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IN THIS REPORT

The fair taxation of telecommunication business property continues to be a challenge to public officials responsible for the administration of tax laws that reflect past rather than current conditions. This report presents two options for resolving the inequities that continue to exist:

- Classify all telecommunication property as utility property and require that all business included in the utility classification be centrally assessed using unitary valuation methods.
- Recognize that technological convergence will continue and result in increased competition in the telecommunications industry, and that such businesses should be taxed in the same way as other commercial and industrial businesses.

TAXING UTILITIES IN TENNESSEE:

ONGOING CHALLENGES IN PROVIDING A LEVEL PLAYING FIELD FOR TELECOMMUNICATION BUSINESSES

by Stan Chervin, Ph.D.

INTRODUCTION

State and local governments have a long tradition of imposing relatively higher taxes and fees on businesses engaged in providing utility services. This category has generally included telephone, transportation, electric, water and sewer, and gas and pipeline companies. Any perceived inequities involved in taxing utilities at relatively high rates were considered part of an acceptable tradeoff involving their regulation and the convenience of a dependable source of revenue for both state and local governments. The general public was provided needed services at a regulated price, the providers were guaranteed a reasonable profit, and governments had a convenient and dependable source of tax revenue.

Since traditional monopolies had few competitors, the relatively higher taxes and fees were easily passed forward onto consumers. This alliance among regulators, taxing authorities, and the monopolies themselves lasted well into the twentieth century; however, the eventual unraveling of this relationship caused by new technologies, changing consumer tastes and preferences, and eventual federal and state legal and statutory changes, has led to increasingly awkward and inequitable taxing situations. This is especially true in the area of utility property taxation in general, and property taxation of the telecommunication industry, specifically.

Senator Mark Norris, Chairman ◆ Mayor Tom Rowland, Vice-Chairman ◆ Harry A. Green, Executive Director

TACIR ◆ Suite 508, 226 Capitol Boulevard ◆ Nashville, TN 37243
Phone: 615.741.3012 ◆ Fax: 615.532.2443 ◆ E-mail: tacir@tn.gov

While this report focuses on existing inequities in the property taxation of telecommunication businesses, taxing inequities resulting from a continuously changing economic environment and somewhat rigid tax systems are not limited to property taxation alone, or to traditional utility type businesses. Comparable inequities—and responses to them—are present in the reaction or inaction of state and local tax systems to new forms of business organizations, continuing problems associated with sales-and-use-taxation of remote sellers, and a general unwillingness in many states to broaden sales tax laws to reflect changes in household spending patterns that increasingly favor services over traditional tangible goods. As is true in many areas of human behavior, the status quo is slow to change without a substantial nudge.

PROPERTY TAX CLASSIFICATION

Prior to 1973, all property in Tennessee was subject to the uniformity requirements of the state constitution and, by law, subject to the same assessment rate. In practice, certain utility and business properties were frequently assessed at higher rates than farm and residential properties. Successful litigation against this practice by railroads and others threatened this status quo. As a result of successful litigation by railroads and utilities, the distribution of the assessments in most counties changed as either utility and business property assessment rates were forced down to farm and residential assessment rates, or assessments for farm and residential properties were increased to bring them in line with the higher rates on utilities and businesses. The net impact was an increase in the relative property tax burden on owners of agricultural and residential properties. The response was somewhat overdue and predictable.

In 1972, Tennesseans voted to amend the state constitution[1] and authorize the classification of property for property tax purposes and set different assessments rates for the various classifications of property. The new classification system became effective on January 1, 1973. Much of the impetus for the change came from farm and rural interests who sought "to shift property tax burdens from themselves onto utilities, businesses, and urban homeowners."[2]

The amendment to the Constitution provided for different assessment rates for the different classifications of properties established:[3]

- Residential and farm properties were to be assessed at 25%, residential and farm tangible personal property at 5%
- Commercial and Industrial real properties at 40%, commercial and industrial personal property at 30%
- Utility real property and personal property at 55%

The constitutional change resulted in commercial and industrial real properties being subject to an effective tax rate 60% higher than that imposed on residential and farm properties and utility real and personal properties bearing an effective tax rate 120% higher than that imposed on residential and farm properties. The strategy worked well and predictably increased the relative tax burden on businesses and utilities. Between 1972 and

[1]The Constitution Convention of 1971 allowed voters in 1972 to amend Article 2, Section 28 of the State Constitution and replace the existing uniformity requirement in property taxation with one authorizing a property classification system.

[2]Green, Chervin, and Lippard (2002), p.18.

[3]Intangible personal property was also subject to tax, but enforcement was never seriously undertaken in most counties. Enforcement of the tax on residential and farm tangible personal property (in excess of $7,500) was also rarely enforced.

1973, effective property tax rates on residential and farm property fell in 81 counties. During the same period of time, effective tax rates on commercial and industrial businesses rose in 87 counties, while effective tax rates on utilities rose in 93 counties.[4] The initial state-wide increase in the relative importance of utility assessments[5] (and reduction in the residential-farm share of total assessments) was short-lived. Their importance has declined steadily since the late 1970s and in 2007 represented only 4.14% of total state-wide property assessments.

The declines occurred as a result of continued litigation by utilities claiming discrimination in assessments (vis-à-vis residential, farm, and commercial and industrial properties), new federal laws designed to protect railroads, then trucking businesses from unfair and discriminatory valuations, and eventually changes in technology that continue today.

IMPORTANCE OF UTILITY PROPERTIES FOR INDIVIDUAL CITIES AND COUNTIES

In fiscal year 2007, businesses classified in the utility classification paid $207 million in local government ad valorem taxes.[6] Approximately 75% of this amount was paid to counties, and the remainder to cities and special school districts. For certain locations, utility assessments still represent a significant share of total assessments and total property taxes. The importance of utility assessments for counties varies from a low of only 0.8% in Sevier County to over 16% in Perry County. The significance of utility assessments is over 10% in nine counties (Hancock, Lauderdale, Grundy, Jackson, McNairy, Morgan, Trousdale, Lake, and Perry).[7] The types of utilities that shoulder most of the utility taxes in these heavily utility-dependent counties reflect some unique situations in addition to the usual suspects such as national telephone companies (BellSouth, AT&T, Verizon, etc.):[8]

- Perry County: a gas pipeline company, followed by a local electric cooperative
- Lake County (located on the Mississippi River): an electric cooperative, and several large barge companies
- Trousdale County: an electric cooperative and several large gas transmission companies

While larger counties may receive more absolute property tax payments from utilities, small counties with unique situations reflect higher dependencies.

The importance of utility assessments for most cities is minor; however, in a handful of cities, utility businesses pay a significant portion of local property taxes. Sixteen cities depend on utilities for 20% or more of their property taxes. This dependence varies from a low of 20.5% in Decatur to a high of 52.9% in Cottage Grove; however, all of these cities are relatively small (based on population), varying from a population of only 97 in Cottage Grove to a high of only 1,426 in Decatur.[9]

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[4](Goolsby 1974, 78)

[5]Utility assessments accounted for almost 14% of total statewide assessments in 1975.

[6]All businesses classified as utilities are evaluated and assessed by the Office of State Assessed Properties (OSAP), a division of the State Comptroller's Office. The $207 million was estimated based on utility assessments and county and other local tax rates as reported in the 2007 Tax Aggregate Report.

[7]See Appendix 1 for data for all counties.

[8]Data from the Office of State Assessed Properties (State Comptroller's Office) website www.tn.gov/comptroller/sap.

[9]Based on population data as reported in Department of Economic and Community Development. 2007. Local Planning Assistance Office. "2007 Certified population of Tennessee incorporated municipalities and counties."

VALUATION OF PUBLIC UTILITIES

Tax liabilities for utilities depend on (1) the method used to initially value utility property, (2) the assessment rate applied to the value,[10] and (3) the property tax rate levied against the assessed value. A majority of states use the unitary valuation methodology to arrive at the market value of traditional public utilities and other businesses classified as "utilities."[11] The unit rule method of valuation has been in use in Tennessee since 1883 when it was used to value the property of railroad companies (and its use affirmed by the Tennessee Supreme Court).[12] This approach was used over the years but not actually written into the law until 1973.[13]

The "unitary or unit valuation method" consists of two major parts, with variations among the states that use this approach. During 2005, 37 states used a variant of the unitary valuation methodology to arrive at the taxable value of railroad and/or other utility-type properties.[14] Most of the states that do not use the unitary valuation method tax utility property on the basis of some measurement of cost (usually original cost less depreciation).[15]

It is not the intent of this report to delve into the complexities of the "unitary methodology" and its many variants as practiced in the different states. The intent of the report is to focus on the inequities that continue to develop in categorizing certain businesses as utilities (and therefore subject to possibly both unitary valuation and the Tennessee utility assessment ratio of 55%) when in fact they no longer fit the criteria for a utility property. The underlying argument gaining strength throughout the United States is that businesses that compete with one another should be taxed alike and not subject to taxation that prevents them from competing on a level playing field.

UNITARY METHODOLOGY

There are generally two parts to the unitary methodology: (1) estimate a business's total taxable value for purposes of ad valorem taxes, then (2) allocate or apportion this value among the many state and local governments in which it is taxable.

Certain large heavily capitalized businesses, especially utility type businesses, often with multijurisdictional locations and property, have a market value that often exceeds the depreciated value of its physical assets. A long-standing approach in such cases is, for ad valorem tax purposes, to estimate the overall value of such a business as an income-earning asset, and not by summing up the market value of specific assets owned by the company such as land, buildings, and equipment.[16] This approach, in essence, uses a measure of the intangible assets of the business as the basis for taxation. Multiple approaches can be used to arrive at an estimate of this number:

- An income approach that estimates the value of a business based on the capitalized value of the income it generates
- A market approach that uses financial information on the value of a business's

[10]In many states, the assessment rate is 100% and therefore equal to the value established in step 1.

[11]The types of businesses classified as utilities vary by state, but generally include gas, electric (includes electric co-ops), water and sewerage companies, railroads, and businesses engaged in telecommunications, trucking, bus transportation, air and water transportation, and pipeline transmission.

[12] (State Board of Equalization 1980, p. 3).

[13]Ibid., p. 3.

[14](New York State Office of Real Property Services 2005)

[15]Land values are based on comparable sales values.

[16]In Tennessee, the "'unit rule of appraisal' means the appraisal of the property as a whole without geographical or functional division of the whole." See TCA 67-5-1302(a)(4).

outstanding stock and bonds to estimate its overall value

- A cost approach

States use various combinations of the above, with the most common utilizing either all three, or income and cost only. In most states that use the unit approach, all valuations are centrally done by a state agency.

Once a value is determined, the value is apportioned or allocated among the states in which a business operates, and then further apportioned (or allocated) among the many local governments in which it operates and/or owns property (in Tennessee, this aspect of the process is also handled by the Division of State Assessed Properties). Apportionment often involves the use of some combination of data on a business's mileage activity, number of vehicles, gross investment by locality, tonnage, number of passengers, etc. The specific items considered in Tennessee to apportion multijurisdictional businesses are spelled out in the Tennessee Code at TCA 67-5-1301 et seq.

In Tennessee, the unit rule of appraisal is used to value railroads, pipelines, gas and electric businesses (including co-ops), all telephone businesses (local, long distance, and wireless), and water and sewer businesses. It is not used to value other transportation businesses (trucking, barge, and air).

SIGNIFICANT CHANGES IN THE TAXATION OF UTILITIES IN TENNESSEE

Railroad property has historically been overtaxed relative to other types of property by most state and local governments. This was especially true in the area of ad valorem property taxation, where railroad property traditionally carried a higher tax value to market value than other types of commercial and industrial properties. This type of discrimination ended with passage of the federal Railroad Revitalization and Regulatory Reform Act of 1976 (known as "4R Act"). This law prohibited state and local governments from treating railroad properties differently than other types of commercial and industrial properties.[17]

While railroads in Tennessee are still valued based on their unitary value, their properties are assessed on the same basis as commercial and industrial property (40% and 30% assessment rates). This change, by itself, lowered railroad assessments on real property by 27%, and by 45% on personal property. In locations where railroad assessments had been relatively important, this change resulted in noticeable increases in tax burdens on other taxpayers (homeowners and other businesses).

Four years later (in 1980) the motor carrier industry in Tennessee was given the same federal protection that was afforded the railroad industry in 1976. The "Motor Carrier Regulatory Improvement Act" prohibited property tax discrimination against the motor carrier industry similar to that provided to the railroad industry. Assessment rates applied to their valuations had to be the same as the rates applied to properties of commercial and industrial businesses. The impact on motor carrier businesses was the same as on railroad companies, a reduction in their assessments of 27% on real property and 45% on personal property.

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[17]The federal law did not affect the new property classification system that became law in Tennessee in 1973, but it did limit the Legislature's powers to determine what types of properties could be placed in the utility classification and be subject to the 55% assessment ratio.

In 1980, the airline industry was given the same protection against discriminatory taxation as the railroad and trucking industries. The "Equity and Fiscal Responsibility Act of 1982" (TEFRA) provided that state and local governments had to impose ad valorem taxes on airlines on the same basis as commercial and industrial properties. Attempts by other industries (classified as utilities) to gain federal protection from what they consider discriminatory ad valorem taxation continue.[18]

CHALLENGES TO UNIT RULE VALUATIONS

One of the first things questioned by a neophyte to utility taxation and the "unit rule" method of determining the taxable value of a business is why such a clearly unequal method of establishing taxable value (unit rule versus the more general market value approach used to established the taxable value of residential, farm, and commercial and industrial real and tangible property) is allowed. The answer is straightforward: while Congress has passed laws that prevent certain discriminatory methods of state and local property taxation in the case of railroads, trucking, and airlines, that prohibition does not extend to the unit rule methods used by states in establishing the "market" value of certain other businesses. The "unit rule" method is well-grounded in the history of most states, especially in establishing the market value of railroads and certain utilities.

Challenges in federal court to the "unit rule" and the different methodologies used by states in administering the rule are generally unsuccessful because of the federal Tax Injunction Act, 28 USC 1341 and the principle of comity. Federal courts generally allow wide discretion in how states administer their tax policy including "unit rule" methodologies; however, in a recent case involving CSX and the Georgia State Board of Equalization,[19] the Supreme Court of the United States reversed a decision by the Federal Court of Appeals that upheld a lower court opinion in favor of the Georgia State Board of Equalization and its "unit rule" methodology.[20] In that case, the Georgia State Board of Equalization denied CSX the right to use an alternate unit rule methodology to establish the market value of its property.

One of the primary reasons voiced by the Federal Court of Appeals in denying CSX's original appeal was its belief that federal intervention in state tax policy was unwarranted, contrary to the long held principle of federalism and contrary to the principle of comity.[21] The Supreme Court vacated the opinion of the Appeals Court and held that "railroads may challenge state method for determining the value of railroad property, as well as how those methods are applied."[22]

CENTRALIZED ASSESSMENT IN TENNESSEE

In Tennessee, the State Comptroller's Office is responsible for the centralized valuation and

[18]The interstate oil and gas pipeline industry continues to have bills introduced in Congress designed to provide the same protection; see H.R. 1369, 109th Cong., 1st sess., and H.R. 2230, 110th Cong., 1st sess.

[19]*CSX Transportation, Inc. v. Georgia State Board of Equalization*. 128 S. Ct. 467, 469 (2007). Original case was decided in favor of the Georgia State Board of Equalization, appealed by CSX, and eventually heard by the U. S. Supreme Court.

[20]*CSX Transportation, Inc. v. Georgia State Board of Equalization*, No 06-1287, slip op at (S Ct, December 4, 2007).

[21]Op. cit, 28.

[22]Opinion of the U.S. Supreme Court as delivered by Chief Justice Roberts, December 4, 2007.

assessment of all of the following types of businesses:[23]

- Railroad companies
- Telephone, radio common carrier, cellular or wireless telecommunications
- Freight and private car companies
- Streetcar companies
- Power companies
- Express companies
- Pipeline companies
- Gas companies
- Electric light companies
- Water and/or sewerage companies
- Motor bus and/or truck companies
- Commercial air carriers
- Water transportation carrier companies

The following classes of business are appraised on the basis of the unit rule in Tennessee:

- Railroad companies
- Telephone (local and long distance), radio common carrier, cellular or wireless telecommunications
- Power companies
- Pipeline companies
- Gas companies
- Electric light companies
- Water and/or sewerage companies

Airlines, trucking and express companies, and water transport businesses are not.

The following businesses are assessed at the utility assessment rate of 55% on both real and personal property:

- Telephone companies (excludes businesses providing cellular telephone service, radio common carrier service, and long distance telephone service)
- Power companies
- Pipeline companies
- Gas companies
- Electric light companies
- Water and/or sewerage companies

THE CHANGING NATURE OF UTILITIES AND THEIR TAXATION

In the past, utilities were synonymous with regulated monopolies or at minimum, oligopolies, and often regulated by either the federal government or state government, or both. You knew one when you saw one. Taxing regulated monopolies proved to be a politically convenient way to raise substantial sums of money for state and local governments, since the taxes were easily passed onto the ultimate consumers of the regulated producers; however, the whole process of regulation and taxation of traditional monopolies began to unravel as technology and the easing of some regulations allowed new competition into traditionally monopolized areas of commerce. This was especially true for the telecommunications industry, and to a somewhat less degree in the electric and gas production and distribution industry.

The impact of new technology and new competition forced changes in the traditional methods used to tax such businesses. Many states and local governments had imposed traditionally higher taxes on regulated monopolies and utilities. But as portions of these traditional businesses began to face competition, the traditionally higher taxes imposed on them became untenable. This was especially true in Tennessee given the

[23]T.C.A. 67-5-1301.

significantly higher property taxes imposed on some utility property (assessed at 55% of value) versus commercial and industrial property (assessed at only 40% on real property and 30% on personal property).

TELECOMMUNICATIONS INDUSTRY: CONVERGENCE IN TECHNOLOGY AND USAGE

Until 1984,[24] one company dominated the local telecommunications market in the United States. AT&T was a textbook example of a regulated monopoly in action; they provided almost all local telephone service, all long distance service,[25] and (through its subsidiary Western Electric) provided almost all telephone equipment.[26] That ended in 1984 with the breakup of AT&T into seven separate regional Bell operating companies (RBOCs). The long distance network was retained by the now much leaner AT&T, but the rules were changed authorizing new businesses to enter the long distance business.[27]

Technological changes since then have further changed the nature of the telecommunications industry. Today it is difficult if not impossible to distinguish between a telephone company and a cable company; traditional land-line telephone companies have entered the television cable industry and traditional cable TV businesses have entered the telephone industry by providing Voice over Internet Protocol (VoIP) telephone services. Cellular service businesses continue to replace (as well as complement) standard phone services provided by traditional land-line telecommunications businesses. A recent estimate of the percent of Tennessee households without traditional land-line service (cases in which cell phones are used as substitutes for home phones) is as high as 20%.[28] Taxing structures based on a highly regulated monopoly business structure no longer make sense and have slowly given way (in many states) to taxing methods that treat telecommunication businesses the same as other types of business activity.[29]

While it is not the intent of this brief to detail the full history of utilities in Tennessee, it should be noted that regulation of certain utilities in Tennessee occurred over a long period of time, commencing in 1897 with the state Railroad Commission. Over time, the state agency responsible for utility regulation had its responsibilities broadened and went through several name changes. During the period 1955 to 1996, the agency was called the Public Service Commission (PSC). The PSC was abolished in 1995 and replaced by the Tennessee Regulatory Authority (TRA). The TRA continues to have oversight authority over part of the telecommunications industry, but no longer sets rates charged by these companies. It has no significant authority over cable television businesses.[30]

In Tennessee, the change was slow in coming. BellSouth, the "Baby Bell" who provided traditional telephone service in Tennessee, was subject to both a special 3% gross receipts

[24]The U.S. Justice Department filed an antitrust suit against AT&T in the early 1970s. In 1982, AT&T agreed to a final settlement that became effective in 1984.

[25]Beginning in the 1970s, new long distance companies appeared on the scene (i.e. Sprint and MCI) and began to compete in the long distance market.

[26](FCC 2007, 9-2)

[27]The newly created regional Bell operating companies (RBOCs) were required to open their local networks to new long distance businesses.

[28](Blumberg et al. 2009, 1)

[29]The challenge of outdated and inequitable tax structures that are still imposed on telecommunications businesses in many states is discussed in an article by Katherine Barrett and Richard Greene in the January 2008 issue of Governing.

[30]It still has oversight over certain charges and services provided by these businesses when the service involves telecommunication services.

tax on its operations within Tennessee, and property tax treatment at the 55% utility classification assessment rate. These taxes also applied to its new competitors in both the local and interstate markets, including cellular and mobile service businesses.

This changed in 1989. The 3% gross receipts tax on telecommunications businesses became awkward and outdated following the divestiture of AT&T and the resulting changes in the relations between the new BellSouth, AT&T, and new competing entrants into the industry. The introduction of cellular or mobile service that did not use public rights of way in the same manner as traditional phone companies complicated taxation further. These new entrants into the telecommunications business were initially assessed at utility rates.[31]

The taxation issue grew and finally became the focus of a special Legislative study committee created in 1988 to analyze the new competitive market situation and make recommendations that would both reflect the changing competitive nature of the telecommunications industry, and at the same time, minimize any negative fiscal impact on the state and local governments from reductions in the traditional utility taxes[32] imposed on the telecommunications industry.[33] The committee's recommendations became the basis for substantial changes in 1989.

Public Chapter No. 312 of 1989 accomplished the following:

- Repealed the 3% gross receipts tax on telecommunication businesses (first imposed in 1937 on intrastate business)
- Extended the state and local sales tax to the provision of interstate telecommunication services (previously exempt). The initial state rate in 1989 was 5.5% (7.5% by 2008)
- Set the local sales tax rate on interstate telecommunication services at 1.5%
- Broadened the definition of taxable telecommunications services to include WATS (wide area telephone service) and private line service
- Removed certain telecommunication personal property owned by local operating companies (that was used in providing access to and from the local network by long distance businesses) from the utility classification to the commercial and industrial property classification. Such properties were extremely difficult to identify and distinguish from other personalty. Long distance companies, resellers and mobile phone companies had initially been subject to the 55% utility assessment rate.
- Removed property owned by companies that were involved in the interexchange side of the telecommunications business from the utility classification. This property was extremely difficult to identify.
- Clarified the law by excluding from the definition of "public utility property" the property of companies providing (1) cellular telephone service (see TCA 65-4-101); (2) radio common carrier

[31]Cell tower operators, a branch of the industry generally separate from the wireless companies themselves, are valued by local officials (not centrally valued), and assessed at the lower commercial and industrial assessment rates.

[32]Both the 3% gross receipts tax and the higher 55% assessment rate.

[33]Joint legislative committee created by state Senate Joint Resolution 334, 1988.

service (TCA 65-30-103); and (3) long distance telephone service.

Additional relief was provided in 2001. In further recognition of the inequities involved in assessing the property of land-line telecommunication providers at 55% (rather than the lower commercial and industrial assessment rates enjoyed by their direct competitors), a special fund was created in 2001 to provide tax relief to telecommunication providers whose property was assessed at the 55% utility rate. The tax relief was provided with revenue from the "Telecommunications Ad Valorem Tax Reduction Fund."[34] This program was funded from revenue raised by an increase in the state sales tax rate on interstate telecommunication services sold to businesses.[35] The annual funding provided by this program has never risen to the level needed to fully compensate the telecommunication companies (whose property is taxed at the 55% utility assessment rate) for the higher property taxes they incur.

There are continuing inequities that challenge the administration of utility ad valorem taxes and credulity of many involved in the area:

- Some telecommunication businesses (generally those traditionally regulated) continue to be subject to the higher utility assessment rates (55%) than other competing telecommunications businesses (using various technologies)
- Some telecommunication businesses are valued using the unit rule methodology (centrally assessed), some are not
- Some telecommunications businesses have personalty valued using longer depreciation lives than comparable property owner by commercial and industrial enterprises
- While certain business are centrally assessed by the Comptrollers Office (public utilities and others such as wireless telecommunication businesses), other businesses that provide like services or products are not, the most obvious exception being cable television businesses

CURRENT STATUS OF INEQUITIES IN TELECOMMUNICATION BUSINESS TAXATION

The situation was most recently addressed in a presentation to the Joint Select Committee on Business Taxes.[36] The presentation consisted of a chronology of telecommunication industry developments and taxation over time, the major players involved, and the attempts at dealing with the ongoing taxation challenges by the Legislature. The presentation briefly mentioned the delicate options for resolving the inequities, but made no specific recommendations.

RESOLVING THE INEQUITIES

There are two obvious solutions for leveling the playing field and mitigating the inequities that continue to exist (and that will likely grow) in the taxation of telecommunication businesses:

1. Classify all telecommunication property as utility property, thereby treating all telecommunication providers alike (level playing field, as least within the telecommunications industry). This would require central (state) assessment of all telecommunication

[34] T.C.A. 67-6-221 (Public Acts, Chapter No. 195, 2001).

[35] The tax was raised from 3.5% to 7.5% with all of the increased revenue earmarked to the new tax reduction fund.

[36] Jones, Kelsie. 2009. Presentation at the Joint Select Committee on Business Taxes, Nashville.

property (not currently true for cable businesses) and a reclassification of any telecommunication property now classified as commercial and industrial property as utility property. It would also require unitary valuation of cable companies that provide telecommunications services (currently true for land line, long distance carriers, and wireless telephone businesses). These changes would increase total telecommunication business assessments and increase local property taxes. The potential tax increase is unknown.

The tax inequities resulting from convergence of technologies in what had previously been different industries has already sparked controversial debate in legislatures as well as in the courts. The issues are especially well documented and described in a recent Utah State Tax Commission[37] case that focused directly on one of the inequities focused on in this report—should cable TV companies be centrally assessed when they offer services that directly compete with traditional land line telephone businesses that are centrally assessed?

In the case before the Commission, Quest, a land line company, was seeking to have Comcast, a cable TV company that offered VoIP services, centrally assessed based on its unitary value (as was Quest), instead of locally assessed. There was no denying that Comcast offered VoIP service, and no denying that this service competed face to face with traditional land line service provided by Quest. The Commission was impressed with the logic and fairness of Quest's request, but in the end, chose not to require Comcast to be centrally assessed. The decision turned on the proverbial "dime"; since only two percent of Comcast's property was devoted to providing VoIP service, the Commission felt that this was insufficient to require what would be a difficult central valuation of its total operations.

The Commission's final statements on this matter are enlightening and express their somewhat dissatisfaction with the ultimate decision they rendered. It is repeated here verbatim "as food for thought" since the controversy will not go away and will only accelerate.

This result may eventually be required under the current statutory scheme. We do not believe it is required, however, when only two percent of the properties are implicated. Taxation is not a matter of mathematical precision. To require central assessment of Comcast, at the current level of its telecommunications business, would allow the telecommunications tail to wag the cable television dog. It would introduce a level of complexity into tax compliance and administration that would not be justified by the relatively small portion of the properties actually involved. Accordingly, we decline to adopt the proposed amendments to the rule at this time.

[37] See Utah State Tax Commission (2008).

Convergence. Although we do not have the power to bind future Commissioners, the implications of our decision are clear. If conventional wisdom is correct, convergence will continue and probably accelerate. If so, and if Comcast's apparent marketing strategy is successful, the portion of its assets engaged in VoIP services will increase. At some point, we believe the current statutory scheme will require Comcast's telecommunications properties to be centrally assessed. We express no opinion on what that point will be. We merely find that two percent is insufficient. As interested parties are considering solutions to the many regulatory and competitive implications of convergence, they may want to consider the implications of our decision as well.[38]

2. The alternative equitable solution is to reclassify all telecommunication businesses currently classified as utilities as commercial/industrial properties. The major obstacle to this change is the large negative property tax impact on local governments. The impact of such a reclassification would be an effective reduction in the taxable assessments (and tax liabilities) of impacted businesses in each taxing jurisdiction of approximately 42%.[39] The estimated state-wide local property tax impact of such a change for tax year 2008 is negative $20.3 million.[40] This loss could be partially offset by redirecting payments from the existing Telecommunications Ad Valorem Tax Reduction Fund to local governments instead of to the telecommunication utilities themselves.[41]

CONCLUSION

Clearly, the fair taxation of telecommunications business property continues to be a challenge to public officials responsible for the administration of tax laws that partly reflect the past rather than the present and the future. While obvious solutions, neither of the options presented here are painless. The first risks raising the ire of all parties, excluding the local governments who would benefit from this change, while the second requires the state to bite the bullet and recognize that technological convergence will continue and in some cases negatively impact state and local government tax revenues. While action is needed, it is a legitimate question whether state government and state law should be used to insulate local governments from the inevitable changes that have occurred in our economy, and will continue to occur.

[38](Utah State Tax Commission 2008, 6)

[39]Based on a reduction in the applicable assessment rate from 55% to 32% (estimated average assessment rate after the change: provided by the Office of State Assessed Properties). Most of the property of utilities consists of personal not real property.

[40]This reduction is distributed as follows: BellSouth (AT&T) – $14.5 million; telephone co-ops – $1.2 million; other telephone companies (assessed at 55% rate) -$4.6 million.

[41]During calendar 2008, the fund received $11.5 million in earmarked revenue.

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APPENDIX 1 - UTILITY SHARE OF TOTAL ASSESSMENTS BY COUNTY

COUNTY	UTILITY SHARE OF TOTAL ASSESSMENTS	COUNTY	UTILITY SHARE OF TOTAL ASSESSMENTS
SEVIER	0.80%	JEFFERSON	5.10%
LOUDON	1.90%	GILES	5.20%
LINCOLN	2.00%	HARDIN	5.30%
UNION	2.20%	PUTNAM	5.30%
CARTER	2.20%	GRAINGER	5.50%
DICKSON	2.30%	SHELBY	5.50%
ROANE	2.70%	VAN BUREN	5.50%
ANDERSON	2.70%	BEDFORD	5.60%
MONTGOMERY	2.80%	JOHNSON	5.60%
SUMNER	2.80%	GIBSON	5.60%
KNOX	2.90%	CANNON	5.80%
HENDERSON	2.90%	FENTRESS	5.80%
WILLIAMSON	3.00%	CLAIBORNE	5.90%
RUTHERFORD	3.00%	POLK	6.00%
GREENE	3.10%	TIPTON	6.10%
BRADLEY	3.10%	WARREN	6.20%
WASHINGTON	3.10%	MEIGS	6.40%
HAMBLEN	3.30%	HUMPHREYS	6.40%
CUMBERLAND	3.30%	MARION	6.40%
HENRY	3.40%	MARSHALL	6.60%
COCKE	3.40%	DYER	6.70%
CAMPBELL	3.40%	CLAY	6.90%
COFFEE	3.50%	HARDEMAN	7.10%
FRANKLIN	3.50%	OVERTON	7.20%
WILSON	3.50%	HOUSTON	7.30%
MOORE	3.60%	CROCKETT	7.30%
MCMINN	3.60%	BLEDSOE	7.60%
DAVIDSON	3.60%	SMITH	7.60%
UNICOI	3.80%	LEWIS	8.00%
SULLIVAN	3.80%	STEWART	8.20%
DECATUR	3.80%	HAYWOOD	8.40%
MADISON	3.90%	OBION	8.40%
BLOUNT	3.90%	CHESTER	8.50%
ROBERTSON	4.00%	HAWKINS	9.00%
CHEATHAM	4.00%	WAYNE	9.00%
CARROLL	4.10%	HICKMAN	9.10%
MAURY	4.20%	SCOTT	9.90%
DEKALB	4.20%	MACON	9.90%
HAMILTON	4.30%	HANCOCK	10.10%
MONROE	4.30%	LAUDERDALE	10.60%
BENTON	4.40%	GRUNDY	10.80%
PICKETT	4.40%	JACKSON	11.20%
WEAKLEY	4.60%	MCNAIRY	11.60%
RHEA	4.60%	MORGAN	12.30%
SEQUATCHIE	4.60%	TROUSDALE	12.80%
LAWRENCE	4.80%	LAKE	13.10%
FAYETTE	4.90%	PERRY	16.10%
WHITE	5.00%		

Source: 2007 Tax Aggregate Report

Tennessee Advisory Commission on Intergovernmental Relations (TACIR)

The Commission was established by the General Assembly in 1978 to

- Monitor the operation of federal-state-local relations,
- Analyze allocation of state and local fiscal resources,
- Analyze the functions of local governments and their fiscal powers,
- Analyze the pattern of local governmental structure and its viability,
- Analyze laws relating to the assessment and taxation of property,
- Publish reports, findings and recommendations, and draft legislation needed to address a particular public policy issue, and
- Provide a neutral forum for discussion and education about critical and sensitive public policy issues.

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