Appendix A: Telecommunications Study Mandate - Chapter 2 of the Laws of 1995, Section 42

On or before December 1, 1996, the Commissioner of Taxation and Finance shall submit to the Governor, the Temporary President of the Senate, the Speaker of the Assembly, the Minority Leaders of the Senate and of the Assembly, the Chairman and Ranking Minority member of the Senate Finance Committee, and the Chairman and Ranking Minority member of the Assembly Ways and Means Committee, a written report prepared by the Office of Tax Policy Analysis of the Department of Taxation and Finance. A preliminary report shall be submitted to the aforestated persons on or before September 1, 1996. The report will evaluate the effectiveness of sections twenty-four through forty-three of this act in achieving the goal of improved taxation of telecommunication services in New York State, taking into account commonly accepted goals of tax policy (such as fairness, simplicity and effect on the economic climate of this State and its telecommunications industry). The report will also take into consideration developments of new technologies in the provision of telecommunication services and the desired goal that this State should formulate an effective telecommunications tax policy. To this end, the report will recommend tax policies that will modernize the taxation of telecommunications providers. The data and supporting documentation underlying the report, to the extent allowed by law, shall be available to the persons designated to receive a copy of the final report.

To provide advice to the Office of Tax Policy Analysis in connection with this study, the Commissioner shall appoint an advisory panel consisting of representatives of affected telecommunications providers such as interexchange carriers, local exchange carriers, cellular carriers, resellers of telecommunications, the cable television industry, academic experts, persons with accounting or legal expertise, or other persons such Commissioner shall deem appropriate. Prior to the initiation of the study prescribed hereunder, such Commissioner shall submit to the persons designated to receive a copy of the report, a work plan that describes the study and indicates the members of the advisory panel.

Appendix B: Advisory Panel Members - Telecommunications Study

Mr. Gail L. Allaman
Time Warner Cable

Mr. Mark Allesse
National Federation of Independent Business

Mr. Arthur Angstreich
National Broadcasting Company, Inc.

Mr. Mark Beshears
Sprint

Mr. Robert D. Brink
Adelphia Cable Communications, Inc.

Mr. E. Parker Brown, II
Attorney at Law
(Representing Southwestern Bell)

Mr. Neil Cieminis
Frontier Corporation

Ms. Judy Van Druff
ACC Corporation

Mr. William A. Dvorak
AT&T

Mr. Jeff Gottlinger
Ernst and Young, LLP
(Representing the Wall Street Tax Association)

Ms. Judy Hard
New York State Executive Chamber

Mr. Darrell Henry
Washington Counsel to the Governor

Mr. William A. Hickey
Bell Atlantic Mobile

Ms. Sandra Hill
Securities Industry Association

Mr. Cary Hinton
Sprint

Mr. Michael Hyman
New York City Department of Finance

Ms. Debra Keith
MFS Communications Company, Inc.

Mr. James N. Kenny
MCI Telecommunications Corporation

Ms. Ann Kutter
New York State Consumer Protection Board

Mr. George LaPointe
New York State Department of Economic Development

Mr. Richard Lounsbury
NYNEX Corporation

Mr. Donald Mele
New York City Chamber of Commerce and Industry

Mr. Daniel C. Murphy
New York State Hospitality and Tourism Association

Mr. Marc J. Naparstek
Teleport Telecommunications Group

Mr. Brian H. Perlee
New York State Assembly Ways and Means Committee Minority

Mr. Philip C. Pinsky
Pinsky and Skandalis
(Representing the Cable TV Association of New York State)

Mr. Steven Pleydle
New York State Assembly Ways and Means Committee Majority

Mr. Robert Powers
Phillips, Nizer, Benjamin, Krim and Ballon
(Representing Cellular One)

Mr. Lee Van Riper
New York State Senate Finance Committee Majority

Mr. Andrew S. Roffe
Plunkett and Jaffe
(Representing the Cable TV Association of New York State)

Mr. Keith J. Roland
Roland, Fogel, Koblenz and Carr, LLP
(Representing Empire Association of Long Distance Telephone Compnaies)

Mr. Michael Rynasko
New York State Senate Finance Committee Minority

Mr. Richard Schwarz
The Business Council of New York State, Inc.

Mr. Philip S. Shapiro
The Cable Television and Telecommunications Association of New York, Inc.

Mr. Robert K. Sharp
Rogers and Wells
(Representing financial services and newspaper industries)

Mr. James Sherman
New York State Division of the Budget

Mr. Colin R. Stoner

Tele-Communications, Inc.

Mr. Wayne Thomas
Pattersonville Telephone Company

Mr. George Trahan
New York State Department of Public Service

Mr. John Urban
Cablevision Systems Corporation

Mr. Robert W. Zinnecker
New York State Telephone Association, Inc.

Appendix C: Executive Summary - Background Study

New York State's taxation of telecommunications dates back to the nineteenth century when telephone operations consisted of a readily identifiable, government regulated monopoly franchise, principally owned by the Bell Telephone System. Over the past two decades the world of telecommunications experienced significant changes in terms of market competition and new technologies, yet New York's tax structure failed to keep pace with these developments.

As new communications technologies emerged, the old methods for determining who is subject to tax, what revenues are taxed, and how much tax is owed, became harder to apply. Often, this led to litigation between taxpayers and the State to settle these types of questions. Clearly, it is time to revisit and update New York State's telecommunications tax structure.

The situation described above exemplified the scene creating the impetus for this study. New York State and AT&T were litigating a provision of the Tax Law instituted in 1990 which affected long distance telecommunications companies. The parties settled the suit through a compromise of reduced refund claims and an improved tax statute going forward. As part of the revamped gross receipts tax legislation contained in Chapter 2 of the Laws of 1995, the State mandated that the Department of Taxation and Finance (the Department) conduct a study of telecommunications taxation in New York State. Appendix A contains the entire mandate language.

The study mandate also provides for the appointment by Commissioner Michael Urbach of an advisory panel consisting of representatives from affected telecommunications providers, users of telecommunications, and government. Forty individuals comprise the telecommunications advisory panel. Appendix B lists each of their names and affiliations. The advisory panel met several times with Department staff to discuss issues and possible solutions that the panel felt the study should examine.

This preliminary report presents background information necessary for developing and evaluating tax policy options that will modernize New York's telecommunications taxes. Embarking on this endeavor is important for New York because telecommunications represents the path by which future economic growth will travel. The communications industry generates just over 111,000 jobs, sales of $29 billion, and yields State and local tax revenues of over $1.7 billion. Nearly two-thirds of all New York State non-agricultural employees occupy jobs that rely heavily on telecommunications.

Although New York's economic welfare depends on a robust telecommunications industry, the applicable tax structure is outdated and may indeed hinder economic development opportunities. The background section of this report provides an overview of the industry and describes all of the state and local taxes and fees telecommunications companies shoulder as they endeavor to do business in this State. It also compares New York's tax system with those in other states.

The issues sections of this report outline issue areas brought forward through discussions with the advisory panel. The issues center on three tax areas, including sales tax on cellular telephone service, general sales tax issues and corporate tax issues. Cellular and other forms of mobile telecommunications pose interesting problems when applying a tax, such as the sales tax, that is based on delivery of a product or service to a specific location. The technology used to deliver mobile service, and the myriad of different local tax rates throughout the State, make sourcing mobile calls quite difficult.

The sales tax also contains definitions and various exemptions for telecommunications that date back several decades. Advanced technologies may make these concepts obsolete, and in some cases it is not clear how the sales tax should apply to technologies that did not exist at the time the State enacted the tax.

The sales tax exemption for central office switching equipment provides a good example of the first situation. Today, telephone calls travel over digital networks where calls between geographically adjacent areas may actually be transmitted across the country. The machinery necessary to transmit the voice may look nothing like a central office switch of the 1960's. Yet it achieves the same goal . . . the routing of a telephone call. The study will examine whether the sales tax exemption for switching equipment needs alteration.

The issue of Internet access illustrates the second case. When the State enacted the sales tax in 1965, no one ever heard of the Internet. Today, it is a common term. However, there exists a large issue regarding the taxation of Internet access. The final report will address this issue.

Corporate taxes provide many areas for discussion in the final report. Most states tax telecommunications companies on a net income basis. New York relies on a combination of capital stock and gross receipts taxes, while its general business corporations typically pay tax on their net income. The final report will study the ramifications of shifting telecommunications companies from a gross receipts tax to a net income tax.

The 1995 amendments to the telecommunications gross receipts tax law, while improving the tax structure, created an anomaly. This anomaly applies to companies principally engaged in a nonlocal telephone business, but not subject to the supervision of the Department of Public Service (DPS). These entities, through a confluence of factors, do not pay any tax on their income derived from nontelecommunications sources. Other companies that do not fit this particular fact pattern owe tax on these income sources. The final report will examine policy options for rectifying this anomalous result.

The final telecommunications report will also contain an analysis of the data derived from the 1995 amendments to the Tax Law affecting telecommunications companies. The report is due December 1, 1996.

Appendix D: Telecommunications Survey and Results

New York State Department of Taxation and Finance
Office of Tax Policy Analysis

Telecommunications Survey
Interested Parties

Please take a few minutes to complete this survey. Your responses will assist us in our study of the taxation of telecommunications in New York State.

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Corporate Tax Questions

Issue: The current corporate taxation of companies principally engaged in telecommunications may not provide a level playing field. This is one of the major reasons for our study. For each of the following policy options to remedy this problem, check the response that best represents your opinion.

1. Tax all companies providing telecommunication services under a net income tax rather than a gross receipts tax.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

2. Movement to a net income tax could create a large revenue impact. In that event, it may require a transition period where the Section 186-e excise tax on telecommunication services is retained and reduced to achieve a desired revenue target.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

3. Reform Article 9 by repealing the Section 184 additional franchise tax on companies principally engaged in a local telephone business, by replacing the Section 186-a excise tax on nontelecommunications income for companies regulated by the Public Service Commission with a net income tax on that income, and by reducing the rate on Section 186-e receipts to achieve a desired revenue target. This could include refinements to the definition of telecommunication services, if desired.

    ___ Good tax policy
    ___ Neutral tax policy
    ___ Bad tax policy

4. Same question as #3 except instead of reducing the Section 186-e rate (or in conjunction with a rate reduction), provide exemptions from the 186-e tax for specific services such as private lines, WATS lines, etc.

    ___ Good tax policy
    ___ Neutral tax policy
    ___ Bad tax policy

5. Please list any other corporate tax options not mentioned above that you feel should be considered in the study.

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Sales Tax Questions

Issue: The current sales tax law exempts central office switching equipment. The state of telecommunications technology may make this construction obsolete. For each of the following policy options to remedy this problem, check the response that best represents your opinion.

6. Modernize the statutory language by replacing current terms such as “station apparatus” or “central office switching equipment” with a list of the similar equipment used today.

    ___ Good tax policy
    ___ Neutral tax policy
    ___ Bad tax policy

7. Replace the current exemption, which focuses on specific types of equipment, with a broader, more generic, function-based exemption such as “tangible personal property used to produce telecommunication transmission for sale.”

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

8. Same question as #7 except limit the exemption to property principally used for providing taxable telecommunications services.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

9. Replace the current exemption, which focuses on the equipment used to “switch” telephone calls, with a broader exemption encompassing the tangible personal property and utility services used in all aspects of telephone production and transmission.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

10. Please list any other sales tax options not mentioned above that you feel should be considered in the study.

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Mobile Telecommunications Questions

Issue: When New York enacted its sales tax in 1965, telephone companies mostly provided wireline service to specific buildings. Today, mobile communications services are rapidly developing and growing in popularity. Mobile services face problems in identifying intrastate telephone calls, determining the correct local tax rate and collecting tax on “roamer” charges. For each of the following policy options to remedy these problems, check the response that best represents your opinion.

11. Conform the determination of the local sales tax rate to the Section 186-e concept of service address, where service address refers to location of primary use of the telecommunication equipment as defined by the telephone number, authorization code or billing address. The service address for subscribers traveling outside their service area (i.e., roamers) is the location of the mobile telephone switching office or similar facility.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

12. Compute the sales tax on all intrastate services, including roaming, at the subscriber's location of primary use (normally the billing address).

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

13. Compute the sales tax on all intrastate services, including services to roamers, using a uniform statewide blended rate regardless of the rate in any particular jurisdiction.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

14. Compute the sales tax on all intrastate services, including services to roamers, using a blended rate within each cellular geographic service area (CGSA).

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

15. Questions 12,13 and 14 implicitly assume that the same rules apply to services provided to a company's own subscribers and to roamers from another company. Each of these options could be modified by separately sourcing roaming charges.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

16. In situations involving roamer charges, the serving carrier collects and remits sales tax.

___ Good tax policy
___ Neutral tax policy
___ Bad tax policy

17. Please list any other cellular options not mentioned above that you feel should be considered in the study.

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General Questions

18. Rank the following eleven tax options from 1 to 11 with 1 being the most important option and 11 being the least important option.

___ Repeal Section 184
___ Amend Article 9 to fix specific problems
___ Lower the tax rate on Sections 186-a & 186-e
___ Provide specific new exemptions in Section 186-e
___ Move all companies to a net income tax
___ Reduce or eliminate local taxes and fees
___ Provide a production exemption under the sales tax
___ Unify all telecommunications taxes instead of many separate taxes each with their own rules
___ Address issues associated with mobile telecommunications
___ Do nothing
___ Other(please specify in your answer to question 19 below)

19. Please provide any additional comments or suggested policy options you feel the Department should consider in the study.

Table 1: Respondents to Telecommunications Survey*

Type of Organization	Number of Responses
State Government	3
Cable Television	3
Combined IXCs and LECs	2
Mobile Communications	1
IXC and Mobile	1
IXC, LEC, and Mobile	1
LEC and CAP	1
IXC Only	1
LEC Only	1
Other	6
Total	20

*Categories reflect respondents that indicated they represent more than one type of organization.

Table 2: Telecommunications Survey: Summary for Panel Members and Interested Parties

		Total	Good Tax Policy	Neutral Tax Policy	Bad Tax Policy	Other
CORPORATE TAX QUESTIONS						
1.	Tax all companies providing telecommunication services under a net income tax rather than a gross receipts tax.	20	9	4	5	2
2.	Movement to a net income tax could create a large revenue impact. In that event, it may require a transition period where the Section 186-e excise tax on telecommunication services is retained and reduced to achieve a desired revenue target.	20	9	6	3	2
3.	Reform Article 9 by repealing the Section 184 additional franchise tax on companies principally engaged in a local telephone business, by replacing the Section 186-e excise tax on nontelecommunications income for companies regulated by the Public Service Commission with a net income tax on that income, and by reducing the rate on Section 186-e receipts to achieve a desired revenue target. This could include refinements to the definition of telecommunication services, if desired.	20	9	2	7	2
4.	Same question as #3 except instead of reducing the Section 186-e rate (or in conjunction with a rate reduction), provide exemptions from the 186-e tax for specific services such as private lines, WATS lines, etc.	20	3	7	8	2
5.	Other	20	0	0	0	20
SALES TAX QUESTIONS						
6.	Modernize the statutory language by replacing current terms such as “station apparatus” or “central office switching equipment” with a list of the similar equipment used today.	20	6	7	7	0
7.	Replace the current exemption, which focuses on specific types of equipment, with a broader, more generic, function-based exemption such as “tangible personal property used to produce telecommunication transmission for sale.”	20	13	1	6	0
8.	Same question as #7 except limit the exemption to property principally used for providing taxable telecommunications services.	20	3	6	11	0
9.	Replace the current exemption, which focuses on the equipment used to “switch” telephone calls, with a broader exemption encompassing the tangible personal property and utility services used in all aspects of telephone production and transmission.	20	16	3	1	0
10.	Other	20	0	0	0	20
MOBILE TELECOMMUNICATIONS QUESTIONS						
11.	Conform the determination of the local sales tax rate to the Section 186-e concept of service address, where service address refers to location of primary use of telecommunication equipment as defined by the telephone number, authorization code or billing address. The service address for subscribers traveling outside their service area (i.e., roamers) is the location of the mobile telephone switching office or similar facility.	20	6	6	3	5
12.	Compute the sales tax on all intrastate services, including roaming, at the subscriber’s location of primary use (normally the billing address).	20	9	3	5	3
13.	Compute the sales tax on all intrastate services, including services to roamers, using a uniform statewide blended rate regardless of the rate in any particular jurisdiction.	20	7	6	4	3
14.	Compute the sales tax on all intrastate services, including services to roamers, using a blended rate within each cellular geographic service area (CGSA).	20	2	9	6	3
15.	Questions 12,13 and 14 implicitly assume that the same rules apply to services provided to a company’s own subscribers and to roamers from another company. Each of these options could be modified by separately sourcing roaming charges.	20	2	4	10	4
16.	In situations involving roamer charges, the serving carrier collects and remits sales tax.	20	10	3	4	3
17.	Other	20	0	0	0	20

Table 2: Telecommunications Survey: Summary for Panel Members and Interested Parties (Con't)

GENERAL QUESTIONS

18. Rank the following eleven tax options from 1 to 11 with 1 being the most important option and 11 being the least important option.

	Total	Avg.	Rank
___ Repeal Section 184	103.5	5.2	4
___ Amend Article 9 to fix specific problems	115.5	5.8	7
___ Lower the tax rate on Sections 186-a & 186-e	117.5	5.9	8
___ Provide specific new exemptions in Section 186-e	144.0	7.2	9
___ Move all companies to a net income tax	112.5	5.6	5
___ Reduce or eliminate local taxes and fees	73.5	3.7	1
___ Provide a production exempt. under the sales tax	94.5	4.7	2
___ Unify all telecommunications taxes instead	103.0	5.2	3
___ Address issues associated with mobile telecommunication	114.5	5.7	6
___ Do nothing	164.0	8.2	10
___ Other	177.5	8.9	11

Appendix E: Technical Appendix for Corporate Tax Issues

Should policy makers decide to move telecommunications companies to a franchise tax based on net income under Article 9-A, a number of technical transition issues would need resolution. Some of these issues include the proper treatment of various deductions such as depreciation and net operating losses.

This appendix does not provide a complete analysis of all of the possible options, or all of the ramifications of the options. Instead it is intended to initiate a discussion of some of the transition issues that would surround a change from a gross receipts tax to a net income based tax. Discussions with industry are imperative to completely understand their asset profiles, and profitability, in order to formulate transition rules that comport with their individual situations.

Issues

When moving from a gross receipts tax to a net income tax, deductions spread over a period of years raise a number of issues. Depreciation and net operating loss deductions (NOLD) represent two important timing deductions. The main issue concerns the proper point in the deduction cycle to use for an initial period under the net income tax. General options include:

- conformity to the federal cycle;
- conformity to generally accepted accounting principles; or
- conformity to where a company would be in the depreciation schedule under state tax rules, as if they were always under a net income tax.

Each option presents decidedly different impacts.

Depreciation

The treatment of depreciation expenses differs between book accounting and tax accounting. Companies depreciate property for federal tax purposes using Modified Acceleration Recovery System (MACRS) (or

ACRS if the property was placed in service prior to 1987.) Companies use generally accepted accounting principles to depreciate property for book purposes. Finally, New York depreciation deductions follow the federal depreciation, for the most part. However, for New York property placed in service between 1982 and 1984, the state did not conform to the federal ACRS, and for non-New York property, New York did not conform to the federal ACRS or MACRS depreciation from 1982 through 1993.[1]

Therefore, in determining the depreciation schedule to use, there are three different possible schedules. One option for calculating the depreciation deduction for companies moving from Article 9 to Article 9-A, is to conform with their federal depreciation deduction. Companies would simply begin the depreciation of their assets wherever they were on their federal depreciation schedule.

A second option would require companies to determine their New York depreciation schedule for each asset (accounting for the differences between New York and federal schedules depending on when the asset was placed in service). They would then depreciate according to where an asset was on the New York depreciation schedule. A modified approach would be for the taxpayer to use a look-back period for those assets placed in service within a past number of years. To the extent that New York has been in complete conformity with the federal depreciation rules since 1994, this would have a small additional impact.

A third option would be to establish a transition asset. This asset would include all of the current depreciable assets, that are not fully depreciated for book purposes (some of them may be fully depreciated for federal income tax purposes). These assets would then be depreciated according to their book depreciation schedule for Article 9-A calculations. All assets acquired subsequent to the move from Article 9 to Article 9-A would be depreciated according to normal Article 9-A rules.

Net Operating Losses (NOLs)

The treatment of accumulated net operating losses for purposes of Article 9-A represents another transition issue. Companies filing federal income tax returns may have carried over net operating losses from prior years into current year returns. Normally under Article 9-A, for a new company entering New York, NOLs accrued while a taxpayer was not an Article 9-A filer are not deductible on subsequent Article 9-A returns. This occurs because the activities which gave rise to the NOL were not conducted in New York State. However, in cases where telecommunications companies have NOLs, these may have been produced by New York State activities.

Numerous options also exist for the treatment of net operating losses and deductions for those losses in the transition from a gross receipts tax to a net income tax. One option is to disallow any deduction for net operating losses from years prior to filing as a 9-A taxpayer, but to allow net operating loss deductions (NOLDs) for any operating losses accrued after the taxpayer became an Article 9-A filer.

A second option for dealing with NOLs would be to allow companies to use all of their federally accrued NOLs for any period in which they were a New York taxpayer, regardless of which article of tax they were subject to during the accrual period.

A third option would be to construct an "as if" New York State NOL for a three year look-back period. This option would allow the accrual of net operating losses for those three years to be used on subsequent New York State tax returns.

Analysis of Options

If telecommunications companies pay their franchise tax under Article 9-A instead of Article 9, there exist various options for dealing with these technical transition issues. Each has advantages and disadvantages. Maintaining federal conformity would provide ease of administration and compliance for the taxpayer. Companies would not be required to separately trace assets. Requiring companies to recreate the depreciation schedule for each asset according to Article 9-A rules could create a substantial burden for taxpayers. In addition, if the assets of telecommunications companies are relatively new, the depreciation schedule for these assets would not substantially differ from the federal schedule.

In either of the above methods, however, companies may be required to establish a state tax deferral account for their financial statements. Booking such an account may make their financial statement appear less profitable. Although establishing transition assets would not require an upfront booking of a tax deferral account as a result of depreciation, it would impose an administrative burden for taxpayers.[2] They would be required to separately trace the transition assets, and the basis of those assets would have to be adjusted from the federal basis for purposes of state taxation.

The most important consideration for the treatment of NOLs pertains to the interaction of this treatment with whatever depreciation option is chosen. Because both depreciation and net operating losses are timing issues, their application interacts for purposes of computing tax. For example, if the option to allow all federally accumulated NOLS were chosen, and the transition asset option for depreciation purposes were chosen, then essentially, taxpayers could be depreciating the same property twice.

Conversely, if the option to allow only NOLs accumulated while the taxpayer was subject to Article 9-A were chosen in conjunction with the option to adopt a transition asset for purposes of depreciation, then in cases where the depreciation resulted in a larger New York NOLD than the federal NOLD, Article 9-A would limit the New York NOLD to the federal amount in any given year. In this case, the taxpayer would lose any advantage from the special depreciation rules.

Endnotes

1. In *R.J. Reynolds Tobacco Co. v. City of New York Department of Finance and Marc V. Shaw, Commissioner of the City of New York Department of Finance*, Index No. 118236/94 (12/18/95), the Supreme Court of the State of New York held that those sections of the New York City Administrative Code that disallow federal MACRS depreciation for non-New York sitused property are both unconstitutional and unenforceable. The City of New York Department of Finance is appealing this decision.

2. Over the long term, as companies acquire new assets, place them in service and use accelerated depreciation, they will have to book a State tax deferral account.