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TO: Co-chairpersons Senator Joe Bolkcom and Representative Philip Wise and Members of the Legislative Property Tax Study Committee

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RE: State Telecommunications Property Tax Systems

I. Introduction

This memorandum describes property taxation methodology for telecommunications companies in various Midwest states (Iowa, Missouri, Minnesota, Wisconsin, Illinois, Indiana, Ohio, South Dakota, North Dakota, Kansas, and Nebraska). While many states share similar approaches to property taxation in this area, disparities exist as to the types of companies taxed and the definitions used by each state. Those differences, where applicable, are noted below. This memorandum is primarily intended to address telephone companies similar to those under Iowa Code Chapter 433, which include any person or business operating any telephone line in the state. However, information regarding wireless telephone companies and cable companies is provided for certain states.

This memorandum uses terms that may vary slightly between states but are intended to provide uniformity for the reader. "Unit value" means the value of a company considered as a whole. "Operating property" means property which is necessary to and without which the company could not perform the activities for which it is formed. Examples of telephone company operating property might include transmission and distribution lines, poles, wires, cables, and switch boards. "Non-operating property" means all other company property which is not required to perform the activities for which it is formed. Non-operating property might include certain office buildings or vacant real property that is owned for future use.

II. Iowa

Iowa Code Chapter 433 establishes an ad valorem (in proportion to value) property tax for telephone companies, under which the state conducts the assessments. Every telephone company operating a line in Iowa is required to file a statement with the Director of Revenue detailing various aspects of the company's operation and revenue, including miles of line, gross receipts, and expenses. The director is required to find the actual value (fair and reasonable market value) of the in-state property of these companies, taking into consideration the information obtained from the required statements and any further information the director can obtain. Each assessment includes all property of every kind and character whatsoever, real,

personal, or mixed, used by the companies in the transaction of telephone business so long as the property in the assessment is not being taxed in any other manner under Chapter 433.

While three valuation methods are included in the department's administrative rules relating to utility companies, the rules state that the director may use the replacement cost new less depreciation (RCNLD) valuation methodology for determining the assessed value of a telephone company's operating property. RCNLD is the cost to the owner of acquiring or constructing at current prices property that is the functional equivalent of an existing property less depreciation. Iowa Code Section 441.21(5) provides for the reduction of property tax valuations according to assessment limitations to cushion the impact of inflation. The change in taxable valuation for utility property, including telephone companies, is limited to 8 percent annual statewide growth from revaluation.

The director is also required to ascertain the value per mile of line by dividing the total value by the number of miles of line of a company within the state. Chapter 433 provides a method for calculating the taxable value based on the company's actual value. The director is then responsible for determining the distribution of value among the counties based on the number of miles of line in each county.

Non-operating property belonging to a telephone company is assessed by the local assessor on the same basis as other commercial property in the jurisdiction where situated.

Cable television company property and wireless telephone company property is assessed locally. However, according to the department, wireless telephone company equipment is currently exempt.

III. Missouri

Missouri imposes an ad valorem tax on telephone companies. (Mo. Rev. Stat. Chapter 153). Missouri law authorizes the use of unit valuation, but the statutes do not specify which valuation approach to follow. Instead, valuation and apportionment methodology is set by administrative rule. The Missouri State Tax Commission (STC) values companies at their market value, which typically includes real property and tangible and intangible personal property. However, the STC has declined to value intangible personal utility property. Telecommunications property is classified with other utilities and with industrial, commercial, and railroad property. Real property of such companies is assessed for taxation at 32 percent of its market value, while personal property is assessed at 33 percent.

Missouri telephone companies are required to annually file a report containing all information necessary for the valuation of company property within the state with the STC and county clerks. The assessment of telephone companies is split between the STC and local county assessors. The STC determines the taxable value of operating property and the counties determine the taxable value for non-operating property within their jurisdiction. The STC apportions the value of operating property to the local taxing districts based on the market value of a telephone company's property in each district.

Missouri law also allows for local assessment and taxation of wireless telephone companies and cable television companies.

IV. Minnesota

In Minnesota, telephone company real property is assessed and taxed locally, and personal property is exempt. Under Minnesota law, real property does not include tools, implements, machinery, equipment, poles, lines, cables, wires, conduit, and station connections which are part of a telephone communications system, regardless of attachment to or installation on real property and regardless of size, weight, or method of attachment or installation. Minnesota law does, however, allow local governments to recover certain costs associated with a telephone company's placements of antennas or towers on a public right-of-way. (Minn. Stat. § 237.163). For example, Bloomington, MN holds "[t]elecommunication providers . . . responsible for payment of property taxes attributable to their equipment in the public right-of-way."

Minnesota law allows for local assessment and taxation of wireless telephone companies and cable television companies.

V. Wisconsin

The telephone company property tax is a state levy on the real property and tangible personal property used in providing telecommunications services. (Wis. Stat. Ann. §§ 76.80-76.84). Until 1998, telephone companies operating in Wisconsin were taxed on their gross revenues. Interexchange carriers and resellers were scheduled to become subject to a state property tax in 1997, while local exchange and wireless telephone companies would continue to pay the gross revenues tax. However, recognizing that a dual system of telephone taxation would result in unequal treatment of telephone companies, the law was amended to make all these companies subject to the state property tax. Beginning in 2003, property that is used less than 50 percent in the operation of a telephone company, and other statutorily specified property, is exempt from the telephone property tax imposed by the state. However, such property is subject to local property taxes. The shift in taxation practices from a gross revenues tax to an ad valorem property tax has reduced the tax burden on telephone companies by nearly two-thirds.

The state-imposed telephone company property tax is designed to be as similar to the local property tax system as possible. The tax is assessed by the Wisconsin Department of Revenue and is imposed at the prior year's net property tax rate of the taxing jurisdiction in which the property is located. However, the tax revenues are deposited in the state's general fund. The department uses assessment methods used to assess manufacturing property and property is assessed at 100 percent of market value. No specific valuation method, other than a requirement that unit valuation be employed, is specified in statute. The statute requires the use of "recognized appraisal methods."

While Wisconsin centrally assesses telecommunications companies, including wireless telephone companies, cable television companies are assessed locally.

VI. Illinois

Illinois provides for local assessment and taxation of telephone company real property. Local assessments of real property generally comprise land and structures. However, sometimes conflicts arise between companies and local assessors over what is real and personal property. Although, Illinois law does not provide for specific valuation methods, the market value approach is the more heavily used. Nevertheless, some structures are still valued using the replacement cost method.

Illinois levies a state Telecommunications Infrastructure Maintenance Fee (TIMF) of one-half of one percent of telephone company gross revenues in addition to local taxes on real property. (35 Ill. Comp. Stat. 635). The TIMFs are imposed on persons in the business of transmitting, supplying, or furnishing telecommunications and all associated services in Illinois for compensation. The TIMFs are collected by the state of Illinois and paid to local governments to replace money that was lost by local governments when their authority to impose personal property taxes on those entities was repealed. Replacement taxes, including TIMFs, resulted when the Illinois Constitution of 1970 directed the legislature to abolish business personal property taxes and replace the revenue lost by local government units and school districts.

In Illinois, local assessments of real property are also conducted on wireless telephone companies and cable television companies.

VII. Indiana

Companies in Indiana that principally provide telephone, wireless, and paging services are subject to property taxation in the same manner as many other utility companies in Indiana. (Ind. Code. § 6-1.1-8-15). Those companies are required to prepare a statement concerning the value and description of the property that is either owned or used by the company and file it with the Department of Local Government Finance and the assessor of each township and county in which the company's property is located.

Property is not assessed at its market value, but rather assessed at its "true tax value," which means the resultant value of property determined in accordance with specific rules. However, this assessment may be rebutted by the taxpayer upon a showing that the calculated value is greater than the fair market value. The valuation made by the department is a unit valuation and includes all real, personal, and operating property of the public utility company located in the state. Local authorities assess the company's non-operating property. The department subtracts the value of locally assessed property, as reported by the county assessor, from the unit valuation. The remainder of the distributable property is then allocated to the various taxing districts. According to Indiana law, the various local taxing units tax public utility company property, including telephone companies, "at the same tax rates at which tangible property assessed for that same year is taxed." (Ind. Code 6-1.1-8-34).

Wireless telephone companies and cable television companies in Indiana are assessed and taxed, by both the state and local taxing authorities, in the same manner as telephone companies.

VIII. Ohio

The Ohio Tax Commissioner determines the taxable value for all telephone company personal property located in Ohio. (Ohio Rev. Code Ann. §§ 5711, 5727). Beginning in 2007, telephone companies operating in Ohio are defined as general business taxpayers instead of public utilities and are valued and taxed as such. However, taxable value of telephone company personal property will continue to be apportioned to taxing districts based on the amount of line or value of property in each district. Such property is taxed based on a percentage of its assessment. Assessment rates of telephone company personal property are scheduled to be phased out until they are eliminated in 2011. The assessment rates were approximately 25 percent in 2005 and are being decreased by 5 percent each year until 2010. Telephone company real property, however, is assessed and taxed by the county at a rate of 35 percent of its value. (Ohio Rev. Code Ann. § 5713).

Wireless telephone companies and cable television companies are also assessed by the state rather than local taxing districts, with the valuations apportioned to local taxing districts based on the value of property in each district. Public utilities, other than telephone companies, are subject to a public utility excise tax in Ohio of 4.75 percent of gross receipts. (Ohio Rev. Code Ann. § 5727).

IX. South Dakota

For property tax purposes, South Dakota separates the telecommunications industry into four different categories: (1) local exchange telephone companies with \$50 million or less annual revenue; (2) local exchange telephone companies with more than \$50 million annual revenue; (3) long-distance telephone companies; and (4) wireless telephone companies. (S.D. Codified Laws § 10-33).

Local exchange telephone companies with \$50 million or less in gross annual revenue are subject to a gross receipts tax instead of the property tax. These companies are taxed at a rate of 4 percent of annual gross receipts. However, a local exchange telephone company in this category shall not be taxed at less than an amount equal to \$0.50 per telephone serviced per year. These companies file a report with the Secretary of Revenue, and following certification, the state allocates the tax revenue to each school district on the basis of telephone company gross receipts received in each district.

The Department of Revenue and Regulation is responsible for assessing local exchange telephone companies with more than \$50 million in gross annual revenue and long-distance telephone companies. Such companies are centrally assessed based on their unit value. In determining the taxable value, the cost approach, market value approach, and income approach may be used. A portion of the unit value is allocated to South Dakota and then is apportioned based on the investment in each taxing district. Property within corporate limits is taxed at the same rate as other property within those limits and property outside corporate limits is subject to the average rate of taxation borne by other property outside corporate limits.

Wireless companies pay a 4 percent gross receipts tax on revenue from the sale at retail of intrastate and interstate telecommunications services to customers with a primary place of use in South Dakota. The wireless gross receipts tax revenue is deposited into the state property tax reduction fund. Moneys in the fund are used to provide property tax reductions for home owners. Cable television company real property is subject to property tax, but the telecommunications services provided by cable companies are subject to the 4 percent gross receipts tax.

X. North Dakota

Telecommunications carriers and rural electric cooperatives that provide two-way communications pay a 2.5 percent adjusted gross receipts tax in lieu of property tax on all property used in two-way communications services. (N.D. Cent. Code § 57-34). The tax applies to all telecommunications carriers, including resellers of telecommunications service. Each telecommunications carrier subject to the tax is required to file a report with the state tax commissioner containing a statement of gross receipts, local sales and use tax collected, federal excise tax collected, and other required information. North Dakota law specifies that certain amounts of the tax collected are to be deposited in certain funds, including the telecommunications carriers tax fund. The state tax commissioner must allocate moneys in the telecommunications carriers tax fund among counties in amounts specified by statute.

Some high-volume telecommunications customers are given refunds. A telecommunications carrier's retail customer in North Dakota is entitled to a refund in an amount equal to 2.5 percent of the telecommunications service charges in excess of \$800,000 paid by that customer in a calendar year.

XI. Kansas

Article 11 of the Kansas Constitution governs the assessment and taxation of property. Property is designated by class, and the real property and tangible personal property of a public utility is assessed at the average rate of 33 percent, while other commercial and industrial real and tangible personal property is assessed at 25 percent.

All public utility property is annually assessed by the Kansas Department of Revenue. Each utility is required to file an annual return with information necessary to complete the appraisal and apportionment of values. Valuation is determined using unit valuation, but the law allows use of a variety of factors. The apportionment method of assigning assessed value to taxing jurisdictions within the state is statutory and based upon an original cost ratio methodology.

A county or city may approve a property tax exemption for economic development purposes for up to 10 years per Article 11, Section 13 of the Kansas Constitution. The state, also pursuant to that Constitutional provision, has made all telecommunications machinery and equipment acquired by qualified purchase or lease made or entered into after June 30, 2006, exempt from property tax. Additionally, all telecommunications machinery and equipment transported into the state after June 30, 2006, for the purpose of expanding an existing business or the creation of a new business, is exempt.

Wireless telephone companies and cable television companies in Kansas are assessed and taxed by local taxing jurisdictions.

XII. Nebraska

Telephone companies in Nebraska are assessed and taxed in the same way as other public service entities, such as electric utilities and natural gas companies. (Neb. Rev. Stat. § 77-800). The Nebraska Property Tax Administrator is responsible for the valuation of a telephone company's operating property. County assessors are responsible for valuation of the telephone company's non-operating property.

The Property Tax Administrator ascertains each telephone company's total taxable value of the operating property that is attributable to Nebraska based on a report furnished by the company. Taxable value is the sum of the "actual value of the operating entity, allocated to Nebraska, less a deduction for the actual value of the tangible personal property" and the "net book value of all tangible personal property of the entity allocated to Nebraska." The state uses cost, income, and market value approaches to determine a value. The telephone company's property is assessed at 100 percent of actual value. The Property Tax Administrator then distributes the telephone company's taxable value to the various taxing subdivisions based on a ratio of the telephone company's original cost of all operating property located in the taxing subdivision to the original cost of all operating property located in the state. The Administrator certifies the distributed taxable value of telephone companies to the county assessor for assessment and taxation at the local government level.