Legislative Committee on Taxation, Public Revenue and Tax Policy

January 2007

Legislative Counsel Bureau

Bulletin No. 07-16

BULLETIN NO. 07-16

Legislative Committee on Taxation, Public Revenue and Tax Policy

Nevada Revised Statutes 218.53741

Members

Senator Mike McGinness, Chairman
Assemblyman David R. Parks, Vice Chairman
Senator Bob Coffin
Senator William J. Raggio
Senator Randolph J. Townsend
Assemblyman Morse Arberry Jr.
Assemblyman Lynn Hettrick
Assemblywoman Peggy Pierce

Staff Contacts

Fiscal Analysis Division:
Russell J. Guindon, Senior Deputy Fiscal Analyst
Donna Thomas, Secretary
(775/684-6821)

Legal Division:
Kimberly Marsh Guinasso, Senior Principal Deputy Legislative Counsel
Joel Benton, Senior Deputy Legislative Counsel
(775/684-6830)

TABLE OF CONTENTS

REPORT TO THE 74TH SESSION THE NEVADA LEGISLATURE BY THE LEGISLATIVE COMMITTEE ON TAXATION, PUBLIC REVENUE AND TAX POLICY

I. INTRODUCTION

The Legislative Committee on Taxation, Public Revenue, and Tax Policy is a statutorily created committee of the Nevada Legislature that consists of eight members whose duties and responsibilities are set forth in Chapter 218 of the *Nevada Revised Statutes*. The Speaker of the Assembly and the Senate Majority Leader each appoint two individuals who were members of the respective standing committees on taxation during the 73rd Session of the Nevada Legislature. The other four members are the Speaker of the Assembly, the Minority Leader of the Assembly, the Majority Leader of the Senate, and the Minority Leader of the Senate or a member designated by each position from their respective houses. Under current statute, the Committee is scheduled to expire on June 30, 2007. A copy of the statutory provisions that create and set forth the power and duties of the Committee (NRS 218.5374 to 218.53749, inclusive) is provided in Appendix A.

A. COMPOSITION OF THE COMMITTEE

The Speaker of the Assembly, Minority Leader of the Assembly, Senate Majority Leader, and the Minority Leader of the Senate appointed the following eight legislators to the Committee for the 2005-06 biennium:

Senator Mike McGinness, Chairman
Assemblyman David R. Parks, Vice Chairman
Senator William J. Raggio
Senator Randolph J. Townsend
Senator Bob Coffin
Assemblyman Morse Arberry Jr.
Assemblyman Lynn Hettrick
Assemblywoman Peggy Pierce

Legislative Counsel Bureau (LCB) staff services for the Committee were provided by Russell Guindon, Senior Deputy Fiscal Analyst, Fiscal Analysis Division; Kimberly Marsh Guinasso, Senior Principal Deputy Legislative Counsel, Legal Division; Joel Benton, Senior Deputy Legislative Counsel, Legal Division; and Donna Thomas, Secretary, Fiscal Analysis Division.

B. OVERVIEW OF THE COMMITTEE PROCEEDINGS

During the 2005-06 interim, the Committee conducted three meetings held in Carson City with videoconferencing to Las Vegas.

Review of the Committee's Duties and Responsibilities

At the Committee's first meeting on November 17, 2005, Chairman McGinness provided an overview of the Committee's history and its duties and responsibilities. The Committee was originally created by Senate Bill 8 of the 20th Special Session to study and review the state's tax system, primarily with respect to the tax changes approved during the 2003 Regular Session and the 20th Special Session. Per Senate Bill 8, the Committee was scheduled to expire on June 30, 2005, but Assembly Bill 498 from the 2005 Regular Session extended the expiration date to June 30, 2007. Assembly Bill 498 assigned the Committee additional duties and responsibilities as well as maintaining those originally established in Senate Bill 8. These new duties included, but were not limited to, a review of the methods of distributing the proceeds from the fuel taxes to local governments and a study of the federal and state regulatory environment including the franchise fees and taxes imposed upon providers of telecommunication, video, data, electrical, and natural gas services.

Review of the Outcome of Legislative Recommendations from the Committee's 2003-04 Interim Study during the 2005 Session

During the 2003-04 interim, the Committee made several recommendations for changes to the state's tax system in two bill draft requests that became Senate Bill 391 and Senate Bill 392 during the 2005 Session. The Committee's 2003-04 interim study and recommendations can be reviewed in Legislative Counsel Bureau Bulletin No. 05-18 published in January 2005.

> Senate Bill 391, approved during the 2005 Regular Session, included the Committee's recommendation to base the definition of a financial institution for the purpose of the Modified Business Tax upon a licensing, registration, or other state or federal requirement for doing business as a financial institution. This replaced the original method established in Senate Bill 8 of the 20th Special Session that based the definition of a financial institution for the Modified Business Tax on the North American Industrial Classification System (NAICS) used by the U.S. Census Bureau for classifying financial business activities.
>
> Senate Bill 392 included the Committee's recommendations primarily regarding changes to the Business License Fee, Modified Business Tax, and Live Entertainment Tax. Although the bill was amended by both the Senate and Assembly, most of the amendments were additions to the primary recommendations made by the Committee during its 2003-04 interim study. Senate Bill 392 was not approved during by 2005 Regular Session, but was approved as Senate Bill 3 of the 22nd Special Session.

The Committee reviewed the outcome of its 2003-04 interim recommendations considered during the 2005 Session as well as other tax changes approved by the Legislature during the 2005 Regular Session and the 22nd Special Session. A copy of the material summarizing the major tax changes approved by the Legislature during the 2005 Regular Session and the 22nd Special Session is provided in Appendix B.

The Committee reviewed the estimated fiscal impact for FY 2005-06 and FY 2006-07 on the various General Fund revenue sources from the tax changes approved by the Legislature during the 2005 Regular Session and 22nd Special Session.

The Committee also reviewed the actual General Fund revenue collections for FY 2003-04 and FY 2004-05 which were the first two years impacted by the tax changes approved during the 2003 Regular Session and 20th Special Session. The Committee was provided information comparing actual collections to the projected amounts by General Fund revenue source, especially with regard to the new General Fund revenue sources implemented, such as the Modified Business Tax, the Real Property Transfer Tax, and the Live Entertainment Tax.

Review of the Method of Distributing Fuel Tax Revenues to Local Governments

Marvin Leavitt, Chairman of the Committee on Local Government Finance, provided the Committee a historical overview on the subject of distributing fuel tax revenues to local governments. Mr. Leavitt explained how the Legislative Committee for Local Government Taxes and Finance had studied the fuel tax distribution issue during the past few interims; discussed the recommendations that were made from these studies; and reviewed the actions approved by the Legislature during the 2003 and 2005 Sessions. The Committee was provided an explanation of the how the actual fuel tax distribution formula worked under current statute along with potential benefits or costs to various local governments from the factors used in the distribution formula calculation based on recent legislative actions.

Chairman McGinness stated he had been a member of the Legislative Committee for Local Government Taxes and Finance when it performed the study of the fuel tax distribution formula issue and recommended changes to the Legislature for modifying the distribution formula. Given the complexity of the issues surrounding the distribution formula and the potential impacts on the various local government entities, Chairman McGinness stated that perhaps the Committee should observe the implementation of the recent changes and monitor any impacts for a few years before considering additional changes. However, if there were any issues overlooked regarding the fuel tax distribution formula, Chairman McGinness requested the members of the Committee, local government officials, and members of the public to contact the Chairman or Committee staff so that these issues could be reviewed and discussed by the Committee. During the 2005-06 interim, no issues regarding the fuel tax distribution formula were brought forward to the Chairman for consideration by the Committee.

Review of the Regulation and Taxation of Communication Services Providers

The Committee received testimony from representatives of the different telecommunication, video, and data services (communication services) providers regarding the current state and federal regulatory structure for their business and the taxes and fees imposed on their specific business sector.

The Committee received testimony on issues regarding the national and state regulation and taxation of the cable industry from Bob Gastonguay, Executive Director of the Nevada State Cable Telecommunications Association; Gardner Gillespie, Hogan and Hartson LLP; Marsha Berkbigler, Vice President of Charter Communications; and Steve Schorr, Vice President of Public and Government Affairs for Cox Communications.

Mr. Gillespie, on behalf of Cox Communications, provided the Committee with an overview of the state of communication services technology especially with regard to the overlap that now occurs between the types of services available to customers by the different service providers. Service providers who once used their technological platform to provide a single type of service now have the ability to offer multiple services to their customers including video, telephone, and internet access. Mr. Gillespie testified that the taxation and regulation of communication services is a much broader issue that affects many other providers of competitive services than cable and direct broadcast satellite companies.

Mr. Gillespie also provided information on the taxation of communication services with regard to recent legislative actions approved in various states and potential legal considerations based on these actions. Mr. Gillespie discussed how the states of Florida, North Carolina, Tennessee, Ohio, and Kentucky had passed similar legislation that attempted to equalize the tax treatment of cable and direct broadcast satellite service providers. Recent legislation approved in Virginia was presented for the Committee's consideration as it established a broad definition of communication services to include voice, data, audio, and video services and taxed these services at a statewide uniform rate.

Ms. Berkbigler provided testimony to the Committee on the tax environment faced by Charter Communications in Nevada. Ms. Berkbigler also reviewed the regulatory environment under which Charter Communications operates based on the conditions specified in the local franchise agreements. Ms. Berkbigler stated from Charter Communications' viewpoint, they would like to see a regulatory and tax system that treated similar services provided by different providers similarly. Such a system would allow for equal tax treatment of functionally equivalent services provided to customers through different technological media. The current system places operation and service requirements through mandated franchise agreements and imposes taxes that are passed through to customers on certain providers, but not to other providers who offer the same competitive service.

Mr. Schorr provided an overview to the Committee on the regulatory and licensing environment faced by Cox Communications. For the Committee's benefit, Mr. Schorr reviewed the relationship that exists between Cox Communications and the various local government franchising authorities in Clark County. Although Cox Communications had established a good partnership with the local government franchising authorities, Mr. Schorr stated that it was important to understand the regulatory mandates placed on cable companies that other service providers did not have to meet. He proposed for the Committee's consideration that if the laws regarding regulation and taxation were to be changed, then like services should be treated similarly on a level playing field for all service providers.

Fred Hillerby and Brian Smith, representing DIRECTV, provided testimony to the Committee on the regulatory and tax environment in which satellite service providers are required to operate under federal and state laws. Mr. Smith provided the Committee an overview of the technological framework used by DIRECTV to provide services to its customers especially with regard to not requiring rights-of-way to provide service. Mr. Smith stated that under current federal law a provider of direct-to-home satellite television service is exempt from taxation imposed by a local government entity. It was further noted that the federal law did not provide an exemption from state government taxation nor prohibit the distribution of state tax revenue to local government entities. For the Committee's consideration, Mr. Smith presented information on the taxation of cable and direct broadcast satellite services in other states, focusing primarily on states that had recently implemented legislative tax changes, such as Kentucky, Florida, Tennessee, and North Carolina, and the legal challenges to these tax changes that were occurring.

Dan Jacobsen from AT&T provided the Committee information on the franchise fees and taxes paid to local governments in Nevada. Mr. Jacobsen stated that it was important for the Committee to understand that the fees imposed by local governments were a pass-through that showed up on the consumer's bill as a local tax. Mr. Jacobsen described the changing environment in which individuals can obtain telephone services and discussed the potential impacts on the industry and local governments from the current regulatory and tax structure. Information was provided that according to Federal Communication Commission reports, there were more wireless phones than traditional wireline phones in Nevada, and that wireless Broadband service was also readily available to consumers in Nevada as an alternative to Broadband service provided over wire. Because of the similar services available using wireless technology, the number of lines provided by AT&T in Washoe County declined in 2002 through 2004. The current reduction and potential future reduction in the use of wireline services may affect the revenue from franchise fees collected by local governments. Finally, Mr. Jacobsen noted that traditional wireline companies have certain regulatory conditions placed on it by local franchising authorities, such as neighborhood build out requirements and specific customer service conditions, not required by wireless service providers.

Linda Stinar, Director of Regulatory Affairs for Sprint of Nevada, explained the types of federal, state and local government telecommunication taxes and fees imposed on Sprint customers in Nevada and the amount of revenue generated by these taxes. Ms. Stinar pointed out for the Committee that these taxes and fees should be viewed as transactional taxes because they are billed to the end-user customer and the revenue collected is passed on to the appropriate government entity. Ms. Stinar testified that the current tax system was established when traditional telephone companies were sole providers and it was much easier to determine who provided the different types of telecommunication services. Ms. Stinar discussed how the changing environment in which consumers can obtain telecommunication services may generate less tax revenue for local governments under the current tax structure as customers migrate towards communication services not subject to the current taxes.

David Fraser, Executive Director of the Nevada League of Cities, and Andrew List, Executive Director of the Nevada Association of Counties, provided the Committee a report on the revenues generated by franchise taxes and fees imposed on providers of communication services at the local level and the importance of these revenues to local government budgets. Mr. Fraser provided information for the Committee's consideration on the local governments' perspective with regard to the need for franchise agreements with service providers who use public rights-of-way and the need for local governments to impose franchise fees.

The Committee reviewed the taxation of communication services in Florida, Virginia, Tennessee, North Carolina, Kentucky, and Ohio. The Committee decided to review these six states because they were referenced by the different industry representatives during their presentations. Secondly, these states had recently implemented legislative changes with regard to defining and taxing the diverse types of communication services offered to consumers by the different service providers. The information considered by the Committee on the taxation of communication services in other selected states is provided in Appendix C.

Based on the information provided on the taxation of communication services in other states and the policy and legal challenges faced by their legislative bodies, the Committee discussed the areas of consideration with regard to amending the current system of state and local taxation of communication services in Nevada. This discussion centered on:

- determining the definition of communication services or service provider;
- determining which communication services or service providers would be subject to taxation;
- determining the structure of the tax;
- determining the tax rate; and
- determining the distribution of tax revenues.

With regard to determining the communication services subject to taxation, the Committee discussed a technologically and competitively neutral approach versus a more narrow and targeted approach to defining communication services. The Committee's discussion regarding the structure of the tax was based on two general approaches: a tax on the gross receipts generated by providers of communication services or a tax on the provision of communication services to consumers at the retail level. The Committee also considered the merits of replacing the current system of each local government entity imposing potentially different rates with a single uniform statewide rate where the revenues could be distributed to local governments based on a formula-based approach. The Committee considered these issues and the potential problems that would have to be addressed and resolved if changes were to be made to the current system of regulation and taxation of communication services in Nevada.

The Committee discussed the status of legislation being considered in the U.S. Congress that would make changes to the regulation and taxation of communication services. Although Congress was in the process of hearing legislation, no legislation was approved by Congress during the 2005-06 interim for which the Committee could schedule hearings for review and consideration of the potential impact and the need for action by the Nevada Legislature during the 2007 Session.

II. CONCLUSION

Given the possibility that Congress may pass legislation changing the federal, state, and local environment for the taxation and regulation of communication services, the Committee chose not to recommend any changes to the current state and local system of taxation of communication services. The Committee decided to continue to monitor the proposed federal legislation and meet, if necessary prior to session, to consider issues for deliberation during the 2007 Legislative Session, if federal legislation is approved.

APPENDIX A

STATUTES CREATING THE LEGISLATIVE COMMITTEE ON TAXATION, PUBLIC REVENUE AND TAX POLICY

APPENDIX A

STATUTES CREATING THE LEGISLATIVE COMMITTEE ON TAXATION, PUBLIC REVENUE AND TAX POLICY

NRS 218.5374 "Committee" defined. [Effective through June 30, 2007.] As used in NRS 218.5374 to 218.53749, inclusive, "Committee" means the Legislative Committee on Taxation, Public Revenue and Tax Policy.

(Added to NRS by 2003, 20th Special Session, 188; A 2005, 1928)

NRS 218.53741 Establishment; membership; Chairman; Vice Chairman; vacancies. [Effective through June 30, 2007.]

1. There is hereby established a Legislative Committee on Taxation, Public Revenue and Tax Policy consisting of:

(a) The Speaker of the Assembly, or a member of the Assembly designated by the Speaker of the Assembly;

(b) The Minority Leader of the Assembly, or a member of the Assembly designated by the Minority Leader of the Assembly;

(c) The Majority Leader of the Senate, or a member of the Senate designated by the Majority Leader of the Senate;

(d) The Minority Leader of the Senate, or a member of the Senate designated by the Minority Leader of the Senate;

(e) Two members appointed by the Speaker of the Assembly who were members of the Assembly Committee on Taxation during the immediately preceding legislative session; and

(f) Two members appointed by the Majority Leader of the Senate who were members of the Senate Committee on Taxation during the immediately preceding legislative session.

2. The members of the Committee shall elect a Chairman and Vice Chairman from among their members. The Chairman must be elected from one house of the Legislature and the Vice Chairman from the other house. After the initial election of a Chairman and Vice Chairman, each of those officers holds office for a term of 2 years commencing on July 1 of each odd-numbered year. If a vacancy occurs in the chairmanship or vice chairmanship, the members of the Committee shall elect a replacement for the remainder of the unexpired term.

3. Any member of the Committee who is not a candidate for reelection or who is defeated for reelection continues to serve until the convening of the next session of the Legislature.

4. Vacancies on the Committee must be filled in the same manner as the original appointments.

(Added to NRS by 2003, 20th Special Session, 188; A 2005, 1928)

NRS 218.53743 Meetings; regulations; quorum; compensation of members. [Effective through June 30, 2007.]

1. The members of the Committee shall meet throughout each year at the times and places specified by a call of the Chairman or a majority of the Committee.

2. The Director of the Legislative Counsel Bureau or his designee shall act as the nonvoting recording Secretary.

3. The Committee shall prescribe regulations for its own management and government.

4. Except as otherwise provided in subsection 5, five voting members of the Committee constitute a quorum.

5. Any recommended legislation proposed by the Committee must be approved by a majority of the members of the Senate and by a majority of the members of the Assembly serving on the Committee.

6. Except during a regular or special session of the Legislature, the members of the Committee are entitled to receive the compensation provided for a majority of the members of the Legislature during the first 60 days of the preceding regular session, the per diem allowance provided for state officers and

employees generally and the travel expenses provided pursuant to NRS 218.2207 for each day or portion of a day of attendance at a meeting of the Committee and while engaged in the business of the Committee. The salaries and expenses paid pursuant to this subsection and the expenses of the Committee must be paid from the Legislative Fund.

(Added to NRS by 2003, 20th Special Session, 189; A 2005, 1928)

NRS 218.53745 Powers of Committee. [Effective through June 30, 2007.] The Committee:

1. Shall:

(a) Analyze the effect of changes in technology on the fees administered and imposed by the state and local governments on providers of telecommunications, video, data, electric or natural gas services.

(b) Monitor the effect of any changes proposed by the Federal Communications Commission and the Congress of the United States to the categorization of different types of telecommunication and video services and the jurisdiction, or lack thereof, of the state and local governments over those services.

(c) Analyze and compare the procedures and methods used by local governments to administer, tax and limit the use of public rights-of-way by the providers of telecommunications, video, data, electric or natural gas services.

(d) Consider individually telecommunications, video, data, electric and natural gas services to determine the most appropriate level of government for administering taxes and fees on such services.

(e) Analyze any services or benefits that are currently offered to providers of telecommunications, video, data, electric or natural gas services by local governments in exchange for the franchise fees charged by local governments.

(f) Examine and consider the proposed effects of eliminating franchise fees, business license fees and all other fees and taxes imposed upon providers of telecommunications, video, data, electric and natural gas services.

(g) Consider the methods of distribution to local governments of the revenue from the tax on aviation fuel and motor vehicle fuel imposed by or pursuant to chapter 365 of NRS.

(h) Review the price and availability of renewable and alternative fuels.

(i) Consider any other matter that the Committee determines is relevant to its duties prescribed in this subsection.

2. May review and study:

(a) The specific taxes collected in this State;

(b) The implementation of any taxes, fees and other methods for generating public revenue in this State;

(c) The impact of any changes to taxes, fees and other methods for generating public revenue that result from legislation enacted by the Legislature on the residents of this State and on the businesses located in this State, doing business in this State or considering locating in this State;

(d) The fiscal effects of any taxes, fees and other methods for generating public revenue;

(e) The impact, if any, on the prices charged to the residents of this State from the compounding of various new or increased taxes such as the real property transfer tax;

(f) The beneficial and detrimental effects, if any, of the reduction of the tax based on wages for the cost of employee health benefits;

(g) Broad issues of tax policy and fiscal policy relevant to the future of the State of Nevada; and

(h) Any other issues related to taxation, the generation of public revenue, tax policy or fiscal policy which affect this State.

3. May conduct investigations and hold hearings in connection with its powers pursuant to this section.

4. May contract with one or more consultants to obtain technical advice concerning its review and study.

5. May apply for any available grants and accept any gifts, grants or donations and use any such gifts, grants or donations to aid the Committee in exercising its powers pursuant to this section.

6. May request that the Legislative Counsel Bureau assist in the research, investigations, hearings, studies and reviews of the Committee.

7. May recommend to the Legislature, as a result of its review and study, any appropriate legislation.

(Added to NRS by 2003, 20th Special Session, 189; A 2005, 1927, 1928)

NRS 218.53747 Administration of oaths; deposition of witnesses. [Effective through June 30, 2007.] If the Committee conducts investigations or holds hearings pursuant to subsection 3 of NRS 218.53745:

1. The Secretary of the Committee or, in his absence, a member designated by the Committee may administer oaths; and

2. The Secretary or Chairman of the Committee may cause the deposition of witnesses, residing either within or outside of this State, to be taken in the manner prescribed by rule of court for taking depositions in civil actions in the district courts.

(Added to NRS by 2003, 20th Special Session, 190; A 2005, 1928)

NRS 218.53749 Fees and mileage for witnesses. [Effective through June 30, 2007.] Each witness who appears before the Committee by its order, except a state officer or employee, is entitled to receive for his attendance the fees and mileage provided for witnesses in civil cases in the courts of record of this State. The fees and mileage must be audited and paid upon the presentation of proper claims sworn to by the witness and approved by the Secretary and Chairman of the Committee.

(Added to NRS by 2003, 20th Special Session, 190; A 2005, 1928)

APPENDIX B

OVERVIEW OF LEGISLATION PROPOSED BY THE COMMITTEE FROM ITS 2003-04 INTERIM STUDY AND CONSIDERED DURING THE 2005 LEGISLATIVE SESSION

APPENDIX B

OVERVIEW OF LEGISLATION PROPOSED BY THE COMMITTEE FROM ITS 2003-04 INTERIM STUDY AND CONSIDERED DURING THE 2005 LEGISLATIVE SESSION

SUMMARY OF 2003-04 INTERIM LEGISLATIVE COMMITTEE ON TAXATION, PUBLIC REVENUE AND TAX POLICY RECOMMENDATIONS AND LEGISLATIVE ACTIONS DURING THE 73RD REGULAR SESSION AND 22ND SPECIAL SESSION

This summary presents the recommendations approved by the Legislative Committee on Taxation, Public Revenue and Tax Policy during the 2003-04 legislative interim at its meeting on August 24, 2004, in Carson City. The Committee submitted these recommendations to the 73rd Session of the Nevada Legislature in two separate bill draft requests. Recommendation number 12 became Senate Bill 391 (BDR 716) and all the other recommendations were included in Senate Bill 392 (BDR 683). S.B. 392 was not passed during the 73rd Regular Session, but was approved as Senate Bill 3 during the 22nd Special Session.

BUSINESS LICENSE FEE

1. Draft legislation, amending the statutes for the annual business license fee (NRS Chapter 360), authorizing the Department of Taxation to:

   a. allow an individual with multiple businesses to establish a common anniversary date mutually agreed upon by the taxpayer and the Department of Taxation for the submission of the $100 annual renewal fee for each business on that anniversary date,

   b. allow for the proration of the $100 annual renewal fee for those businesses in which the $100 business license fee has been paid for a partial year based on the anniversary date established for all businesses,

   c. allow for the proration of the original $100 business license fee required for any additional new businesses licensed by an individual who has established a common anniversary date with the Department of Taxation with the proration based on the established anniversary date. (BDR 683)

   Approved as recommended in S.B. 3 (22nd S.S.).

2. Draft legislation, amending the statutes for the business license fee (NRS Chapter 360), specifying that a natural person is required to obtain only one business license for multiple business activities reported to the Internal Revenue Service on the schedules cited in NRS 360.785. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

3. Draft legislation, amending the statutes for the business license fee (NRS Chapter 360), that:

   a. eliminates NRS 360.770 which defines an employee,

   b. eliminates the provision in paragraph (c) of subsection 2 of NRS 360.780 requiring a business to report the estimate of the number of employees to the Department of Taxation when paying the annual business license fee,

   c. eliminate the provision in subsection 4 of NRS 360.795 that requires the Director of the Department of Taxation to report the number of employees to the Division of the Industrial Relations of the Department of Business and Industry. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

4. Draft legislation, amending the statutes for the business license fee (NRS Chapter 360), that specifies that the term "earns" in paragraph (c) of subsection 2 of NRS 360.765 means "net earnings". (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

5. Draft legislation, amending the statutes for the business license fee (NRS Chapter 360), that specifies:

   a. a person or governmental entity that operates a facility at which craft shows, exhibitions, trade shows, conventions or sporting events are held is responsible for the payment of the business license fee for those persons who do not have a business license fee,

   b. the entity operating the facility where the craft show, exhibition, trade show, convention or sporting event can pay the fee due in one of two ways:

      (1) as an annual flat fee of $5,000 on or before July 1 for all shows held at the facility during that fiscal year

      (2) on a per show or event basis equal to the product of the total number of businesses taking part in the show or event who do not have a business license multiplied by the number of days the show or event is held multiplied by $1.25, payable to the Department of Taxation on a quarterly basis. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

6. Draft legislation, amending the statutes for the business license fee (NRS Chapter 360), providing an exemption from the business license fee for a person who derives rental income from four or fewer dwelling units. (BDR 683)

   Approved as recommended in S.B. 3 (22nd S.S.).

7. Draft legislation, amending the statutes for the business license fee (NRS Chapter 360), removing the exemption for businesses that create or produce motion pictures (as defined in NRS 231.020) from the business license fee. (BDR 683)

   This recommendation was amended out of the final version approved by the Legislature in S.B 3 (22nd S.S.).

MODIFIED BUSINESS TAX

8. Draft legislation, amending the statutes for the modified business tax (NRS Chapter 363B) and the modified business tax on financial institutions (NRS Chapter 363A), indicating the tax does not apply to things the state is prohibited from taxing under the Constitution or laws of the United States or the Nevada Constitution. (BDR 683)

   Approved as recommended in S.B. 3 (22nd S.S.).

9. Draft legislation, amending the statutes for the modified business tax (NRS Chapter 363B) and the modified business tax on financial institutions (NRS Chapter 363A), eliminating the requirement for a taxpayer to submit a copy of his/her quarterly unemployment insurance tax form along with the modified business tax form filed with the Department of Taxation each quarter. (BDR 683)

   Approved as recommended in S.B. 3 (22nd S.S.).

10. Draft legislation, amending the statutes for the modified business tax (NRS Chapter 363B) and the modified business tax on financial institutions (NRS Chapter 363A), to include in statute the following definitions adopted in regulation for implementing the health care deduction allowed under the modified business tax and the modified business tax on financial institutions:

    a. "Claims" to mean claims for those categories of health care expenses that are generally deductible by employees on their individual federal income tax returns pursuant to the provisions of 26 U.S.C. § 213 and any federal regulations relating thereto, if those expenses had been borne directly by those employees.

b. "Direct administrative services costs" to mean, if borne directly by a self-insured employer and reasonably allocated to the direct administration of claims:

(1) Payments for medical or office supplies that will be consumed in the course of the provision of medical care or the direct administration of claims,

(2) Payments to third-party administrators or independent contractors for the provision of medical care or the direct administration of claims,

(3) Rent and utility payments for the maintenance of medical or office space used for the provision of medical care or the direct administration of claims,

(4) Payments for the maintenance, repair and upkeep of medical or office space used for the provision of medical care or the direct administration of claims,

(5) Salaries and wages paid to medical, clerical and administrative staff and other personnel employed to provide medical care or directly to administer claims, and

(6) The depreciation of property other than medical or office supplies used for the provision of medical care or the direct administration of claims.

c. "Employees" to mean employees whose wages are included within the measure of the excise tax imposed upon an employer by NRS 363A.130 and their spouses, children and other dependents who qualify for coverage under the terms of the health insurance or health benefit plan provided by that employer.

d. "Health benefit plan" to mean a health benefit plan that covers only those categories of health care expenses that are generally deductible by employees on their individual federal income tax returns pursuant to the provisions of 26 U.S.C. § 213 and any federal regulations relating thereto, if those expenses had been borne directly by those employees.

e. "Any amounts paid by an employer to a Taft-Hartley trust formed pursuant to 29 U.S.C. § 186(c)(5) for participation in an employee welfare benefit plan" to mean any amounts which are:

(1) Paid by an employer to a Taft-Hartley trust which:

(a) Is formed pursuant to 29 U.S.C. § 186(c)(5); and
(b) Qualifies as an employee welfare benefit plan, as that term is defined in 29 U.S.C. § 1002; and

(2) Considered by the Internal Revenue Service to be fully tax deductible pursuant to the provisions of the Internal Revenue Code. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

11. Draft legislation, amending the statutes for the modified business tax (NRS Chapter 363B), to exempt the wages paid by individuals to employees who provide in-home domestic health care services to their employer or family member's of the employer. (BDR 683)

S.B. 3 (22nd S.S.) was amended to exempt the wages paid by individuals to employees who provide <u>domestic services</u> (not just health care services) to their employer as long as the services or activity are not conducted for profit by the employer.

12. Draft legislation, amending the statutes for the modified business tax on financial institutions (NRS Chapter 363A), replacing current statutory language for defining financial institutions relying on the North American Industrial Classification System (NAICS) definitions with language defining a financial institution based upon the licensing, registration, or other state or federal requirements for doing business. (BDR 716)

The recommendations by Committee included in this item were approved in S.B. 391. The bill was amended regarding when issuers of credit cards are deemed to be financial institutions and subject to the modified business tax on financial institutions. Entities who are issuers of credit cards or a service provider for an entity issuing credit cards are defined to a be financial institution, but a seller of goods or services who issues a credit card for the purpose of providing or extending credit only in connection with the goods or services provided are not deemed to be financial institutions.

LIVE ENTERTAINMENT TAX

13. Draft legislation, amending the statutes for the Live Entertainment Tax (NRS Chapter 368A), to provide the Gaming Commission with the regulatory authority over the gaming portion of the live entertainment tax. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

14. Draft legislation, amending the statutes for the Live Entertainment Tax (NRS Chapter 368A), specifying that the tax is based on maximum occupancy of the facility, not maximum seating capacity. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

15. Draft legislation, amending the statutes for the Live Entertainment Tax (NRS Chapter 368A), to provide an exemption for food and product demonstrations conducted at shopping malls, craft shows, membership stores, and similar facilities. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

16. Draft legislation, amending the statutes for the Live Entertainment Tax (NRS Chapter 368A), exempting a nonprofit organization from the live entertainment tax on the purchase price of a ticket to a live entertainment event in the situation when a for-profit entity sells tickets to an event at a discount to the nonprofit organization for resale by the nonprofit with the difference benefiting the nonprofit organization. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

NEVADA TAX COMMISSION

17. Draft legislation, amending NRS 360.050, to make the salary of the Chairperson of the Nevada Tax Commission $55,000 per year and the other seven members of the Nevada Tax Commission salary $40,000 per year. (BDR 683)

The recommended salary amounts were reduced to $27,500 for the Chairperson and $20,000 for each member of the Commission in the final version approved by the Legislature in S.B 3 (22nd S.S.).

TAXPAYERS' BILL OF RIGHTS

18. Draft legislation, amending the statutes for the Taxpayers' Bill of Rights (NRS Chapter 360), that:

    a. makes the provisions of the Taxpayers' Bill of Rights (NRS 360.291) applicable to
        (1) the Insurance Premium Tax administered by the Nevada Tax Commission covered under Title 57, Chapter 680B of the NRS,

        (2) the Short-Term Car Rental Tax administered by the Nevada Tax Commission covered under Title 43, Chapter 482 of the NRS,

        (3) the fuel taxes administered by the Department of Motor Vehicles covered under Title 32, Chapters 365 and 366 of the NRS.

    b. changes the dissemination requirements for the Taxpayers' Bill of Rights in NRS 360.292 by
        (1) eliminating the provision requiring a pamphlet on the Taxpayers' Bill of Rights be distributed to each taxpayer on record and

(2) requiring the Taxpayers' Bill of Rights be made available to taxpayers and the public on the websites and at the offices of the Department of Taxation and the Department of Motor Vehicles, and at public libraries. (BDR 683)

Approved as recommended in S.B. 3 (22nd S.S.).

SUMMARY OF LEGISLATIVE ACTIONS APPROVED DURING THE 73RD REGULAR SESSION AND 22ND SPECIAL SESSION REGARDING MODIFICATIONS TO TAX CHANGES APPROVED BY THE 2003 LEGISLATURE

1. Senate Bill 3 (22nd Special Session) [Senate Bill 392 of the 73rd Regular Session] made the following changes, not included in the recommendations by the Committee:

   (a) Business License Fee - requires that a business or natural person must perform a service or engage in trade for profit to be subject to the requirements to register and pay the $100 business license fee.

   (b) Branch Bank Excise Tax - provides an exemption for one branch office maintained by a bank in each county, replacing the previous exemption of only one branch office per bank.

   (c) General Fund Appropriation – provides an appropriation in both FY 2005-06 and FY 2006-07 to the Department of Taxation of $153,500 for the expenses related to the increase in the salaries on the members of the Nevada Tax Commission and $2,300 for expenses related to the printing of the Taxpayers' Bill of Rights.

   (d) Highway Fund Appropriation – provides an appropriation in both FY 2005-06 and FY 2006-07 to the Department of Motor Vehicles of $3,920 for expenses related to the printing and mailing of the Taxpayers' Bill of Rights for Taxes on Fuels.

2. Senate Bill 523 reduces the Modified Business Tax on General Businesses from 0.65 percent to 0.63 percent of wages paid during a calendar quarter less allowable health care expenses, effective July 1, 2005 to June 30, 2007.

3. Assembly Bill 554 made the following changes, primarily to the Live Entertainment Tax and Sales and Use Tax:

   (a) Live Entertainment Tax

      (i) Lowers the maximum occupancy threshold to determine whether a liability exists from 300 to 200;

      (ii) Establishes statutory definitions for casual assemblage, shopping mall, and a trade show;

(iii) Clarifies the term "admission charge" to include an entertainment fee, a cover charge, a table reservation fee, or a required minimum purchase of food, refreshments, or merchandise;

(iv) Places in statute the events or activities defined to be or not to be live entertainment in the regulations adopted by the Nevada Tax Commission and Nevada Gaming Commission (items listed after item (c) below) ;

(v) Specific exemptions were provided for: 1.) live entertainment that is incidental to an amusement ride, a motion simulator, or a similar digital, electronic, mechanical or electromechanical device; 2.) live entertainment provided to the public in an outdoor area and there is no admission charge or requirement to purchase food, refreshments, or merchandise; 3.) an outdoor concert unless provided on the premises of a licensed gaming establishment; 4.) race events that are part of the National Association for Stock Car Auto Racing Nextel Cup Series and all races associated with such an event, effective July 1, 2007; and 5.) live entertainment provided in a restaurant which is incidental to any other activities conducted in the restaurant or serves as ambience as long as there is no admission charge;

(vi) Clarifies that live entertainment provided by or for the benefit of a non-profit entity filed with the Secretary of State under NRS Chapter 82 is exempt.

(b) Sales and Use Tax - tangible personal property worth less than $100 and acquired free of charge at a convention, trade show, or other public event is exempt from the state and local use tax.

(c) Provides for the submission to the voters a question of whether Sales and Use Tax Act of 1955 should be amended to include an exemption from the state sales tax for certain farm equipment and the trade-in value of a vehicle. If the ballot question fails, the provisions of the bill provide for the discontinuation, effective December 31, 2006, of the current exemption from the local sales taxes for the trade-in value of a motor vehicle. The current exemption provided from the local sales tax for certain farm equipment is extended from June 30, 2005 to December 31, 2005 and if the question is approved by voters, becomes effective again January 1, 2007.

Items Included or Excluded from the definition of live entertainment:

The term live entertainment includes, without limitation, any one or more of the following activities:

(1) Music or vocals provided by one or more professional or amateur musicians or vocalists;
(2) Dancing performed by one or more professional or amateur dancers or performers;
(3) Acting or drama provided by one or more professional or amateur actors or players;

(4) Acrobatics or stunts provided by one or more professional or amateur acrobats, performers or stunt persons;
(5) Animal stunts or performances induced by one or more animal handlers or trainers, except as otherwise provided in number (7) below under items excluded;
(6) Athletic or sporting contests, events or exhibitions provided by one or more professional or amateur athletes or sportsmen;
(7) Comedy or magic provided by one or more professional or amateur comedians, magicians, illusionists, entertainers or performers;
(8) A show or production involving any combination of the activities described in subparagraphs (1) to (7), inclusive; and
(9) A performance involving one or more of the activities described in this paragraph by a disc jockey who presents recorded music. For the purposes of this subsection, a disc jockey shall not be deemed to have engaged in a performance involving one or more of the activities described in this paragraph if the disc jockey generally limits his interaction with patrons to introducing the recorded music, making announcements of general interest to patrons, and explaining, encouraging or directing participatory activities between patrons.

The term live entertainment excludes, without limitation, any one or more of the following activities:

(1) Instrumental or vocal music, which may or may not be supplemented with commentary by the musicians, in a restaurant, lounge or similar area if such music does not routinely rise to the volume that interferes with casual conversation and if such music would not generally cause patrons to watch as well as listen;
(2) Occasional performances by employees whose primary job function is that of preparing, selling or serving food, refreshments or beverages to patrons, if such performances are not advertised as entertainment to the public;
(3) Performances by performers of any type if the performance occurs in a licensed gaming establishment other than a licensed gaming establishment that is licensed for less than 51 slot machines, less than 6 games, or any combination of slot machines and games within those respective limits, as long as the performers stroll continuously throughout the facility;
(4) Performances in areas other than in nightclubs, lounges, restaurants or showrooms, if the performances occur in a licensed gaming establishment other than a licensed gaming establishment that is licensed for less than 51 slot machines, less than 6 games, or any combination of slot machines and games within those respective limits, which enhance the theme of the establishment or attract patrons to the areas of the performances, as long as any seating provided in the immediate area of the performers is limited to seating at slot machines or gaming tables;
(5) Television, radio, closed circuit or Internet broadcasts of live entertainment;
(6) Entertainment provided by a patron or patrons, including, without limitation, singing by patrons or dancing by or between patrons;
(7) Animal behaviors induced by animal trainers or caretakers primarily for the purpose of education and scientific research; and
(8) An occasional activity, including, without limitation, dancing, that:
    (I) Does not constitute a performance;

(II) Is not advertised as entertainment to the public;
(III) Primarily serves to provide ambience to the facility; and
(IV) Is conducted by an employee whose primary job function is not that of an entertainer.

APPENDIX C

REVIEW OF THE TAXATION OF COMMUNICATIONS, VIDEO, AND DATA SERVICES IN SELECTED STATES.

APPENDIX C

REVIEW OF THE TAXATION OF COMMUNICATIONS, VIDEO, AND DATA SERVICES IN SELECTED STATES.

A. FLORIDA

OVERVIEW OF THE TAXATION OF COMMUNICATIONS SERVICES

Florida Communications Services Tax Simplification Law (S.B. 1338)

Motivated by the confluence of federal legislation, industry deregulation and the convergence of service offerings by communications services providers, in 2000 the Florida Legislature enacted reforms aimed at providing a fair, efficient and uniform method of taxing communications services.

Senate Bill 1338 established Chapter 202 in Florida Statutes, known as the Communications Services Simplification Law. Prior to the enactment of this law, telecommunications services in Florida were subject to five different taxes imposed at both the state and local levels:

1. State Gross Receipts Tax.
2. State Sales and Use Tax.
3. Local Sales and Use Tax.
4. Local Municipal Utility Tax.
5. Local Franchise Fees.

The rates of these taxes could vary significantly based on location. In addition, each tax had a different base so competing communications services were provided under dissimilar circumstances with respect to tax treatment. Senate Bill 1338 restructured the separate taxes and fees into revenue-neutral mandatory statewide and discretionary local taxes on communications services that would be centrally administered by the Department of Revenue.

Tax Structure

Senate Bill 1338 comprehensively overhauled the prevailing tax structure as it applied to the taxation of communications services. It established a two-tiered system of taxation that consists of mandatory state taxes and a discretionary local tax on the sales price of communications services. The bill did not set explicit tax rates, instead deferring to the findings of the Revenue Estimating Conference, which was tasked with calculating revenue neutral rates. The Revenue Estimating Conference presented its findings to the 2001 Legislature. The findings were duly approved, setting the stage for the full implementation of the reform.

The total state portion of the communications services tax consists of two separate taxes applied to a uniform base: 1) sales and use tax on the sales price of communications services, and 2) a gross receipts tax.

The state-mandated sales and use tax was levied on the sales price of communications services sold at retail. General communications services, not including direct-to-home satellite services, were taxed at a rate of 6.8 percent. Direct-to-home satellite services were taxed at a rate of 10.8 percent.

A state-mandated gross receipts tax of 2.37 percent was applied to the sales price of the same taxable transactions subject to the state sales and use tax, thereby affecting a uniform base for both state levied taxes.

The total state rate for general communications services, not including direct-to-home satellite services, is 9.17 percent. The total state rate for direct-to-home satellite services is 13.17 percent.

Senate Bill 1338 repealed a host of local taxes and fees and replaced them with the local option component of the new communications services tax. Local governments were granted the authority to levy, by ordinance, a discretionary communications services tax on the sales price of the same taxable transactions subject to the state rate, with the exception of direct-to-home satellite services. The new local option tax was designed to serve as a revenue neutral substitute for the municipal utility tax, franchise fees and the local sales and use tax.

Chapter 337 of Florida Statutes grants local government entities the authority to regulate the use of public roads and rights-of-way by utilities through the collection of permit fees. Under Senate Bill 1338 local government entities could not require providers of communications services to apply for or enter into individual licenses, franchises or other agreements as a condition of placing or maintaining facilities in its roads or rights-of-way. Furthermore, local government entities were required to make an election with the Department of Revenue regarding the imposition of permit fees. Local governments that elect to impose such fees must bear an automatic reduction of 0.12 percent in the rate charged for the local communications services tax.

Charter counties and municipalities that chose not to charge permit fees were granted authority to levy the local communications services tax up to a maximum rate of 5.1 percent. Charter counties and municipalities that elected to impose permit fees were granted authority to levy the local communications services tax up to a maximum rate of 4.98 percent.

It was the Legislature's specific finding that the new centrally administered taxation scheme, while it would reduce local governments' authority to levy certain public services taxes, would not reduce their ability to raise revenue in the aggregate.

Finally, the Department of Revenue was designated as the tax collector for the new taxes and charged with the added duty of distributing the appropriate funds back to the local governments through the Local Communications Services Tax Clearing Trust Fund.

Taxable Services

Senate Bill 1338 provided a broad definition of "communications services" that would be taxable under the new law. The definition of communications services was intended to be technology neutral, encompassing any current, developing and future communications services technology.

For the purpose of levying the communications services tax, "communications services" means "the transmission, conveyance, or routing of voice, data, audio, video or other information signals, including cable services, to a point, or between or among points, by or through any electric, radio, satellite, cable, optical, microwave, or other medium or method now in existence or hereafter devised, regardless of the protocol used for such conveyance."

Services taxable under this definition include:

- Landline and Wireless Telephone Services;
- Voice Over Internet Protocol (VOIP);
- Cable Television;
- Satellite Television; and
- Satellite Radio.

The transactions deemed taxable under the prevailing definition of communications services constitute, largely, the uniform basis for the state and local communications services tax, with one exception. Providers of direct-to-home satellite services are specifically exempted from the tax base of the local communications service tax by virtue of the federal mandates prohibiting the taxation of satellite service by local government entities.

Public Rights-of-Way and Franchise Management

It is a circumstance unique to the provision of communications services that certain entities provide services in a manner that utilizes public roads and rights-of-way while others offering similar services do not. Although similar communications services may be provided through different means, it was the state's desire to treat providers of communications services in a competitively neutral manner. To that end, S.B. 1338 expressly preempted the authority of local governments to require franchise fees from providers of communications services. Rules or regulations imposed by local governments governing the placement or maintenance of communications facilities in public roads or rights-of-way must be generally applicable to all providers of communications services. Service providers are no longer required to pay franchise fees as a condition of placing or maintaining facilities in public roads or rights-of-way.

Local governments do maintain the authority to negotiate the terms and conditions of a cable service franchise as allowed by federal law (47 U.S.C § 541) with the exception of those terms and conditions relating to franchise fees. Furthermore, local governments may exercise the right, to the extent permitted by federal law, to exact in-kind requirements, including but not limited to, institutional networks and public, educational or governmental access facilities as a condition of a cable franchise.

Additionally, local governments can elect to charge permit fees from providers of communications services that use or occupy public roads or rights-of-way if such fees are reasonable and commensurate with the direct and actual cost of the regulatory activity and equitably applied to all users of the roads or rights-of-way.

B. VIRGINIA

OVERVIEW OF THE TAXATION OF COMMUNICATIONS SERVICES

Virginia Communications Sales and Use Tax (H.B. 568)

In 2002 and 2003, the Virginia Legislature created the Joint Subcommittee to Study State and Local Taxation of the Entire Telecommunications Industry and Its Customers within the Commonwealth. The joint subcommittee, in cooperation with other state authorities, developed the following guiding principles for restructuring telecommunications taxes and fees to ensure that the tax burden falls equitably on all users of telecommunications services.

1. Reduce consumer confusion.
2. Consolidate taxes and fees.
3. Make taxes and fees uniform statewide.
4. Reduce tax rates levied on the vast majority of Virginians.
5. Make taxes and fees competitively neutral.
6. Preserve state and local government revenues.
7. Establish a single point of administration.

Currently, communications services, such as landline and wireless telephone service and cable television service, are subject to one or more of the following state and local taxes and fees:

- Local Consumer Utility Tax on landline and wireless telephone service;
- Local E-911 Tax on landline telephone service;
- State E-911 Tax on wireless service;
- Virginia Relay Center Assessment on landline telephone service for the costs of a telephone relay service for the hearing impaired;
- Local Gross Receipts Tax in excess of 0.5 percent;
- Cable television franchise fees;
- Local Video Programming Excise Tax;
- Local Consumer Utility Tax on cable television; and
- State and local right-of-way fees.

Satellite television and satellite radio providers are generally not subject to these taxes. Federal law prohibits the taxation of satellite television by local taxing entities. Furthermore, satellite television providers are not included in the base for the remaining state taxes on telecommunications services.

Virginia House Bill 568, approved in April 2006, creates a centrally administered Communications Sales and Use Tax and a uniform state E-911 tax to replace the aforementioned array of state and local taxes and fees. It also establishes a state Public Rights-of-Way Use Fee for cable television providers that would supersede local franchise fees paid as consideration for the use of public roads and rights-of-way.

Tax Structure

Effective January 1, 2007, H.B. 568 repeals the following state and local taxes and fees:

- Local Consumer Utility Tax on telephone services and cable television;
- Local E-911 Tax;
- Virginia Relay Center Assessment on landline telephone service;
- Local gross receipts in excess of 0.5 percent;
- Video Programming Excise Tax; and
- Cable Television Franchise Fees.

In their place, the bill levies a statewide Communications Sales and Use Tax ("Communications Tax") to be administered by the Department of Taxation. The new Communications Tax is imposed on the consumers of communications services at a rate of 5 percent of the sales price of taxable services. The tax is to appear as a separate line item on the consumer's bill.

The Communications Tax will be collected by communications services providers with sufficient contact, or nexus, within the state to be subject to the tax by virtue of the same rules that govern the Retail Sales and Use Tax.

Virginia House Bill 568 also imposes a new state E-911 surtax on landline telephone services, which will be administered by the Department of Taxation. The E-911 tax will be levied on the end user of each access line at a rate of $0.75 per access line.

The rate imposed on the new Communications Tax is designed to be revenue neutral for local governments. To that end, the bill requires the Auditor of Public Accounts to determine the amount of revenues received by each locality in FY 2005-06, at rates adopted on or before January 1, 2006, for the aforementioned local taxes and fees earmarked for repeal. The Communications Tax revenue will be distributed to local governments in proportion to each entity's share of the total FY 2005-06 receipts from these sources.

Virginia House Bill 568 creates a non-reverting fund known as the Communications Sales and Use Tax Trust Fund ("Fund") to serve as the depository for revenues collected from the Communications Tax, E-911 Tax and Public Rights-of-Way Use Fees.

Taxable Services

Virginia House Bill 568 provides a broad definition of "communications services". Services deemed taxable under the new law would include:

- Landline and wireless telephone services;
- Voice Over Internet Protocol (VOIP);
- Paging;
- Cable television;

- Satellite television; and
- Satellite radio

Communications services that would not be considered taxable include:

- Information services such as electronic publishing, web hosting, 900-number services, alarm-monitoring, check guaranty services and database search services;
- Internet access services, electronic mail service, electronic bulletin board service or similar services incidental to Internet access, such as voice capable e-mail or instant messaging;
- Digital products delivered electronically, such as software, download music, ring tones and reading materials; and
- Over-the-air radio and television service broadcast without charge by an entity licensed for such purposes by the Federal Communications Commission.

Public Rights-of-Way and Franchise Management

Local governments are prohibited from including franchise fees as a term or condition of any cable franchise agreement entered into or renegotiated after January 1, 2007. Cable franchise agreements in effect as of January 1, 2007, would remain in effect until their expiration. However, under the tax new structure, franchisees bound by such agreements would include a report listing by locality the franchise fees due that month with the monthly Communications Tax remittance to the Department of Taxation. The department would then distribute the franchise fees to each locality after deducting for administrative costs and other mandated allocations.

The state assesses a Public Rights-of-Way Use Fee on providers of telecommunications services, namely landline telephone and cable service providers that use or occupy public roads or rights-of-way intended to replace all fees of general application. The fees collected from cable service providers are deposited into the Communications Sales and Use Tax Trust Fund and distributed to local entities.

C. TENNESSEE

OVERVIEW OF THE TAXATION OF COMMUNICATIONS SERVICES

Taxation of Services

Chapter 6 of Title 67 of Tennessee Code provides for the imposition of a tax on the retail sale of certain services. Services deemed taxable under the chapter include:

- Charging a fee for subscription to, access to or use of television services, provided by any electronic means.
- The furnishing, for a consideration, of intrastate, interstate or international telecommunication services.
- Ancillary services.

Sales Tax on Television Services

A state tax at the rate of 8.25 percent is imposed on each sale at retail with respect to fees for subscription to, access to or use of television programming or television services delivered by providers of cable television service, wireless cable television service and direct-to-home satellite service.

Local government entities maintain the right to regulate the operation of a cable television company that serves customers within its terrestrial limits through the issuance of franchise agreements, which may include franchise fees paid as a percentage of gross receipts.

Sales Tax on Telecommunication Services

In 2004 and 2005, legislation was adopted to amend Title 67, Chapter 6 with respect to telecommunications services. Tennessee, as a participant of the Streamlined Sales and Use Tax, approved Public Chapters 782 (2004) and 499 (2005) which provided new and uniform definitions relating to telecommunications, including:

- Telecommunications services.
- Private communications services.
- Data processing and information services.
- Ancillary services.

"Telecommunications services" means the electronic transmission, conveyance or routing of voice, data, audio, video or any other information or signals to a point, or between or among points. The term 'telecommunications services' includes such transmission, conveyance or routing in which computer processing applications are used to act on the form, code or protocol of the content for the purposes of transmission, conveyance or routing without regard to whether such service is referred to as voice over Internet protocol services or is classified by the Federal Communications Commission as enhanced or value added.

This definition specifies that telecommunications services include services used to transport signals regardless of the technology used for transmission and regardless of whether the content is voice, audio, video, data or others. As long as the primary purpose of the service is the transmission, conveyance or routing of content, such service is a telecommunication service subject to tax.

The definition further clarifies that services that are not regulated by the FCC because they are considered to be enhanced or value added services are subject to sales tax in Tennessee if the purpose is the transmission, conveyance or routing of content. Voice over Internet protocol (VOIP) and electronic data interchange (EDI) are encompassed in this definition.

Intrastate telecommunications services are subject to a state rate of 7 percent and a flat local rate of 2.5 percent.

Interstate and international telecommunications services sold to businesses are subject to a state rate of 7.5 percent and are exempt from the local tax.

Interstate and international telecommunications services sold to persons other than businesses are subject to a state rate of 7 percent and a flat local rate of 1.5 percent.

"Private communication services" means a telecommunication service that entitles the customer to exclusive or priority use of a communications channel or group of channels between or among termination points, regardless of the manner in which the channels are connected, and includes switching capability, extension lines, stations and any other associated services provided in connection with the use of such channels.

Private communication networks can be built within the public network or the Internet backbone. Such services may be referred to as virtual private network services. Dedicated access lines may be used to connect customers' locations or sites to the virtual private network. Such virtual private network services and dedicated access lines are examples of private communication services and thus taxable under the new definition.

Charges for private communication services that are sourced to Tennessee are subject to a sales tax based on the location of the customer channel termination point.

Exclusions from the Definition of Telecommunications Services

The amending legislation specifically excluded the following items from the definition of telecommunications service. While these items are not subject to sales tax as telecommunications services, they may be deemed taxable under different provisions of the sales tax statutes.

- Data processing and information services;
- Installation or maintenance of wiring or equipment on a customer's premises;
- Tangible personal property;
- Advertising, including directory advertising;
- Billing and collection services provided to a third party;
- Internet access services;
- Radio and television audio and video programming services;
- Ancillary services; and
- Digital products delivered electronically, including software, music, video, reading materials or ring tones.

"Data processing and information services" allow data to be generated, acquired, stored, processed or retrieved and delivered by an electronic transmission to a purchaser where the purchaser's primary purpose of the underlying transaction is the processed data or information.

Examples of data processing or information services delivered electronically that are not telecommunication services include check guaranty services, database search services and home security services.

"Ancillary services" means services that are associated with or incidental to the provision of telecommunications services, including but not limited to detailed telecommunications billing, directory assistance, vertical service and voice mail services.

Ancillary services were previously taxable as a part of the gross charge for telecommunications services. While they are not defined as telecommunications services, they remain taxable under a separate provision of the sales tax statute. Ancillary services are taxed at a state rate of 7 percent and a flat local rate of 2.5 percent.

In compliance with the Streamlined Sales and Use Tax, the effective date of Tennessee's statutory changes has been delayed until July 1, 2007.

D. NORTH CAROLINA

OVERVIEW OF THE TAXATION OF COMMUNICATION SERVICES

2001 LEGISLATION

In 2001, the North Carolina General Assembly passed Senate Bill 1005, which was the first attempt by the state of North Carolina to equalize taxes between cable and satellite companies. Prior to the approval of S.B. 1005, cable companies were levied a local franchise tax of up to 5 percent; satellite companies had no similar taxation. The 2001 legislation imposed a sales tax of 5 percent on the gross receipts derived from providing direct-to-home satellite TV service to consumers within North Carolina, and took effect on January 1, 2002. Cable companies were still subject to the local franchise taxes, and were not subject to a state sales tax.

On October 1, 2003, DirecTV and DISH Network filed a lawsuit against the state of North Carolina alleging that the satellite tax imposed under S.B. 1005 was unconstitutional (in that the tax created unequal treatment of cable and satellite service providers that was a violation of the commerce clause). In reaction, the North Carolina General Assembly revised the taxation of cable and satellite services during its 2005 Session.

2005 LEGISLATION

Senate Bill 622 (2005), The Current Operations and Capital Improvements Appropriations Act of 2005, was passed out of both houses of the North Carolina General Assembly in August 2005. This legislation increased the sales tax rate on direct-to-home satellite service from 5 percent to the combined general rate, which is currently 7 percent of gross receipts under *North Carolina General Statutes* (NCGS). In North Carolina, gross receipts for these providers are based on the sales price, which is defined in NCGS as “the total amount or consideration for which personal property or services are sold, leased, or rented.”

The same legislation extended the sales tax to cable companies as well, requiring the cable companies to pay the same 7 percent rate on gross receipts as the direct-to-home satellite companies. Cable companies were still subject to local franchise taxes; however, cable companies were allowed to take a credit against their sales taxes in the amount of local franchise taxes paid to cities or counties. Under NCGS, this credit is given by allowing the cable companies to collect the sales tax at a rate equal to the combined general rate of 7 percent, less the applicable local franchise tax rate.

Senate Bill 622, in addition, imposed a 7 percent sales tax (4.5 percent state tax, and 2.5 percent local) on the gross revenue of satellite radio companies. It also raised the sales tax rate on other telecommunication companies, such as telephone companies. These companies, who had formerly been subject to a 5 percent sales tax on their gross revenues, are now subject to taxation at the combined general rate of 7 percent.

In North Carolina, “telecommunications services” are defined as “the transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points, by or through any electronic, radio, satellite, optical, microwave, or other medium, regardless of the protocol used for the transmission, conveyance, or routing. The term includes mobile telecommunications service and vertical services. Vertical services are switch-based services offered in connection with a telecommunications service, such as call forwarding services, caller ID services, and three-way calling services.” Senate Bill 625 also specifically expanded the definition of “telecommunications services” to include gross revenues from voice mail services sold by telecommunications companies.

In addition, S.B. 622 directed the Revenue Laws Study Committee, a permanent statutory committee that is tasked with studying the enactment and administration of revenue laws within the state of North Carolina, to study the equity of taxation of video, cable, satellite, and data service providers. The committee is required to provide an interim report of their findings back to the 2006 Regular Session of the 2005 General Assembly and final report to the 2007 General Assembly.

2006 LEGISLATION - VIDEO SERVICE COMPETITION ACT

Tax Structure

In response to the provisions of S.B. 622, Bill Draft 2005-RBxz-36B, the Video Service Competition Act (VSCA), was submitted to the North Carolina Revenue Laws Study Committee. This legislation was designed to create equal taxation in this area, the study of which was required by S.B. 622. The determination of the committee in drafting this legislation was that no video programming service (be it cable, direct-to-home satellite, or other telecommunication companies providing this service) should receive a competitive advantage over another through unequal taxation, and that, even though the rates may be similar, the current tax system was not necessarily providing that equity (despite the attempts of the General Assembly over the prior four years).

The bill draft was recommended by the Revenue Laws Study Committee at its May 2, 2006, meeting and was filed as House Bill 2047 on May 17, 2006. It eventually passed through both the House and Senate, and was signed by the Governor on July 20, 2006 with an effective date of January 1, 2007.

The VCSA eliminates the varying tax methods and rates approved in the 2005 legislation in favor of a common, uniform taxation system. This system charges sales tax at the combined general rate (currently 7 percent) on the gross revenue of all video programming services and eliminates the authority of local governments from levying a franchise tax. (Additionally, the credit that is given to cable companies against the local franchise tax is also repealed.) To maintain the revenue stream of the local governments, a formula was developed to distribute a portion of the sales tax revenue from telecommunications and video programming back to the locals, with a hold-harmless amount of $65.3 million written into the legislation for the first year.

Public Rights-of-Way and Franchise Management

The legislation also moves the franchise authority for video services to the North Carolina Utilities Commission, and all state-negotiated franchise agreements require these companies to provide public, education, and government (PEG) channels. Local governments, however, would still have control over rights-of-way and specific negotiations for PEG channel support. Further, currently existing local franchise agreements that are still in effect as of January 1, 2007, (the effective date of the legislation) would not be affected until their expiration date.

The fiscal note released by the General Assembly's Fiscal Research Division estimates that this measure will not have an impact on general fund sales tax revenues, and would have an approximate general fund impact on expenditures of $222,525 per year for enforcement of the provisions of the legislation. The Fiscal Research Division's analysis also estimates that the hold-harmless amount of $65.3 million in the first year would provide $3.3 million in additional revenues for local governments than if the current taxing structure were kept in place.

E. KENTUCKY

OVERVIEW OF THE TAXATION OF COMMUNICATION SERVICES

Until 2005, cable companies were subject to local franchise fees, and satellite companies were not subject to similar taxation within Kentucky. In an effort to equalize taxation between cable and satellite companies in the commonwealth, language was included in House Bill 272, the 2005 tax package, that established equal taxation among all providers of “multi-channel video programming services” (defined to be cable and satellite companies). House Bill 272, which was signed by the Governor in March 2005, created a multi-tiered system of state taxation on the gross revenues derived from these services.

Tax Structure

For video programming services, there are two tiers of taxation:

- A 3 percent excise tax is imposed on the retail purchase of cable and satellite services. The tax is paid by the consumer and collected by the company providing the service.

- A 2.4 percent tax is imposed directly on the gross revenues of the cable or satellite company. In general, gross revenues is defined to be all amounts received in money, credits, property, or other money's worth in any form, by a provider for furnishing multi-channel video programming service or communications service in this state. This tax cannot be directly passed to the consumer.

The revenues from these taxes are to be deposited into a Gross Revenues and Excise Tax (GRET) Fund, which is distributed as follows:

- 1 percent is distributed to the state for administrative costs.

- $3,034,000 per month (or $36,400,000 per year) is distributed to counties, cities, school districts, special districts, and sheriff’s offices as a means to hold these entities harmless from franchise fees or taxes that can no longer be collected. Each government’s share is distributed on a formula that is based on the historical percentage of these fees collected by each entity.

- $1,250,000 per month (or $15,000,000 per year) to the State General Fund.

- The remaining money in the fund is transferred to the State Baseline and Local Growth Fund, which further allots a portion of the money to counties based upon the proportion of the taxes collected within that county. The county portion is then divided among cities, school districts, and special districts within that county based on their proportion of historical revenue collections within that county.

Public Rights-of-Way and Franchise Management

The legislation also, effective January 1, 2006, prohibits cities and counties from levying any franchise fees or taxes against cable, satellite, or telephone companies (but it does not eliminate the right of these local governments to obtain franchises or regulate their rights-of-way). The definition of “franchise fee or tax” was broadly defined to include any in-kind payment of property or services, but it does not include any of the following:

- Donations of property and services by the company to a political subdivision.
- Ad valorem property taxes.
- Right-of-way inspection or permit fees.
- Fees for the placement or attachment of poles, antennas, towers, or similar devices on public property.
- Fees or requirements relating to PEG channel capacity.

Also excluded from this definition of “franchise fee or tax” was any gross revenue utility tax or fee levied as a result of *Kentucky Revised Statutes* 160.613 and 160.614. *Kentucky Revised Statutes* 160.613 authorizes a gross receipts tax not to exceed 3 percent for the benefit of school districts within the commonwealth, with administration and compliance responsibilities handled by the Kentucky Department of Revenue. *Kentucky Revised Statutes* 160.614 expanded the base of this tax to include satellite companies as well, though it also provided that a school district could opt out of taxing satellite revenues by also removing cable companies from the base.

Oversight Committee

As part of the implementation of the tax, a nine-member oversight committee was created to monitor the implementation of the act and the distribution of funds, as well as acting as a fact-finder for the Secretary of the Revenue Cabinet in the event of disputes. The commission is chaired by the Commissioner of the Governor’s Office of Local Development, and the remaining members are appointed to three-year terms based on lists submitted by the Kentucky League of Cities, the Kentucky Association of Counties, the Kentucky School Boards Association, the Kentucky Superintendents Association, and the Kentucky School Administrators Association, as well as one member selected to represent the interests of special districts.

Post-Implementation Issues

In May 2005, DirecTV and Dish Network filed suit in federal court in an attempt to block implementation of the Kentucky law, stating that the new law gave an unfair advantage to cable companies and violated the commerce clause of the U.S. Constitution. The structure of the taxes was such, they argued, that the cable companies were paying no new taxes, since the new tax was merely a replacement for taxes that were previously levied.

On March 30, 2006, the U.S. District Court for the Eastern District of Kentucky dismissed the suit stating that the law was not discriminatory on the basis of geographic location and that the commerce clause only protected interstate markets, not particular delivery mechanisms. It also found that the law would not induce economic activity within Kentucky at the cost of discouraging economic activity in other states. (The decision was silent as to the issue of whether local franchise fees were equivalent to excise or gross revenue taxes in being distinct from right-of-way use payments.)

Another issue arising from the implementation of this tax has been in the “hold harmless” provisions written into H.B. 272. According to the Kentucky League of Cities, the specified threshold of $3,034,000 per month guaranteed to the local governments is not sufficient to hold them harmless as the legislation intended. (The Kentucky League of Cities estimates that the annual shortfall to local governments is approximately $5.2 million per year based on the hold-harmless amount written into the language.) The Kentucky League of Cities has requested that the Legislature or the executive branch either revise or eliminate the specific hold-harmless amount in order to ensure that the local governments are truly held harmless by the legislation. However, this issue was not addressed during the 2006 Session of the Legislature.

F. OHIO

OVERVIEW OF THE TAXATION OF COMMUNICATION SERVICES

Legislation

In February 2003, the Governor of Ohio introduced a state budget that proposed the addition of a 5 percent excise tax on the gross revenues of cable and satellite companies providing service within the state of Ohio. However, before the passage and eventual signing of H.B. 95 on June 26, 2003, the tax had been revised so that the tax rate only applied to satellite companies; cable companies, who were still subject to their local franchise fees, were declared exempt from this tax. (Additionally, the tax rate was now set as 6 percent, commensurate with an across-the-board 1 percent sales tax increase that was included within the measure.) This tax was effective August 1, 2003.

Despite the exemption that applies to cable companies, it should be noted that the sales tax exemption on cable companies does not apply to any telecommunications services offered by these companies, such as voice over Internet protocol (VOIP) or other telephone services.

Legal Challenge

On the day that the law was signed, DirecTV and Dish Network filed a lawsuit against the state of Ohio, seeking to block enforcement of the tax on the grounds that the unequal treatment of satellite and cable companies was unconstitutional. Cable companies argued that they were already taxed at the local level as part of their franchise agreements. The satellite companies believed that these franchise "taxes" were, in reality, fees for rights-of-way.

In October of 2005, a district court in Ohio overturned the satellite tax due to its inequity. Despite this ruling, the Ohio Department of Taxation is still collecting this tax on companies providing satellite broadcasting services in accordance with Section 5739.01 of the *Ohio Revised Code*, with cable companies still being exempt from the tax. The statute defines "satellite broadcasting service" as being "the distribution or broadcasting of programming or services by satellite directly to the subscriber's receiving equipment without the use of ground receiving or distribution equipment, except the subscriber's receiving equipment or equipment used in the uplink process to the satellite, and includes all service and rental charges, premium channels or other special services, installation and repair service charges, and any other charges having any connection with the provision of the satellite broadcasting service."