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TELECOMMUNICATIONS TAXATION : THE GEORGIA CASE

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FOREWORD

The telecommunication industry is in a throes of a dramatic restructuring. The technology in the industry is changing rapidly, its productivity growth the highest of any industry in the country and the variety of services now offered by the industry is expanding. Moreover, the industry has shed many of the regulations which, in the past, governed the behavior of its firms.

One implication of the changing structure of this industry is that the system of taxation which it currently faces, one designed specifically for the regulated monopoly of times gone by, has become obsolete. The system, as it now stands, is economically inefficient, horizontally inequitable and administratively burdensome. The general sales tax in most states is too narrowly defined to capture all of the firms which provide services which are functionally equivalent to those provided by the traditional "phone company". The methods of assessing and taxing telecommunications firms under the property tax are outdated and, as with the sales tax, do not apply equally to all firms which provide telecommunications services. And, finally, telecommunications firms are frequently subject to special franchise fees to compensate for the rights to provide services in an area with some protection from competition and for the rights to public right of ways. The rationality of this system of franchise fees is under attack as the monopoly status of the traditional provider of services is disappearing. The methods used for assessing these fees can also be called into question as some of the newer technologies which provide telecommunications services use less and less of the rights of way. Differences in the method of franchise fee assessment across alternative providers of these services must now be addressed as participants in the market begin to offer similar packages of services.

In this paper, the current structure of telecommunications taxation in the state of Georgia is examined and compared to that existing in other states. An assessment of the system is provided, highlighting the structural problems in the current system and suggesting possible avenues for reform.

EXECUTIVE SUMMARY

The telecommunications industry is in the midst of a profound restructuring. Technological advances have combined with regulatory reform to render an industry which barely resembles that of just ten years ago. With the signing into law of the Telecommunications Competition and Deregulation Act of 1995 (TCDA95), many of the last vestiges of the regulatory system which had for year governed the activity of the industry long associated with "Ma Bell" have been swept away. Competition, having for years snuck into the market, will now have fuller rein.

It is perhaps axiomatic that government, its laws and its regulation will change more slowly than the market it is designed to monitor. The slow and painful delivery of TCDA95 is a perfect illustration of this fact. Yet, there are many other elements of the relationship between the telecommunications industry and government which have not kept pace. One example, and one which will be increasingly important in years to come, is the system of taxation placed on the industry. This system of Federal, state and local taxation, designed for a highly regulated natural monopoly, now has elements which are not only obsolete, but could threaten the fair and efficient development of this essential and important sector of the economy. The system of telecommunications taxation in Georgia is among the most egregious examples of a tax system which has not kept up with technological and market developments.

Structural Problems With Telecommunications Taxation in Georgia - The telecommunication sector in Georgia is, in many ways, taxed differently than other private sector industries. Three specific taxes present problems with the methods of taxation imposed on the industry.

In principle, the general sales tax is one placed on the consumption of final goods and (specifically designated) services. A fair and efficient sales tax system should tax all functionally equivalent goods and services the same. Yet, the general sales tax system on the telecommunications industry defines the base of the sales tax on telecommunications very narrowly. At this time, the Georgia sales tax places a tax only on traditional, two-way local service. The primary source of growth in the telecommunications sector has been long distance service and in competitive services, such as paging. The future promises the growth of many new competitive telecommunications services and it is important that each of these alternative services be treated the same as all other services.

The importance of more careful scrutiny of the telecommunications sales taxation is more evident when one considers the impact of technological and market "convergence" in the industry. Cable companies, cellular companies, long distance companies, the internet providers and the traditional phone companies will now all be offering "bundles" of telecommunications services. To the extent that the state distinguishes among these services for tax purposes, the administrative and compliance costs of the sales tax will grow. Thus, reform of the sales tax system will not only be fair and efficient (in an economic sense), but will save on simple administrative costs.

The most rapidly growing sector of the economy, the internet and its access providers, present a special problem for the state sales tax. On the one hand, the internet simply uses telecommunications infrastructure to deliver its final output. But recent software development have made it possible to use the internet to make long distance phone calls. As a direct competitor

to the long distance service providers, it is important that they be treated, for tax purposes. This issue opens the whole, difficult issue of internet taxation to legitimate scrutiny. Many states, most notable Texas and Florida, are currently struggling with this issue.

The system of *local government franchise fees* is also one which will require a great degree of attention in the coming years. Local governments have traditionally placed levies on public utilities in compensation for the access to public rights of way. Now, with the new technologies available for the delivery of telecommunications services, such as cellular technologies, Multi-point Multimedia Delivery System (MMDS) and Personal Communications Networks (PCN), among others, the fairness and rationality of the existing system of franchise fees. How should cable be treated relative to phone companies in light of the fact that they both will soon be providing the same services using common technologies? How should cellular companies be compelled to compensate local governments for access to rights of way in comparison to phone companies? How should franchise agreements between long distance service providers and local government be altered in light of the fact that they will soon also provide local service? How should the government treat Direct Broadcast Service (DBS), or satellite service? While many local governments see the expansion of technologies and the necessary enhancement of telecommunications infrastructure as a potential windfall for local governments, telecommunications services providers see a fundamental challenge to the rationale and fairness of the system of local franchise fees. Legal challenges against the system of franchise fees have already occurred in several states and are sure to appear in Georgia. It is best that the state of Georgia begin to rethink this system in advance.

The system of *property taxation* is perhaps the best example of the current disparity in the treatment of the traditional telecommunications companies and their new competitors. By law, public utilities are assessed using the "unit valuation" method, in which the company has its property assessed as a complete operating unit, rather than on the basis of the market value of its physical property. By virtue of its assessment as a unit, the value of intangible property is implicitly included in the value of property. At the same time, cable companies and other providers of similar services are assessed using the "summation" method, which explicitly excludes such intangible values.

Comparisons With Other States - Georgia is by no means alone in its need to face the emerging problem with telecommunications taxation. Many states have established commissions to formally address one or another of these problems.

In many ways, the State of Georgia is much further behind the curve than other states. For example, the state of Georgia only taxes local telephone service - one of only two states to so narrowly define their base. Not only does such a narrow base lead to the sorts of inequities and inefficiencies described above, it stands to lose revenue over time as the telecommunications market shifts to alternative means of service provision. By allowing this segment of the market to escape the net of taxation, pressure will grow to increase tax rates. Carefully defining the tax base will allow the state to adequately fund its public institutions without the need for higher, distortionary and anti-growth tax rates.

TELECOMMUNICATIONS TAXATION: THE GEORGIA CASE

by
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I. OVERVIEW

With the passage and signing of the 1996 Federal Telecommunications Reform Act, the revolutionary deregulation of this important industry is nearly complete. In the space of just thirteen years, since the enactment of the Modified Final Judgement by Judge Harold Greene, the telecommunications industry has gone from a highly-regulated monopolistic industry to one with many participants and few remaining controls on their activity.

What makes this deregulation all the more important, from the standpoint of public policy, is that this industry also happens to be one of the most technologically dynamic in the world economy today. Hardly a month passes without the announcement of some new product or technology which improves the quality and delivery of telecommunications services. The industry has one of the highest rates of increase in productivity of any industry in the country. What makes the advances in this industry so important to the economy is that the telecommunications service is an important input into the production process of many other industries. Technological advancements in the telecommunications industry thus have secondary impacts on the productivity of other industries. In short, the industry is very dynamic. Not only are the services provided by the industry expanding and improving, but the very market structure within which it operates is changing.

It is perhaps axiomatic that public policies affecting the market move more slowly than market forces themselves. Consequently, many government policies and rules are often outdated or may even be classified as obsolete. Tax policies, for example, designed for one age or to deal with a previously existing problem, will hang on long beyond their purposes. In the realm of the telecommunications industry, which has changed so drastically over the past few years, it is the system of state and local taxation applied to this industry which has become increasingly difficult to rationalize.

The system of taxation which currently applies to the telecommunications industry is one which was designed for the traditional regulated monopoly. Moreover, the tax system mattered little to the regulated firm, since rate regulation permitted full-forward shifting of taxes to customers. Now, with the encroachment of competition in the industry and the dismantling of the regulatory system, tax levels DO matter. It is also an industry which sells a product whose character is changing rapidly. In short, the state and local taxation of telecommunications is an issue which needs careful study, and needs it quickly.

This obsolescence of the telecommunications taxation system is also an interesting and important issue to study since the experience of this sector presages ongoing transitions with other traditional regulated monopolies which are now entering periods of increased competition. The natural gas and electric utility markets are also showing signs of bursting out of the monopoly mold. Yet they too face a tax system unique to regulated monopolies. Consequently, any lessons which can be learned about the taxation of telecommunications in a period of emergent

competition will have important applications to the natural gas and electric utility industries as well.

This report reviews the current system of taxation of the telecommunications industry in the state of Georgia. The intent is to show how Georgia treats the industry differently than other industries, how Georgia treats its telecommunications industry differently than other states treat their telecommunications industry and, finally, to show that the system, as it now exists, is in need of reform.

II. THE TAXATION OF TELECOMMUNICATIONS IN GEORGIA

At first glance, it would appear that telecommunications firms in Georgia are generally subject to the same forms of taxation, and subject to the same tax rates, as any other firm operating in the state. State and local governments impose the sales tax, the property tax and the corporate income tax on these firms. In addition, however, firms which are classified as regulated public utilities, like local telephone companies, natural gas companies, electric companies and cable TV companies, are also subject to an additional local government levy: the local gross receipts or franchise tax. This extra tax is levied by counties and municipalities in the state.

While these firms are subject to the same taxes (in addition to the gross receipts tax), there are peculiarities in the form and administration of these taxes as applied to the telecommunications industry which ultimately renders a tax treatment which is operationally different from that faced by other firms. Also, inasmuch as the number and nature of firms providing telecommunications-like services is changing, the issue of the similar treatment of firms providing equivalent types of services is becoming important.

SALES TAXATION

The Georgia general sales tax, for the most part, has traditionally been levied on the final sale of tangible goods. However, as in most states, the base of the general sales tax has grown over time to include various kinds of services as well as tangible goods. To illustrate, entertainment services are becoming an important component of many states' tax bases. In Georgia, taxation of services accounted for 8.4% of total sales tax revenue in Fiscal 1994; 17.2% when utility services are included.

Local telephone services are taxed in Georgia. The tax is levied on basic service, the monthly charge plus the subscriber line charge - (the \$3.50 levy for customer access to long distance companies). Enhanced services, such as call forwarding and voice-mail, are also taxed. The tax is levied on both residential and business customers. Intrastate and interstate long distance service is exempt from taxation in Georgia.

The general sales tax is levied on local service provided by both the local phone company and cellular companies. Cellular companies charge a monthly fee and also charge for measured service (air time). Both of these charges are taxed. However, as with the traditional phone company, any service related to long distance escapes taxation. Cellular users are also assessed

a "roaming charge" for calls made from outside of the area covered by their cellular carrier. These charges are taxable in Georgia.

No other element of the evolving telecommunications sector, such as paging services, are taxed. On-line services, such as E-mail, the services of the internet access providers or providers of other enhanced services such as teleconferencing services, are not taxed. In short, the State of Georgia taxes telecommunications services, but only very narrowly-defined telecommunications services.

In 1994, Georgia raised \$52.8 million in taxes on telephone and telegraph company services. This is up from \$41.9 million in 1990.

PROPERTY TAXES

All telecommunications companies are subject to the real and personal property tax. The rate of property taxation is determined by the local jurisdictions.

One important difference between the taxation of telecommunications firms and regular businesses is the method of assessment. All property in the state must be valued, or assessed, by the government. For most residences and businesses, this assessment is done at the county level. However, telecommunications property, like all utility properties, is centrally assessed (at the state level). The reason for this difference in assessment methods is two-fold. First, much of the property owned by the traditional public utilities crosses many county borders. Purely local assessment would require a group of individual and independent assessors to value similar property lying on different sides of a county's boundaries, with no guarantee of consistency or conformity. Second, the traditional public utility is difficult to assess since the assessors have little information on the current market values, unlike residential properties, which are frequently sold and "reveal" their market value. Therefore, the local assessors have little to go by in terms of valuing the property of a large public utility.

Another difference in assessment between a typical business and a public utility is the approach taken to determining total value of property. The value of most business property is calculated using the "summation method", in which the depreciated value of all items of plant and equipment are summed to determine total market value of the firm. Public utilities, however, are taxed using an approach known as unit valuation. With unit valuation, the property value of the firm is not determined by adding up the depreciated value of each individual piece of property but rather is determined as a unit. That is, the assessor simply asks: "What is this whole operation worth?" The basis for the valuation of property under the unit valuation method can be the value obtained from the stock market value of the firm and/or a capitalized value of the income flowing to the firm. In the end, the level of the total assessment is often negotiated between the state's assessor and the public utility based upon these alternative measures of market value. Once the aggregate value of the firm is determined, the value is allocated to local taxing jurisdictions on the basis of a number of possible factors: the location assets (based upon book value), miles of wire or other measures of activity.

Unlike some states, the assessment ratio (that proportion of the total market value of property which is taxed) is the same for both public utility and other business and residential property - 40 percent.¹

In Georgia, smaller public utilities, defined as a utility with less than \$5 million in annual revenue, can opt to pay a gross receipts tax in lieu of their property tax.

CORPORATION INCOME TAXATION

The Georgia Corporation Income tax is a levy on the proportion of a company's total profits which are attributable to its operations in the state of Georgia. If a company fully operates within the state of Georgia, the taxation of their corporate income poses no special problems. However, since most companies operate in more than one state, the total profits of those companies must be apportioned to the state in some way.

Like most states, Georgia apportions these profits to the state on the basis of a formula which attempts to reflect the share of their activity occurring in Georgia. The formula is structured to allocate total corporate profits on the basis of the share of total payroll, total sales and total property in the state of Georgia. Since 1994, Georgia has double weighted the sales factor in this formula.²

The structure of corporate taxation of telecommunications firms is essentially the same as that for all other firms, although some states make special allocation provisions for telecommunications firms. For example, a state may allocate total profits on the basis of the share of total miles of wire located in the state.

GROSS RECEIPTS TAXATION

In addition to the other taxes which public utilities pay in the state of Georgia, they also pay an additional local levy. All public utilities firms in the state of Georgia are subject to a local levy (fee) for access to rights-of-way and rights to do business. The franchise fee is negotiated between each municipality and the utility. In Georgia the tax is typically a tax on gross receipts (defined as recurrent revenues). For example, in most municipalities, the electric industry pays four percent of gross receipts. The telephone companies pay three percent. Gross receipts are defined as the total receipts of the firm, less the amounts received from non-telecommunications business (such as rental of office space) and out-of-state business. Although this is of importance for electric and natural gas companies, who do (or soon will) compete with suppliers from outside of the state, it is of little or no consequence for local phone companies. In addition, the receipts

¹Variations in assessment rates between "normal" businesses and public utilities are discussed more fully in the next section.

²A state's share of total company taxable profits equals 50 percent of the company's share of sales made in the state plus 25 percent of its share of property and 25 percent of its share of total payroll in the state.

of "access charges" paid to the local exchange companies are taxed or deductible. In some areas, the interexchange companies and other participants in the telecommunications industry often pay a flat fee (e.g., per mile of wire or per cell-site) for access to the right-of-way instead of a gross receipts tax.³

Although not considered a traditional public utility, cable companies are also subject to a gross receipts tax of up to five percent levied by the county governments (as opposed to the municipal governments to whom telephone companies pay franchise fees). The existence of this separate tax on cable companies is important since cable companies will soon be major players in the telecommunications market. This dichotomous treatment of potential competitors is discussed further in section IV.

In order for a firm to be taxed under this levy, they must be classified as a public utility by the Georgia Public Service Commission. Inasmuch as cellular companies are not categorized as a public utility, they are not assessed the gross receipts tax. Neither are paging companies nor other providers of telecommunications-like services.

In some states, the state government also levies a separate gross receipts tax. Typically, the state gross receipts tax is levied in lieu of some other tax. For example, in Ohio a gross receipts tax on public utilities is levied in lieu of the corporation income tax, while in South Dakota and Wisconsin it is levied in lieu of the property tax. Georgia imposes no such statewide gross receipts tax.

The justification for this particular differential taxation of these public utilities is that these firms have traditionally been given a greater degree of market protection by the government and certain rights which other private firms are not granted. For example, each public utility obtains a local franchise to provide exclusive service in their area. Until very recently, the local telephone companies were protected against competition in the local exchange service market. The state gross receipts tax can be considered a quid pro quo for both the access to the rights of way and for the franchise monopoly.

III. HOW GEORGIA COMPARES WITH OTHER STATES

Georgia's system of telecommunications taxation is not typical of the other states. In fact, NO state's taxation of telecommunications is "typical." The ways that these firms are taxed varies substantially from state to state and there is nothing systematic about how they are treated. There appears to be no generally accepted paradigm as to how these firms should best be taxed. A comparison of tax systems follows.

³The difference between the rates for the electric companies and the telephone companies is often explained as a historical result of the desire by the municipalities to encourage universal service in their region at the time the telephone companies entered the state.

SALES TAXATION

Most states tax telecommunications services of one sort or another, either under the general sales tax or as a statutorily separate telecommunications of public utilities excise tax. In 1995, of the 45 states which levied general sales taxes, 40 taxed telephone services. In addition, two of the states which do not have a general sales tax imposed specific levies on telecommunications services. Thus a total of 43 states tax telephone services.⁴

TABLE 1
SUMMARY OF TELEPHONE SERVICE
TAXATION IN THE U.S.

Tax Base:	Number of States: 1990	Number of States: 1995
Local Service Only	3	3
Local & Intrastate Toll	17	19
Local & Intra/Interstate Toll	19	16
Interstate Toll Only	2	2
Telephone Exempt	5	6
No State Sales Tax	5	5
... of which tax telephone	2	2

Within this group of 43 states, there are many variations in the breadth of telecommunications taxation. For example, within the category of traditional telephone services, there are three types of basic or telephone services which might be taxed: local service, intrastate long distance and interstate long distance. Thirty-six of the states tax long distance service as well as local service. Of these 36, there is a nearly equal mix of states which tax, and which exempt, interstate long distance from the tax base (19 tax interstate toll calls while 17 exempt them). Two additional states, Hawaii and Delaware, tax only interstate long distance, exempting all local service.

The general pattern is to include toll service in the tax base, with some states exempting interstate calls. There are only three states in the country which tax only local service. Georgia is among this small group.

⁴It is important to note that states define telephone services differently. In some states, the tax is imposed on regulated telephonic companies only, others on any two-way voice message but not one-way, others on voice and data transmissions and still others on a specifically enumerated list of telecommunications services.

In recent years, there has been a trend toward the broadening of the general sales tax base with regard to their treatment of telecommunications. Two states added interstate calls to the tax base, while one added both intra- and interstate toll calls. One state entirely eliminated the exemption of phone services from the tax base. In general, the trend is toward the expansion of the sales tax base for telephone services.

While most states have treated telecommunications as any other part of the general sales tax base, at least two states tax telecommunications services at a rate higher than the general sales tax rate: Alabama and Florida. North Carolina taxes all services at a 3 percent rate while taxing intrastate toll at 6.5 percent.

An issue of growing importance is that of the taxation of the services of other types of telecommunications providers beyond the traditional telephonic service providers. A recent survey of 31 states performed by the Ohio Department of Taxation is summarized in the accompanying table. What is of interest in this table is the relative treatment of the different types of institutions in the telecommunications market. Two in particular are of interest: paging companies and cellular companies. The cellular companies clearly provide a service which is comparable to that of the local exchange companies or the traditional phone companies. Paging companies provide a non-voice method of communications although it is a substitute, of a sort, for traditional phone service.⁵

TABLE 2
SUMMARY OF 31 STATE SURVEY
OF SALES TAXATION OF TELECOMMUNICATIONS

Local Exchange Companies	23
Interexchange Companies	17
Cellular	25*
Paging	17
Cable	16
On-line Services	12

Source: Ohio Department of Taxation

Here we see that the treatment of the local exchange companies and cellular is basically the same. More of the surveyed states reported taxation of cellular than did those reporting taxation of local exchange service. This is the case since Ohio exempts from sales taxation any

⁵States are currently grappling with the issue of whether paging services constitute a type of two-way communications by which a telephonic service is typically defined.

company which is subject to the statewide gross receipts tax. On the other hand, paging services are taxed in just over one-half of the states, as are on-line services.

PROPERTY TAXATION

There are five substantive ways by which the property tax and its administration vary from state to state with regard to the telecommunications industry.

First, the property can be assessed centrally (by the state government) or locally. In Georgia, all public utility property is assessed by the state. This is generally the case, with only nine states reporting public utility taxation at the substate level.⁶

Second, the value of the property can be set using the summation method or it can be set using the unit method. In Georgia, it is assessed using the unit method. This is also fairly standard treatment. Thirty eight of the states currently use the unit assessment approach for public utilities.

Third, states may differ in the uniformity of the assessment laws across competitors in the telecommunications market. For example, the state may centrally assess the local exchange companies (e.g., BellSouth) but assess cellular companies, competitive access providers and paging companies locally. While this does not necessarily imply unequal treatment of equals, the potential does exist. Specifically, a comparatively large share of the "value" of a telecommunications firm is derived from intangible value. Such intangible value will be picked up using the unit approach, but not with the summation approach.

Fourth, some states employ a property tax classification scheme in determining the taxable value of property. That is, some states tax different shares of the total market value of property depending upon the type of property. For example, most of the states with classification schemes will assess residential property at a lower rate than nonresidential property. This leads to higher effective property tax rates on non-residential property, in spite of the fact that the nominal millage rate is the same on all property. Public utility property, such as the public utilities will usually be taxed more heavily than other types of property. Currently, 29 states have classification schemes. Georgia does not have such a system.

Fifth, some states do not tax tangible personal property at all. Currently, 12 states fully exempt personal property from taxation. This is a particularly important factor for telecommunications firms since most of the fixed capital of these firms is classified as personal property.

⁶See Survey of Railroad and Utility Taxation Practices Among the States, State of New York Board of Equalization and Assessment, Albany, NY, December 1993.

TABLE 3
ASSESSMENT LEVELS IN STATES TREATING TELECOMMUNICATIONS UTILITIES
DIFFERENT FROM REGULAR BUSINESSES

	Real Property		Personal Property	
	Regular	Telecom	Regular	Telecom
Higher Telecom Taxes:				
Kansas	30	30	20	30
Louisiana	15	25	15	25
Mississippi	15	30	15	30
Montana	3.86	12	3.86	12
North Dakota	10	10	0	10
South Dakota	6	10.5	10.5	10.5
Tennessee	100	100	0	100
Utah	40	55	30	55
	95	100	100	100
Lower Telecom Taxes:				
Connecticut	70	0	70	0
Maine	100	100	100	0
New Hampshire	100	0	0	0
Wisconsin*	100	0	100	0

Source: ACIR, Significant Factors of Fiscal Federalism: Volume 1. Budget Processes and Tax Systems-1992, Table 43.

*Gross Receipts tax paid in lieu of property tax by telecommunications firms.

In Georgia, by virtue of its unit method of assessment, the personal property of telecommunications firms is taxed. It is probably worth noting that all of the states specifically exempting personal property from taxation are in the Northeast of the Upper Midwest. Georgia is very much in line with its neighboring states in this regard.

TABLE 4
STATES EXEMPTING TELECOMMUNICATIONS PERSONAL
PROPERTY FROM TAXATION

Connecticut
Delaware
Hawaii
Illinois
Iowa
Maine
Minnesota
New Hampshire
New York
Pennsylvania
Wisconsin

GROSS RECEIPTS TAXATION

Currently, seventeen states impose a state level gross receipts tax.⁷ The rates for this tax vary widely, from a low of 0.3 percent in South Carolina to a high of 6.0 percent in Rhode Island. Georgia does not impose such a statewide gross receipts tax.

OVERALL TELECOMMUNICATIONS TAX BURDENS

How does the level of taxation of telecommunications firms in Georgia compare to that in other states? Since the potential for over taxation of telecommunications firms exists in every state, this issue of the aggregate amount of taxation of telecommunications firms has become a topic of interest to tax policy analysts. A recent report by Karl Case (1994) provides a measurement of the relative rates of taxation on telecommunications firms in all states.

In Table 5, we present estimates of the total amount of state and local taxes paid per dollar of operating revenues for these firms in all states. All things considered, Georgia taxes its telecommunications firms is relatively lightly compared to other states. In 1990, the last year for which data were compiled, the national average rate of tax liabilities as a share of gross operating revenues was 9.1 percent. In Georgia, it was just 6.3 percent. There are only nine other states which have tax burdens (expressed in this way) which are lower than those in Georgia.

⁷In most states, a franchise fee is levied at the municipal level. This fee is typically set at a percentage of gross receipts.

TABLE 5
STATE AND LOCAL TELEPHONE TAXES AS A PERCENTAGE
OF BELL COMPANY OPERATING REVENUES FOR SELECTED STATES: 1984 AND 1990

State	1984	1990
Georgia	5.7	6.3
Alabama	8.1	7.6
Arizona	9.5	13.0
California	4.9	6.6
Colorado	9.8	11.5
Connecticut	11.6	12.6
Florida	8.5	9.7
Kentucky	7.6	7.5
Mississippi	10.9	11.5
Nevada	1.9	3.2
New Hampshire	4.6	3.8
New York	17.8	13.5
North Carolina	6.0	6.6
Oklahoma	9.5	12.2
Rhode Island	20.4	14.0
South Carolina	6.8	10.3
South Dakota	9.5	10.9
Tennessee	11.0	10.8
Vermont	6.2	6.3
Washington	6.1	10.9
Wyoming	7.8	5.6

Source: Karl Case, State and Local Tax Policy and the Telecommunications Industry. Council of Governors' Policy Advisors, 1992.

There are three primary reason for the low tax burdens on Georgia's telecommunications firms. First, Georgia is, overall, a low tax state. A recent ACIR report on tax effort among the states, puts Georgia's effort index at 95, where the U.S. average is 100. Second, Georgia does not impose a state gross receipts tax on its telecommunications firms, as many other states do. Third, the state does not differentially assess telecommunications property at a higher rate.

IV. STRUCTURAL ISSUES IN THE TAXATION OF TELECOMMUNICATIONS FIRMS

THE PRINCIPLES OF TAXATION

Before moving to a discussion of current issues in the taxation of the telecommunications industry and its services in Georgia, a review of the economic principles of good taxation is

warranted. From this basic discussion of the design of a good tax system, the existing structure of such taxation in the state can be evaluated.

Economists have defined five principles of good taxation. They are: allocative efficiency, horizontal and vertical equity, ease of compliance and administration, revenue stability, conduciveness to growth.

First, the tax must be "allocatively efficient". Economic efficiency refers to the which the tax system has on the allocation of an economy's scarce resources across alternative uses. That is, a good system of taxation is one which would raise revenues without unduly affecting the patterns of production and consumption which we would observe in the absence of the tax. Perhaps the best way to illustrate the concept of efficiency in taxation is to describe the consequences of an inefficient system of taxation. An inefficient tax would be one which is placed disproportionately, or has a disproportionate impact, on one particular good, sector or activity in the economy. A tax which is narrowly focused on one sector of the economy would add an artificial distortion in the market, inducing people to alter their behavior in order to avoid or minimize their tax. If the tax system places a higher tax on one form of consumption over another, then more of the economy's resources would be devoted to the "tax-favored" activity than would have been the case in the absence of taxation. The inefficiencies of such a tax are heightened when very close substitutes (in production or consumption) are treated differently. It is for this reason that systems of general taxation, which treat all types of consumption or production equivalently, are generally considered superior. They do not artificially induce producers and consumers to act differently than they would have in the absence of the tax.

Second, the tax must be fair. Fairness is a difficult concept to address in a tax system since there is little consensus, economically or even philosophically, as to what constitutes "fair" treatment. However, economists have identified general principles of fairness, or equity, in taxation: vertical equity and horizontal equity.

The principle of vertical equity states that a tax system should not be designed to unduly burden those with the least capacity to bear those burdens. In practice, this principle states that a tax system is unfair if the burdens of the tax fall disproportionately on lower income households. A tax which takes a higher proportion of income from lower income households than from higher income households is called a "regressive tax". Those which take a higher proportion of income from higher income than lower income households, is called a "progressive tax". Those treating households at all income levels equivalently is called a "proportional tax". Where along the spectrum from regressive to progressive taxes the most appropriate tax system lies is a value-laden issue with no definitive answer. At a minimum, it might be said that a regressive tax is less preferred to proportionate or progressive taxes, at least with regard to the vertical equity of taxation.

The other principle of equity in taxation is that of horizontal equity. Horizontal equity states that equivalent taxpayers should be treated equivalently. Two households with the same capacity to pay taxes should be taxed the same. Two businesses providing the same types of services should also be treated equivalently. One should note that this principle of horizontal inequity is very closely related to that of efficiency in taxation. If the tax which is levied on one provider of service is different from that on another firm providing an equivalent service, the heavily taxed company will have an incentive to change its structure or service provision to reduce

taxation. This, again, is an example of the economic inefficiency in taxation, since firms are induced to behave in a certain way solely because of tax policy.

Third, the tax should be easy to understand, comply with and administer. The payment and collection of taxes uses up an economy's resources. It is essential that the tax system be structured in such a way that the fewest possible resources are devoted to this purely administrative activity as possible.

Fourth, the tax should provide a stable and reliable source of revenue. Independent of all the other characteristics of a good tax, if the tax cannot perform its fundamental task, which is to support needed public services, then the tax cannot be considered adequate. If the tax is unstable, then tax rates and tax bases will need to change frequently to provide a steady stream of revenues. Frequently changing bases and rates will cause economic and administration turmoil and inefficiency of its own.

Fifth, a tax or tax system should not unduly inhibit economic growth and development. This principle of taxation is particularly important in the context of state and local taxation. In the past decade, the competition among regions for new employers has grown strong. Since high taxes are a deterrent to growth, the system of taxation must be designed to minimize inevitable the growth-inhibiting aspects of the tax system.

It is important to appreciate that there are trade-offs among these principles of taxation. A tax which is vertically equitable may be economically inefficient. A tax which is horizontally equitable, taxing all equivalent services the same, may be very difficult to administer. A tax which is perfectly designed in terms of equity and efficiency may also be a strong deterrent to growth and development.

TELECOMMUNICATIONS TAXATION IN GEORGIA: THE ECONOMIC ISSUES

Having reviewed the principles of taxation, we now turn to the system of telecommunications taxation in Georgia.

General Sales Taxation

There are significant issues with regard to the general sales taxation of the telecommunications industry in Georgia. The ideal general sales tax, as it relates to the telecommunications sector, would be uniformly applied to all similar and competing telecommunications services. In a perfect tax world, for example, it should matter little what kind of firm is providing the telecommunications service, a regulated common carrier or any private sector provider of the service. It should also not matter whether a person is communicating via phone or fax, voice or message; through land lines or radio waves. If one form of communications is taxed, then the equivalent service should also be taxed.

In practice, the issue revolves around what one considers a telecommunications services. In many states, telecommunications services are defined narrowly as electronic two-way, voice communications over radio or wire. Other states define telecommunications services more

broadly to include one-way transmissions by voice or other electronic methods. Some states provide for the taxation of specifically defined and regulated telephone or telegraph companies while others make no distinction between the types of service providers. The most appropriate way to define these services is one which is broad enough to cover all potential methods of service delivery which are competitive, or to find circumstantial justifications for the differential taxation. Given the increased substitutability of telecommunications between alternative methods of communications, the time is right for an assessment of the system of sales taxation.

The Multistate Tax Commission, in their Hearing Officer's Report of transactional taxation of telecommunications defines the services in the following manner:

"Telecommunications" in addition to the meaning ordinarily and popularly ascribed to it, includes, without limitations, messages, programming or information transmitted through the use of local, toll and wide area telephone services; private lines service; channel service; telegraph service; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two-way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages, programming or information by electronic or similar means between and among points by wire, cable, fiber-optic, laser, microwave, radio, satellite or similar facilities."

The general sales tax on telecommunications services in Georgia applies only to local voice service. Both intrastate and interstate long distance are exempt from taxation. Basic cellular service is also taxed, as is air time and roaming charges, but the air time associated with long distance calling is exempt. Paging services, on-line services, internet access and cable services are not taxed. The structural implications of these elements of the tax system are discussed here.

The Exemption of Long Distance

All long distance service in Georgia, intrastate, interstate and international is exempt. As noted earlier, Georgia is one of only three states which currently exempt all long distance service.

There is no clear conceptual reason that basic service should be taxed while toll service is exempt. A telecommunicating service is a telecommunicating service—regardless of the physical distance of the call or the method of pricing.

There may be a legal rationale for the distinction in the tax treatment of intrastate versus interstate long distance. Interstate long distance is exempt in a larger share of states than is intrastate toll service. This is the case for two reasons. First, it had long been held that the taxation of interstate service would constitute a violation of Commerce Clause of the constitution. Second, states continue to exempt long distance service for economic development purposes. Inasmuch as a large share of new economic activity in the country is coming in the telecommunications-intensive sectors of the economy, many states fear that the taxation of interstate toll service may provide a disincentive for firms which rely heavily on long distance

service, such as major retailing services, direct marketing firms, telemarketing firms or reservations centers, to locate in their state.

With regard to the first rationale for the interstate exemption, the commerce clause issue, the Supreme Court recently ruled in *Goldberg v. Sweet* that taxation of interstate toll service did not violate the commerce clause. Since then, some states have taken the opportunity to include interstate long distance in their tax base.

With regard to the economic development implications of taxation of long distance services, the picture is not so clear. A qualitative case can be made that the taxation on interstate long distance might impel employers to move or choose other locations, particularly since telecommunications advancements themselves have made some industries "footloose". However, there has been no formal econometric work done which can be used to address the question. The historical experience with regard to the issue has been of such a short duration that hard quantitative evidence of the impact does not exist.

It should be noted, however, that even in those states which tax long distance, some allowance is made for the economic development implications of such taxation through the exemption of the taxation of 800, WATS and WATS-like service. Again, however, the true economic consequences of the taxation of 800 services remains a matter for speculation.

Finally, the technology of the alternative forms of telecommunications to the traditional landline phone company are rendering the concept of a "long distance" call increasingly blurry. What may be considered a long distance call for one telecommunications firm will not be considered long distance for another. This brings up issues with regard to horizontal equity in the treatment of providers of similar service. To illustrate, the "footprint" (the region within which a call is considered local) of the traditional wire-based telephone company and the radio-based cellular companies are different. A call from one area to another may be considered local and part of the basic service offered by the cellular company (and taxed as part of the monthly fee) but will be considered long distance (and exempt as a long distance call by the local exchange company).

Changes in billing practices can be even more troublesome for those states which attempt to distinguish between intrastate and interstate long distance. For example, many cellular companies currently offer a single-price unlimited long distance program which permits phone calls among collections of states. This could cause problems of horizontal equity as well as significant administrative problems. If the fixed price is for all long distance calls, intrastate and interstate, how will the appropriate tax be imposed for only the intrastate portion of all calls? If no effort is then made to distinguish between the two, then there will be an inequity in the treatment of calls made by the cellular companies and those made through the traditional local exchange and long distance companies. This issue also arises for the calling cards which provide a certain number of minutes of calls for a fixed price. Determining which calls are taxable and which are nontaxable is costly to comply with and very difficult to administer.⁸

⁸The sales tax could be imposed at the sale of the calling card on its gross value or the phone company could be asked to track taxable versus nontaxable calls and remit taxes appropriately. The former approach may yield inappropriate taxes while the latter renders uncertain net revenues to the firm.

With the passage of the Communications Act of 1995, it is a certainty that there will be mergers of firms in different parts of the industry which will inevitably lead to the provision of multiple services at single or blended rates. For example, the merger of AT&T and McCaw cellular will likely lead to bundled cellular and long distance rates. One might imagine fixed price nationwide cellular long distance. Assessing the appropriate sales tax on these transactions when the law attempts to distinguish between types of service will be very difficult to administer and inevitably unfair.

In summation, the exemption of long distance calling is an important issue to be addressed for efficiency, equity and administrative reasons. It is also important in terms of its revenue implications. We estimate that the long distance exemption costs the State of Georgia in excess of \$80 million per year.

Taxation of Alternative Telecommunications Services

In recent years, the popularity of alternative forms of communications has grown significantly. For example, many households have begun to rely on paging services as a method of messaging. In fact, it is the personal use of the paging services which accounts for the largest share of the growth in this dynamic market. Part of the reason for the growing demand for this service is the recent introduction of service which allows the emitter of the message to send a multi-word message to the person being paged and, in response, the person who is paged may deliver a response. The paged party need not find a phone in order to respond. This makes paging a more attractive alternative relative to the traditional voice telecommunications. Moreover, the paging services now cover a much broader geographic area, making the service an alternative to, and a competitor with, the traditional long distance telecommunications service. The principles of horizontal equity and efficiency dictate that all such competitors to traditional phone service be included in the tax base.

In addition, the nation is turning rapidly to the Internet as an alternative to many traditional forms of communications. The Internet Access Providers are allowing households access to the world wide internet and providing them with the E-mail address to facilitate communications. Many households now utilize Internet E-mail services as an alternative to long distance calling. The existence of the internet is also facilitating remote commerce, again substituting for the traditional long distance phone and mail order commerce. Here, too, the principles of taxation call for more attention to the equivalent taxation of competitive providers and substitutable services than would have been the case just a few year ago. In identifying the appropriate method of taxing these services, care will also need to be taken that no double taxation of the telecommunications service occur.

In summation, there is an increasing array of alternatives to plain old telephone service for telecommunications purposes. By taxing one form of communications and not the other, the tax system is favoring one particular form of communications over another, artificially imparting an advantage to these forms of communication. That is, differential treatment of essentially similar services is horizontally inequitable and allocatively inefficient. While the argument can be made that these alternative forms of communications are not strictly "telecommunications" because they

do not constitute two-way voice services and are not technically perfect substitutes, one must still admit that these are alternative forms of communications and consumers can substitute one form for another in consumption.

"900" calls

A popular use of the telecommunications infrastructure is the data retrieval and other entertainment uses, such as those associated with calls to "900" numbers. What, if anything, should be taxed is an issue of great interest. For example, a caller may place a call to a "Sports Information" 900 number and receive whatever information he desires. He may call a 900 number and register an opinion or place an order for a good or service. The bill for the call will appear on the monthly phone statement. Part of the charge on the phone bill is for the telecommunications service and part is for the informational and other services. What part, if any, of this call should be subject to taxation? Currently, in Georgia, none of the call will be taxed since informational services are non taxable and the 900 call is presumed to be long distance.⁹ If the informational services are taxed but the telecommunications service is not taxed (and it would not be taxed in Georgia at this time), then the phone company and the company providing the service accessed through the 900 call will need to separately report the portion of the total cost which arises from each portion of the service - the price will need to be unbundled.

These 900 services are a growing share of telecommunications industry revenues. The tax treatment of 900 services must be carefully addressed, particularly if long distance services are taxable.

On-line services, E-mail services and Internet access

An issue arises with respect to the taxation of services which require telecommunications services to access them, although they may not be considered telecommunications services themselves. For example, on-line services and internet access require telecommunications equipment and time. Are they then taxable telecommunications services? Some states currently tax the on-line services a part of a telecommunications service. Others, particularly those who do not tax information services of any sort, tend not to impose the tax on on-line, e-mail and internet services. A recent brief survey of 15 states showed that these states are fairly evenly split on this issue. While some states define telecommunications broadly enough to include these services, others make the distinction between the telecommunications service and the informational

⁹Technically, the telecommunications service portion of the 900 call charge is considered a non-recurring charge and is not taxed on that basis.

and other services. Another issue with regard to the taxation of these services is the *nexus* - that is, whether the provider of the service has enough of a presence in the state to be taxable.

With the growth in these services, it is important that the state think carefully through all of these issues with regard to taxation of telecommunications-related taxation.

Taxation of access charges

The general sales tax is designed as a tax on the purchase of a final good. That is, if a good is purchased as an input into another product, it should not be taxed, lest that input ultimately be taxed twice or even more times. In the realm of telecommunications taxation, there is a large degree of "purchase for resale". In particular, the interexchange (long distance) companies pay "access charges" to the local exchange companies for the access to the local switched network. In fact, nearly forty percent of the expenses incurred by interexchange company will be for these access charges. For a tax to avoid this double taxation of the access charges, these access charges should not be subject to the general sales tax. It should be exempted from taxation through exemption by the local exchange company. Internet access providers purchase access to long distance phone lines and then "resell" this access. It is important that this purchase not be taxed once at the "wholesale" level and then again at the "retail" level.

Under the new Telecommunications Reform Act in Georgia and the reform of the telecommunications regulation from the Federal government, the government will attempt to enhance competition by requiring the local exchange companies to provide interconnection by any other provider of telephonic services with their network in exchange for a reasonable fee. Undoubtedly, the flow of charges for this access will increase rapidly in the coming years. The state of Georgia will need to formally address the issue of taxation of access fees, as a sale for resale, in the coming years.

TABLE 6
STATE TAXATION OF ON-LINE,
E-MAIL AND BULLETIN BOARD SERVICES

State	On-Line Access	E-Mail	Bulletin Board
GEORGIA	No	No	No
Alabama	No	No	No
California	No	No	No
Florida	Yes	Yes	Yes
Illinois	No	Yes	Yes
Kentucky	?	?	?
Louisiana	Yes	Yes	No
Mississippi	No	No	No
New York	?	Yes	Yes
North Carolina	No	No	No
Ohio	No	Yes	Yes
South Carolina	Yes	Yes	Yes
Tennessee	Yes	Yes	?
Texas	?	Yes	Yes
Virginia	No	No	No
West Virginia	Yes	Yes	Yes

THE PROPERTY TAX

The property tax on public utilities differs from the "normal" property tax in several substantive ways. First, it is the state government, not the local governments, which assesses the value of the public utility property. Second, the value of the public utility firm is measured differently than that of the typical firm, with the taxable value of the utility determined using unit valuation which values the firm as an ongoing enterprise rather than on the market value of tangible plant and equipment. Third, the base of the utilities tax is allocated by the state across jurisdictions within the state rather than taxed on the value in the place in which it is physically located.

The largest issue with regard to property taxation is its method of assessment - unit assessment versus the summation method. In particular, there is much controversy concerning

the implicit treatment of intangibles under unit taxation relative to the summation method. First, when a company is assessed according to the unit method, the value of the property is estimated based in part upon the flow of income arising from those assets or the market value of the firm. A problem arises because the assets of the firm do not always correspond to the base of the property tax and the base used for other non utility firms, which is physical equipment and structures. In particular, the property tax is placed on the value of fixed tangible assets while the assets of a firm, like a telecommunications firm, may also include intangible assets, such as the rights to the spectrum or the value of a franchise or firm's current competitive position ("goodwill"). The issue of whether these intangible assets of a telecommunications firm is now taxed, and if so, legally subject to the property tax, remains a debate.

Regardless of whether the intangible assets should or should not be included in the base of the property tax, it is essential that all firms in the same industry be treated the same. If the intangible value of the traditional local exchange company is implicitly included in the tax base by virtue of the unit assessment, then horizontal equity requires the same be done for all other participants in the market. However, since most other providers of telecommunications services are not assessed under unit assessment, equal treatment is unlikely since current Georgia law does not allow for the taxation of intangible values under the property tax.¹⁰

The potential inequity has two dimensions: within the industry and among all industries. Regarding the equal treatment of firms in the telecommunications industry itself, there is much cause for concern. The local exchange companies are assessed using unitary assessment and intangible assets are included in the base. However, other providers of similar services, such as the competitive access providers, paging companies and the cable companies are not assessed using the unit assessment method. They are assessed by the county assessors using the summation method, and as such, intangible values escape taxation. In the very near future, cable companies and alternative exchange carriers will become major providers of telecommunications services. It is essential that these companies be treated similar to the local exchange carriers under the property tax. This would imply either that all telecommunications firms be taxed using the unit approach or that the state switch to a summation method of assessment of all telecommunications firms.

With regard to the interindustry implications of the current property tax assessment of the telecommunications sector, it should be kept in mind that many non-utility companies have net worth which deviates substantially from the value of their land and physical property. For example, the purchase price and presumably the market value of a professional sports franchise far exceeds the value of the stadium, the offices and other physical assets of the team. Should a sports franchise be valued for property tax purposes using a method which captures the intangible value, as occurs with telecommunications companies?¹¹ If equity considerations indicate that the property tax treatment of, for example, the Braves and BellSouth be the same, it would seem as

¹⁰The state does have a separate intangibles tax, but the base of the tax does not include the value of radio spectrum, "goodwill" and other factors contributing to the intangible value of a telecommunications firm.

¹¹ Recent experience in California and Wisconsin indicates that the difference in assessments between the two methods could be as high as thirty percent.

though they should. There are many other kinds of private firms which have the same characteristics of the telecommunications firms in which the value deviates from the sum of the individual pieces of property. The sports franchise example is one given above. The value of some restaurant franchises may be another. The value of a local television station will surely differ from the summation of its individual parts or pieces of equipment and structures. Yet, inasmuch as they are not subject to unit and centralized assessment, this extra value escapes taxation. This separate, and arguably higher, taxation of the telecommunications sector will make it artificially difficult for this sector to attract investment funds.

The most important principle of taxation with regard to the appropriate method of assessment is the equivalent treatment of all firms. In this regard the question becomes: As more and more firms enter the telecommunications market, should each of these firms be subject to unit valuation? As individual non public utility companies by-pass the local network (or interconnect with the network) and provide their own internal telecommunications, should that element of the firm be subject to unit assessment or valuation? If so, how can individual elements be separately and fairly valued on a unit basis? As long distance, cellular, cable and alternative exchange carriers begin to build their own networks, should part or all of their taxable property be switched to a system of unit valuation, with "the rest" subject to assessment by the summation method? Given the number and variety of firms, including the many firms for whom the provision of a telecommunications is tangential or internal to their primary business activity it would be administratively impossible to include all providers of telecommunications and telecommunications-like services to be so taxed. Many providers would surely fall through the cracks.

The conceptual case for equivalent, non-unit assessment can be made. However, there are three potential problems with the application of the summation method in the telecommunications environment. First, the current values of many telecommunications assets are currently difficult to assess. The industry employs many new technologies. Determining depreciated values of these new technologies, given the lack of historical evidence in their depreciation, would be difficult. Moreover, the adoption of new technologies will render old equipment and technologies obsolete. How can the quantitative impact of this obsolescence or taxable property be valued? It is difficult to identify solid, believable estimates of the value of equipment for many of the new technologies which have currently been employed in the telecommunications market as well as the obsolescing old equipment.

Second, the administrative cost of attempting to value the physical property of these telecommunications firms would be significant. Leaving aside the conceptual measurement problems discussed above, the time and labor which would be required to perform this evaluation is far beyond the resources available to the state assessment office. To illustrate, in the State of Wisconsin, which is planning to switch from unit to summation assessment of telecommunications by the year 2000, estimates that the switch will require nine new positions in their public utility assessment office. Any revision in the method of assessment will require substantial new funding for the administration of the assessment.

Third, such a dramatic switch in assessment practices, from unitary to summation method, would have important distributional impacts. Many local governments receive large shares of total revenue from the property taxation of telecommunications firms. For example, many poorer

rural counties rely very heavily on public utilities as a source of revenue. Revenue considerations, in and of themselves, should not play an overly significant a role in the definition and design of the fairest and most efficient tax base, the political reality is that the distribution of revenue is frequently an unavailable constraint to the reform of a tax system. Any fundamental switch in methods of assessment will surely cause turmoil in some of these areas.¹² In addition, such a change would likely reduce the total yield of taxes from this source. Again, the example of Wisconsin is instructive, where they anticipate a 27 percent reduction in assessed value upon switching to the summation method.

On balance, given the growing importance of intangibles value which are likely captured with the unit approach, and the inequities which this taxation brings into an increasingly intensive competitive environment within which the telecommunications firms must operate, it would seem that the gains in efficiency and equity of the summation method may outweigh the potentially higher administrative and revenue costs. The problem, such as it now is, will only worsen in coming years. The time is ripe for a change.

The Local Franchise (Gross Receipts) Tax - Municipalities and counties in Georgia impose franchise fees, typically on the gross receipts from business within the jurisdiction, on regulated public utilities in the State of Georgia: municipalities on telephone, gas and electric companies, counties on cable companies. The rationale for the franchise fees is twofold. Since the traditional public utility uses public right-of-way to deliver their service, a tax is imposed to compensate the local government for the use of that right-of-way. Second, as these companies have traditionally been granted some form of protection from competition, the tax is seen as a quid pro quo for the protection of that franchise from competition, and the permission to do business in an area.

Given the changes in telecommunications technology and market structure over the past decade, one would have to feel increasingly uncomfortable with the design and traditional rationale for the existing system of public utility franchise taxation. In this section, we review some of the important issues which these technological and market developments raise.

The current system of franchise taxation in Georgia is on a collision course with market development, which will derail the underlying rationality of the system. To illustrate under the new Georgia and Federal Telecommunications laws, it is now permissible for cable companies to provide telephone services. Local phone companies may themselves provide cable television services. In short, these two entities will very soon be competing with each other in the same geographic markets. The current system of franchise taxation in the state, however, taxes cable companies and telephone companies at different governmental levels: cable companies at the county level and phone companies at the municipal level. When both types of companies provide both types of services, each using the same infrastructure, the rationality of the existing system is greatly strained. If municipalities charged phone companies for their provision of phone services on the existing infrastructure, should they not then charge them for the cable services they provide, since the same infrastructure is used? If the municipalities charge phone companies for the provision of phone services, should they not then charge cable companies for their provision

¹²This issue is more significant with regard to the electric utility and natural gas industries, then with the local exchange companies.

of phone service, since the same infrastructure is used? And the flip side of this coin is true as well. If counties charge cable companies for the provision of cable services, should they not also charge cable companies for the provision of phone services, since the same infrastructure is used? If counties charge cable companies for the provision of cable services, shouldn't they also charge phone companies for the provision of cable services, since the service is the same? The mixing of services presents new challenges to the system.

One way of preserving the status quo, while sidestepping the "rationality" question, would be for each level of government to charge based upon the service which they currently levy their fees. Phone companies would pay gross receipts taxes to municipalities solely on the basis of their receipts from phone services, as would cable companies. Likewise, cable companies would pay gross receipts taxes to counties solely on the basis of their receipts from cable services, as would phone companies.

Yet, this approach not only begs the rationality question, it does not come to grips with a market and pricing problems which is sure to arise, as mentioned in the sales tax discussion. As each of these companies becomes providers of many types of telecommunication-like services, they will soon "bundle" their services; that is, offering cable service along with phone service (or perhaps other telecommunications services) at a single price, and vice versa. To the extent that this occurs, and it certainly will, the administration of the local (county and municipal) franchise tax will become very difficult. Tensions between municipal and county governments are sure to arise regarding "who gets what."

A second issue with regard to local franchise taxation arises as a result of new technologies to provide telecommunications services. In particular, the growing use of radio-based telecommunications provides an interesting issue with regard to the local franchise tax. The cellular technology does not rely on landwire technology. As such, it does not necessarily "attract" those types of gross receipts taxes which are premised on charges for the use of public rights of way, as the land-based systems would. Cellular technology (and its cousin, Personal Communications Services - PCS) requires "cells-sites" or small transmitters of radio waves for the completion of calls. These cell-sites may, or may not, be located on public rights-of-way. Should these cell-sites be subject to taxation, and if so, how? Does the placement of a cell-site on a telephone pole or in an underground conduit represent as much of a cost for the use of public right-of-way as a buried strand of copper or fiber-optic cable? On what basis should the value of this access to public rights-of-way assessed? And, should it be determined that the cell-sites on public rights-of-way be taxed on gross receipts in a jurisdiction, how will calls routed through a particular cell-site, be allocated for tax purposes to a municipality or county, when it is only a portion of an entire system of cells which "hand-off" calls from many origins and destinations? The administrative difficulties of maintaining the current system of gross receipts taxation for use of public rights-of-way will be daunting.

Many communities are now struggling with this issue. On the one hand, many governments see the imminent growth in the number of cell-sites on public rights-of-way as a

source of strong revenue potential.¹³ On the other hand, operators see it as a challenge to the local franchise fee system. Why should the presence of a cell on an existing telephone poll be treated the same as lines buried in public rights of way, if the fee is premised on the cost to government of maintaining those rights-of-way? Clearly, the cost to governments for these two methods of delivering telecommunications services will differ. One thing is certain: this issue is certain to generate much legal and legislative attention in the coming years. Already, legal challenges have been raised in St. Petersburg, Florida and Roseville, Minnesota - two municipalities which have proposed imposing a franchise fee for cell-sites.

Other impending market developments will raise issues of fairness and administrability. As indicated earlier, the local exchange companies in the state currently pay a tax based upon gross receipts while some of the interexchange companies pay these fees on the basis of a set fee per mile of wire. In recent weeks, since the enactment of the new Federal Telecommunications law, long distance companies have announced their intention to build their own networks and begin to supply local exchange services. On what basis will these franchise fees be assessed on these long distance companies: on the basis of a fixed charges per mile, as they currently pay, or on the basis of gross receipts, as the existing providers of local exchange services pay? And, as in the case of cable companies providing telephonic and cable services at a fixed price (and vice versa), long distance companies will soon offer long distance and local service at one price. Are all of these charges then considered as taxable "recurrent revenues", implicitly subject to taxation whereas they were exempt in the past? These are all very difficult questions with no simple answer.

Finally, there is the issue of the equal treatment of those providing similar services. As noted at the outset, there are two rationales for the imposition of the local franchise fee: charges for the use of public rights-of-way and, second, charges for the privilege of doing business in an area. On the second point, it is important to remember that horizontal equity requires that all providers of similar services be treated equivalently. This principle indicates that ALL providers of services in an area be required to pay similar fees. If the fee is justified on the basis of the fact that the service provided by telephone companies are some protected "franchise" monopoly, then that justification disappears as competition emerges. Should the tax or fee remain in place, and somehow applied equivalently on ALL providers of telecommunications services, then some justification is needed as to why this industry in particular, and not all industries, should pay this tax. Currently, all industries in Georgia pay Business and Occupational License Taxes, but at a much lower rate than the telecommunications franchise fees.

In short, the existing system of local franchise taxation is under challenge owing to technological and market factors which have rendered the old paradigm obsolete. The rationale for separate treatment of the telecommunication industry has disappeared. The justification of the tax on the basis of its use of public rights-of-way remains viable, although many question the size of the fee relative to the cost of maintaining the right of ways. If the fee for the use of public rights of way is to be imposed, it should reflect the cost of administering the access to the public

¹³See, for example, George T. White and Mona G. James, "Local Government Franchise Agreements: Will New Technology Bring New Revenue Sources", *Government Finance Review* (August 1995): 23-26.

right-of-way, the financial impact of the activity on the right-of-way and some reasonable rental value for the access to the right of way. This fact may provide a reasonable argument for the imposition of flat fees, rather than administerably difficult charges based upon volumes of business, for access to these rights of way.

V. PROBLEMS WITH THE TAXATION OF OTHER PUBLIC UTILITIES

As has already occurred with the telecommunications industry, there are ongoing technological and regulating developments in other traditional public utilities which will render their markets more competitive. And, in a way analogous to the telecommunications industry, these changes will also render the existing structure of taxation outdated and potentially discriminatory. In this section, we examine two of these industries.

ELECTRIC UTILITIES

In recent years, there has been a substantial growth in the degree of competition in the electric utility industry. While electric utilities have always competed with each other in subtle ways (for example, by competing with each other for large customers by helping local economic development agencies and governments in inducing them to locate in their regions or by competing for the business of firms located near district borders), the list of potential competitors has grown more substantial in recent years. The growing list of competitors includes the customers of the electric utilities themselves; that is, large businesses which generate their own power on-site (cogeneration) and substitute it for the power purchased from the electric utility.

A major source of competition comes from non-regulated alternative suppliers of electricity, referred to as independent power producers (IPPs) or nonutility generators (NUGs). The growth in the importance of the non-regulated providers is illustrated by the fact that although they currently produce just 8 percent of total power, since 1989 these IPPs have accounted for over 50 percent of new generating capacity.

To understand the nature of the growth in competition in this industry, one should keep in mind that the provision of power to customers requires the generation of the power, the transmission of the power and the distribution of the power to the end user. Independent power producers can sell their power to the regulated utilities, which then distribute the power through their existing grid. These independent power producers are a competitive force in the industry since they may provide a cheaper source of electrical energy.

The power producers not only face competition from these IPPs, but they may face competition from other public utilities. The cost of electric power generation varies considerably across the country. Technological advances in the industry made it possible to transmit power cheaply over long distances. As a result, a local utility may find it advantageous to purchase its power directly from another electric utility and then simply distribute it to their customers. In this way, competition among power generators is enhanced.

Until a few years ago, these purchases of power were allowed only at the "wholesale" level; that is, among utility companies. However, the 1992 Energy Policy Act gave local regulatory agencies the ability to permit the sale of power directly from these alternative providers of power to large private customers. This direct sale of power to individual customers is termed "retail wheeling". In this case, the customer pays the generator of the power for the electricity and pays the local utility only for the distribution of the power. Although Georgia does not yet permit retail wheeling, the pressures to do so will only grow. The state of California authorized retail wheeling in that state beginning in 1996 for large industrial customers and will permit wheeling for all customers in 2002.

In short, the electric utility industry is entering a period of growing competition, at least in the generation of power.

NATURAL GAS INDUSTRY

Like the electric utility industry, the natural gas industry has become more competitive through the unbundling of the services of the natural gas companies into production and transmission. Also, like the electric utility industry, regulatory changes over the past few years have ushered in a more competitive environment. In 1992, FERC Order 636 required equal access to transport facilities for all natural gas producers. This effectively permitted the purchase of natural gas directly from individual producers while payment to the local utility would be for distribution of that gas. Like wheeling in the electric industry, the unbundling of production from transportation and distribution has introduced significant competition.

The natural gas market has also seen the growth of "bypass", in which the suppliers of natural gas circumvent the local distribution companies (LDC) by direct connection with an interstate pipeline company.

VI. TAX CONSEQUENCES OF ELECTRICAL AND GAS UTILITY COMPETITION

In terms of the taxation of this industry, there are two taxes for which problems exist or will soon arise: the gross receipts-type franchise fees and the property tax.

The gross receipts tax in the electric industry is a local tax levied by municipalities on the eligible receipts of public utilities. The rate of this tax is negotiated between the public utility and each municipality. The largest provider of electric power in the state is Georgia Power. Currently, Georgia Power pays a gross receipts tax to most municipalities in the state at a rate of 4 percent. Smaller utilities in the state negotiate their own rate. Currently, they range from three to four percent of gross receipts.

Problems with this tax will arise as competitors to the public utilities begin to provide power in the state. This competition will arise largely from the "wheeling" of power into the state from out of state sources. It is unclear whether under Georgia law, these out-of-state companies would be subject to the gross receipts tax. The Georgia public utility whose facilities transport the power would be subject to the tax only on the cost of transporting and distributing

and the power and natural gas itself would escape taxation. This ,may seriously erode the base of the gross receipts tax.

The ability to purchase cheaper power from out-of-state may have a more complex impact on local governments. The ability to "shop" for the least costly power generator will provide a new incentive for the creation of municipally-owned utilities, who could break from the local distribution companies and wheel in cheaper power for its citizens. Municipal utilities do not charge franchise fees and the cost of maintaining the rights-of-way would fall to the government. This is a more serious issue in those states which impose a state gross receipts tax than it is in Georgia, which does not.

There are also issues with regard to the property tax similar to those in the telecommunications industry. All regulated public utilities in the state are assessed under the unit approach. While neither the gas and electric utilities nor the state have any particular problem with this method of assessment as of now, there is an issue which may arise.

Only regulated public utilities in the state are state assessed. As competition emerges in these industries, or alternative sources of energy become available, these providers of energy will not be assessed in the same manner. Although the potential for inequity is not as great in these industries as in telecommunications, where intangible values are so important, the differences in approaches certainly raises the spectre of uneven handedness. For example, some firms may produce power as a byproduct of their operations. If they do, will these cogenerator facilities be assessed on the same basis as the public utility? Will the receipts of that company for the sale of their power be subject to the local gross receipts tax? How will the IPPs and NUGs be assessed?

VII. CONCLUSION AND RECOMMENDATIONS

Every several years, an economic, political or technological development arises which forces policy makers to step back and assess the role which government plays in managing the economy. The recent and ongoing developments in the telecommunications industry presents just such a challenge.

The regulatory system which governed the operation of this sector for sixty years has slowly adjusted to accommodate the promise which the technological changes in the industry has provided. However, not only have the developments in the industry rendered the old regulatory environment obsolete, but the changes in the industry and the regulatory structure itself presents challenges to other elements of the public environment within which this industry must operate. This report has attempted to highlight the ways by which the archaic system of telecommunications taxation in the U.S. is leading to inequities, inefficiencies and administrative problems which may ultimately hinder the future development of this important industry.

The current system of telecommunications taxation in Georgia -sales tax, property tax and franchise fees - is clearly deficient in many respects. It fails with regard to the basic principles of economic efficiency by artificially encouraging the production by, or purchase from, certain kinds of service providers over others. This results from the differential treatment of firms based upon their classification as a utility or non-utility, and the differential treatment of equivalent services by different methods of taxation. The tax system is also riddled with horizontal inequities

arising from the same imbalances in the treatment of firms providing functionally equivalent services. Finally, in administrative terms, the tax system is becoming a "nightmare" for both the government and taxpayer. The specter of increasing litigation looms large, promising hefty legal bills for government and industry.

Georgia is by no means alone in this regard. Every state in the country is currently grappling with the economic and administrative problems inherent in the taxation of an industry which is so dynamic. Some states have undertaken efforts to comprehensively address these issues, while others have dealt with individual issues as the problems with the system become too obvious to ignore or, worse yet, as the legal system forces the state to address these issues.

It is perhaps time for Georgia to look comprehensively at the tax treatment of telecommunications. Not only would such a comprehensive examination of the telecommunications tax system preempt future legal action, but the setting of a rational system of taxation of the telecommunication sector would allow those operating in the industry to act and set their own operating policies in a more stable tax environment. The state and local governments themselves will be better able to plan for the long-term consequences of the inevitable restructuring of their revenue base.

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