calvert County	Calvert
Jones Intercable, Inc. of Charles County	Charles
Marcus Cable	Dorchester and Wicomico
Mid-Atlantic Cable	Carroll, Frederick, Howard Montgomery and Prince George's
Metrovision of Prince George's Co., Inc.	Prince George's
Multivision Cable TV	Prince George's
North Arundel Cable	Anne Arundel
Oldtown Community Systems	Allegany
Prestige Cable TV of Maryland, Inc.	Carroll
Sharpsburg Cable TV	Washington
Simmons Communications	Caroline, Dorchester, Kent, St. Mary's, Talbot, Calvert, Queen Anne, Wicomico, Worcester
SRW Cablevision	Garrett
Storer Cable Communications of Delmarva	Somerset, Wicomico and Worcester
TCI of Maryland	Allegany and Cecil
Triax Cablevision	Garrett
United Cable Television of Annapolis	Anne Arundel, and St. Mary's
United Cable Television of Baltimore	Baltimore City
United Cable Television of Eastern Shore	Worcester

Source: TV & Cable Factbook No. 62 (1994 Edition).

Prepared by: Department of Fiscal Services, November 1994

U.S. CABLE PENETRATION STATE BY STATE

(As of November 1, 1993)

Note: Figures reflect information supplied by system operators.

State	Systems	Basic Subscribers	Expanded Basic Subscribers	Pay Units	Miles of Plant	Homes Passed
ALABAMA	230	845,428	251,797	389,476	23,130	1,091,067
ALASKA	43	97,552	1,881	98,124	2,007	155,226
ARIZONA	110	733,761	17,270	447,476	19,807	1,341,318
ARKANSAS	291	502,831	116,594	209,628	13,080	616,425
CALIFORNIA	383	6,280,654	1,248,775	4,174,988	90,108	10,503,329
COLORADO	189	725,735	314,188	521,352	14,065	1,289,395
CONNECTICUT	26	959,669	300,693	771,582	18,912	1,164,095
DISTRICT OF COLUMBIA	3	162,690	149,586	175,271	1,044	263,000
DELAWARE	6	340,516	136,455	168,998	4,630	114,638
FLORIDA	297	3,460,807	521,925	1,893,755	73,705	5,366,240
GEORGIA	269	1,452,043	281,759	827,384	41,901	2,145,003
HAWAII	15	347,747	0	233,954	3,508	363,351
IDAHO	84	198,361	125,864	118,458	4,568	312,284
ILLINOIS	602	2,164,219	548,215	2,074,850	45,715	4,066,330
INDIANA	332	1,145,500	211,817	745,391	27,071	1,847,030
IOWA	540	595,150	324,663	414,422	12,436	932,331
KANSAS	424	561,989	205,326	338,718	10,652	803,570
KENTUCKY	289	830,507	348,881	416,882	21,894	1,124,206
LOUISIANA	213	929,866	306,369	579,063	20,026	1,285,038
MAINE	98	289,499	10,776	135,139	8,645	367,719
MARYLAND	46	1,008,605	273,963	939,880	21,156	1,677,010
MASSACHUSETTS	93	1,563,285	445,658	1,431,141	28,000	2,176,657
MICHIGAN	370	2,066,905	451,439	1,443,644	45,392	3,132,880
MINNESOTA	383	784,307	343,804	560,154	18,651	1,401,126
MISSISSIPPI	190	461,406	58,625	210,525	11,702	552,447
MISSOURI	440	981,762	487,302	738,355	24,291	1,754,826
MONTANA	118	165,040	115,931	131,461	3,369	234,309
NEBRASKA	342	384,659	86,473	241,073	6,692	541,133
NEVADA	50	331,641	87,704	285,925	5,294	546,607
NEW HAMPSHIRE	58	349,561	31,075	189,226	8,293	294,728
NEW JERSEY	63	1,982,540	273,796	1,810,175	30,296	2,777,469
NEW MEXICO	94	304,443	62,796	167,805	6,893	462,857
NEW YORK	261	3,712,249	1,083,338	3,512,582	56,483	5,115,104
NORTH CAROLINA	220	1,452,134	437,697	704,069	46,701	2,085,746
NORTH DAKOTA	209	142,886	55,243	70,488	2,546	193,916
OHIO	378	2,420,747	570,123	1,575,370	51,681	3,889,137
OKLAHOMA	323	667,475	240,458	387,417	16,191	1,097,249
OREGON	154	627,360	529,393	436,863	16,168	1,071,834
PENNSYLVANIA	417	3,191,217	674,977	1,747,570	59,809	3,867,725
RHODE ISLAND	13	276,831	0	246,028	5,538	491,555
SOUTH CAROLINA	146	710,996	125,614	301,155	21,584	945,033
SOUTH DAKOTA	225	151,009	23,571	69,007	2,758	189,089
TENNESSEE	168	1,075,270	131,656	606,728	29,861	1,599,999
TEXAS	880	2,980,175	1,311,366	2,110,945	81,346	5,665,040
UTAH	77	241,673	172,057	256,840	7,512	540,331
VERMONT	48	122,167	44,819	37,937	2,843	135,457
VIRGINIA	162	1,440,378	231,193	1,097,253	33,280	1,904,382
WASHINGTON	189	1,166,828	450,004	747,845	22,935	1,827,066
WEST VIRGINIA	219	455,529	154,674	212,429	10,894	572,414
WISCONSIN	293	907,894	257,947	492,144	18,945	1,425,878
WYOMING	67	118,326	69,572	87,431	2,686	150,065
CUBA	1	2,096	0	3,924	40	3,000
GUAM	1	26,449	0	13,093	588	35,700
MARIANAS ISLANDS	1	6,580	0	2,184	110	10,000
PUERTO RICO	15	193,814	65,682	118,472	3,753	532,387
VIRGIN ISLANDS	2	25,117	23,771	33,165	605	34,000
TOTAL	11,160	55,123,878	14,794,555	37,755,214	1,161,790	84,085,751

**APPENDIX 7
COUNTY AND MUNICIPAL FRANCHISE FEE REVENUE - FY 1993**

COUNTY	MUNICIPALITY	FRANCHISE FEE RATE *	COUNTY FRANCHISE FEE REVENUE	MUNICIPAL FRANCHISE FEE REVENUE	CNTY. AND MUN. FRANCHISE FEE REVENUE
Alleghany		5%	\$163,166		\$163,166
	Cumberland	3%		\$126,874	\$126,874
	Frostburg	3%		\$22,912	\$22,912
Anne Arundel		5%	\$1,342,883		\$1,342,883
	Annapolis	5%		\$203,580	\$203,580
Balt. City		5%	\$2,453,909		\$2,453,909
Balt. County		5%	\$3,749,969		\$3,749,969
Calvert		5%	\$240,692		\$240,692
	North Beach	3%		\$3,538	\$3,538
Caroline		NA	NA		NA
Carroll		3%	\$208,183		\$208,183
	Manchester	3%		\$5,694	\$5,694
Cecil		3%	\$67,958		\$67,958
	Elkton	NA		\$72,008	\$72,008
Charles		0%	\$0		\$0
Dorchester			\$0		\$0
	Cambridge	3%		\$36,245	\$36,245
Frederick		0%	\$0		\$0
	Frederick	3%		NA	NA
Garrett			\$0		\$0
	Accident	0%		\$0	\$0
	Grantsville	3%		NA	NA
	Kitzmiller	3%		NA	NA
	Oakland	3%		\$7,315	\$7,315
Hartford		3%	\$334,878		\$334,878
Howard		5%	\$1,019,563		\$1,019,563
Kent		5%	\$4,760		\$4,760
Montgomery		5%	\$5,539,221		\$5,539,221
Prince George's		5%	\$2,408,097		\$2,408,097
Queen Anne's		NA	\$64,785		\$64,785
	Centreville	3%		\$3,400	\$3,400
St. Mary's		5%	\$265,098		\$265,098
Somerset		3%	\$40,367		\$40,367
	Crisfield	5%		\$17,117	\$17,117
Talbot		0%	\$0		\$0
	Easton	0%		NA	NA
Washington					
	Boonsboro	2%		\$7,371	\$7,371
	Hagerstown	3%		\$111,232	\$111,232
	Hancock	5%		NA	NA
	Sharps town	3%		\$2,738	\$2,738
	Smithsburg	2%		\$4,250	\$4,250
Wicomico		5%	\$236,519		\$236,519
	Salisbury	2%		\$149,412	\$149,412
	Willards	3%		\$3,684	\$3,684
Worcester		0%	\$0		\$0
	Ocean City	5%		\$359,540	\$359,540
Totals			\$18,140,048	\$1,136,910	\$19,276,958

* - % of Gross Revenue

NA - Data was not available

Prepared by: Department of Fiscal Services, November 1994

Source: Maryland Association of Counties and Uniform Financial Reports

APPENDIX 8

PROPERTY TAX REVENUE PAID TO COUNTIES AND STATE FROM CABLE COMPANIES
FY 94

	COUNTY PROPERTY TAX RATE	COUNTY PERSONAL PROPERTY TAX REVENUE	COUNTY REAL PROPERTY TAX REVENUE	TOTAL COUNTY PROPERTY TAX REVENUE	STATE REAL PROPERTY TAX REVENUE	TOTAL COUNTY AND STATE PROP. TAX REVENUE
Allegany	2.410	\$126,380	\$95	\$126,475	\$8	\$126,483
Anne Arundel	2.460	\$407,778	\$11,199	\$418,977	\$988	\$419,965
Balt. City	5.950	\$1,023,840	\$70,545	\$1,094,385	\$2,511	\$1,096,896
Balt. County	2.895	\$728,702	\$0	\$728,702	\$0	\$728,702
Calvert	2.230	\$41,668	\$0	\$41,668	\$0	\$41,668
Caroline	2.490	\$47,519	\$0	\$47,519	\$0	\$47,519
Carroll	2.350	\$139,392	\$0	\$139,392	\$0	\$139,392
Cecil	2.500	\$84,059	\$0	\$84,059	\$0	\$84,059
Charles	2.230	\$135,442	\$12,305	\$147,747	\$1,059	\$148,806
Dorchester	2.240	\$23,579	\$232	\$23,811	\$22	\$23,833
Frederick	2.190	Exempt	\$0	\$0	\$0	\$0
Garrett	2.240	\$8,914	\$0	\$8,914	\$0	\$8,914
Harford	2.730	\$209,453	\$0	\$209,453	\$0	\$209,453
Howard	2.450	\$228,720	\$0	\$228,720	\$0	\$228,720
Kent	2.330	Exempt	\$0	\$0	\$0	\$0
Montgomery	1.936	\$923,484	\$0	\$923,484	\$0	\$923,484
Prince George's	2.400	\$666,615	\$27,415	\$694,030	\$2,348	\$696,378
Queen Anne's	2.170	Exempt	\$0	\$0	\$0	\$0
St. Mary's	2.330	\$48,307	\$0	\$48,307	\$0	\$48,307
Somerset	2.000	\$8,212	\$132	\$8,344	\$13	\$8,357
Talbot	0.750	Exempt	\$0	\$0	\$0	\$0
Washington	2.130	\$109,447	\$7,129	\$116,576	\$677	\$117,253
Wicomico	2.150	\$80,817	\$0	\$80,817	\$0	\$80,817
Worcester	1.590	\$70,753	\$0	\$70,753	\$0	\$70,753
Totals		\$5,113,081	\$129,052	\$5,242,133	\$7,626	\$5,249,759

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Prepared by: Department of Fiscal Services, November 1994

Source: Department of Assessments and Taxation and Maryland Association of Counties

APPENDIX 9

TELEPHONE COMPANY FCC APPLICATIONS FOR VIDEO SERVICE

Bell Atlantic

Arlington, Virginia - Video on Demand Trial (Approved for 300 subscribers)
Morris County, New Jersey - Cable TV Services (Approved)
Dover Township, New Jersey - Cable TV Services
Maryland, Virginia, parts of Washington, D.C. - Video on Demand
Alexandria, Virginia - Video on Demand

Pacific Bell

Milpitas, California - Video on Demand
Los Angeles, Orange County, San Diego, San Francisco - Video on Demand,
Other services

U.S. West

Omaha, Nebraska - Cable TV Services, Video on Demand, Other Services
Boise, Denver, Minneapolis/St. Paul, Portland, Oregon, Salt Lake City -
Cable TV Services, Video on Demand, Other Services

Ameritech

Cleveland and Columbus, Ohio; Chicago; Detroit; Indianapolis; Milwaukee
- Cable TV Services, Video on Demand, Other Services

Southwestern Bell Corporation

Richardson, Texas - Video on Demand, Other Services

GTE

Unknown Areas - Video on Demand; Cable TV Services, Other Services

Rochester Tel

Rochester, New York - Video on Demand

NYNEX

East Side of Manhattan, New York - Video on Demand
Warwick, Rhode Island - Not Determined

Southern New England Telephone

West Hartford, Connecticut - Video on Demand

Bell South

Florida; Las Vegas, Nevada; Brentwood, Tennessee; Vestavia Hills,
Alabama, North Carolina - Cable TV Services, Video on Demand

Puerto Rico Telephone

San Juan metropolitan area - Video on Demand

Source: "Cable World", May 23, 1994

Prepared by: Department of Fiscal Services, November 1994