

The Taxation of Poles and Wires Owned by Telephone Companies

This report explains the history of the property tax exemption for telephone companies' poles and wires and the recent expansion in the amount of property exempted. This analysis also examines the current level of telephone companies' state and local taxes relative to their revenues; and, if the exemption were eliminated, the potential revenue growth for municipalities, the possibility that costs for consumers might rise, and the concern that investments in telephone infrastructure might diminish.

History of the Telephone Poles and Wires Exemption

Historically, Massachusetts law exempts corporations from the payment of personal property tax on all property except, "real estate, poles, underground conduits, wires and pipes, and machinery used in manufacture or in supplying or distributing water" (M.G.L.c. 59 § 5, Sixteenth, 1st paragraph).¹ In 1915, however, the Massachusetts legislature passed a law exempting telephone and telegraph companies from taxation on their poles, wires, and equipment located on public property or public rights-of-way (M.G.L.c. 59, § 18, Fifth). At the time, the legislation was designed to promote the further development of the state's fledgling telephone infrastructure.

Though telephone companies are classified, under Massachusetts law, as utilities, their poles and wires are tax-exempt, unlike those of other types of utilities (M.G.L.c. 63 § 52a). For example, if electric and telephone wires are carried on the same pole, the electric company pays taxes on their share of the pole's value while the telephone company's share is tax-exempt.

Because of the complexity of valuing property such as telephone infrastructure, and the possibility of inconsistent methods between communities, the Massachusetts Commissioner of Revenue annually determines the value of taxable telecommunications property in each of the state's municipalities (M.G.L.c. 59, § 39). Under the exemption, only telephone equipment that is underground or on private property is subject to taxation. The Commissioner's valuation is based on filings submitted by telephone companies in March of each year. The Department of Revenue, at present, only tracks the taxable portion of telecommunications' companies property.²

Why has the amount exempted grown?

In the last several years, as a result of rulings of the state's Appellate Tax Board (ATB) and Supreme Judicial Court (SJC), entities not historically considered telephone companies have been able to exempt larger portions of their personal property from municipal taxation under the telephone and telegraph exemption. One of the most recent rulings was delivered by the SJC in January 2005 in *RCN-Becocom v. Commissioner of Revenue*.³ Because RCN delivers cable television and internet service, the Town of

¹ Massachusetts also exempts manufacturing firms from the payment of personal property tax on their machinery used in manufacturing (M.G.L.c. 59, § 5, Sixteenth, 3rd paragraph).

² Because the Department of Revenue does not collect data on the exempt portion of telephone companies' property, it is difficult to reliably estimate how much revenue is lost as a result of the exemption.

³ *RCN-Becocom, LLC vs. Commission of Revenue & Board of Assessors of the City of Newton*, January 6, 2005, SJC-09197.

Newton brought the case, arguing that RCN is not a telephone company and is not eligible for the tax exemption.

The *RCN* case affirmed a prior decision of the Appellate Tax Board and led to significant declines in municipal revenues from personal property tax collections on telecommunications property. Interpreting the exemption in the context of new technologies, the SJC found that a company was eligible for an exemption on any property that carried even one phone call if the provision of telephone service was determined to be a substantial portion of the company's overall business.⁴ Under this ruling, companies providing bundled cable television or internet service, if they also provide services such as Voice over IP (VoIP) telephone service, became eligible for the telephone tax exemption on any of their eligible property that carried even one phone call. Therefore, companies providing bundled services, such as RCN, could avoid paying municipal property taxes on all poles, wires, and switching equipment on public property if that equipment carried one phone call during the year.

Because Massachusetts law specifically exempted only the property of businesses structured as Corporations, the Court further ruled that RCN, a Limited Liability Company (LLC), could not claim the exemption. While this would seem to limit the availability of the exemption, a number of telecommunications companies have, since the ruling, shifted the ownership of their property to entities structured as Corporations.

With more companies eligible to claim the telephone tax exemption on more of their property, municipal property tax revenues from telecommunications companies have declined over the last several years. In the case of RCN, the value of the company's taxable property fell by \$100 million or 50 percent between FY 2006 and FY 2007.

What amount of local revenue might be realized from ending the exemption?

If the telephone company exemption were repealed, Massachusetts' municipalities would realize significant new property tax revenues. The Massachusetts Association of Assessing Officers estimates

Counting Telecommunications Investment in Massachusetts

In understanding the economic contribution that businesses make to the Commonwealth, it is important to consider both the amount taken in and the amount spent in Massachusetts. In an opinion editorial published in the *Boston Globe*, Donna Cupelo, Regional President of Verizon in Massachusetts and Rhode Island, highlighted the fact that, "in 2006 Verizon alone poured over \$2 billion into the state's economy." While this reflects the amount spent in Massachusetts, Verizon took in \$2.4 billion in operating revenue in Massachusetts in 2006. Therefore, the \$2 billion that Verizon invested in Massachusetts appears to be \$400 million less than the residents and businesses of Massachusetts paid Verizon in the same year.

Cupelo also says that Verizon "generated" \$180 million in state and local taxes in 2006. According to the Federal Communications Commission, in 2006 Verizon paid \$25 million in state and local taxes in Massachusetts. The remainder of the \$180 million is likely the income taxes paid by Verizon's employees and the sales taxes paid by customers of Verizon's goods and services (again money coming from residents and other businesses in Massachusetts).⁵

⁴ The standard for a substantial share of a company's overall business activity is based on shares of financial returns, capital investment, employment, and total business activity involved in providing telephone service.

⁵ Cupelo, D.C. (2007). State tax loophole or smart policy? Opinion Editorial. *The Boston Globe*, April 10, 2007.

that elimination of the telephone company exemption would result in about \$78 million in new revenue for the state’s municipalities. In some communities the potential increase is estimated to be more than 2 percent of their current tax levy.

Because these revenues would be generated by property not previously taxed, they would be considered new growth and not subject to the limits of Proposition 2½. Communities would have a one-time opportunity to realize an increase in property tax revenues without an override. Municipalities also might opt to use additional revenues to lower the amount of property taxes paid by residents and other business.

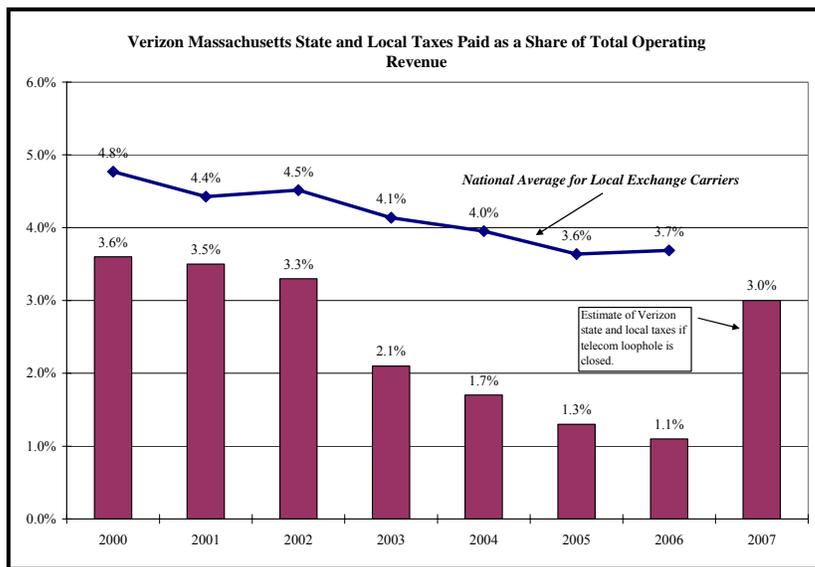
Consequences of Eliminating the Exemption

While municipalities stand to realize significant new revenues as a result of ending the exemption, a number of concerns have been raised about the economic impact of such a change. Telecom businesses have suggested that closing the loophole might lead to less capital investment in telecommunications and higher rates for consumers. Furthermore, there are concerns about the impact of higher taxes for telephone companies on overall economic activity in the state. Using publicly-available data from the Federal Communications Commission, we are able to examine these issues.⁶

What has been the trend in taxes paid by telephone companies in Massachusetts?

Telecommunications companies, responding to the Governor’s proposal to close the telephone tax loophole, have argued that they already pay sufficient state and local taxes in Massachusetts. Data from the Federal Communications Commission, however, indicates that the state and local taxes paid by the state’s principle local phone company, as a share of operating revenues, have declined over the last several years.

In 2000, Verizon’s total operating revenue in Massachusetts was \$2.9 billion and the company paid \$106 million, or 3.6 percent of operating revenue, in state and local taxes. This includes both local property taxes and the state’s corporate income tax. By 2006 Verizon was paying only 1.1 percent of total operating revenue in state and local taxes (\$25 million in taxes on total operating revenue of \$2.4 billion).⁷ The FCC’s data indicate that Verizon’s state and local taxes, as a share of total operating revenue, have fallen by 69 percent in six years.



⁶ In general, the data available from the Federal Communications Commission only includes information from a state’s primary local phone carriers (also called local exchange carriers). Verizon is the sole local exchange carrier in Massachusetts; therefore, much of the data in this portion of the report is based on Verizon of Massachusetts.

⁷ While Verizon’s net state and local tax bill in 2006 was \$25 million, the company paid no corporate income tax in Massachusetts in that year.

Comparing Verizon’s state and local taxes in Massachusetts to that of local phone companies in other states, it appears that phone companies in only five states in the nation pay a lower share of their revenue in state and local taxes. In 2006, local phone companies in 31 states paid 3 or more percent of their operating revenue in state and local taxes (compared to 1.1 percent in Massachusetts).

Nationally, in 2006, local phone companies on average paid 3.6 percent of their total operating revenue in state and local taxes. Based on a rough estimate of Verizon’s state and local tax liability if the telephone company loophole is closed, their state and local taxes as a share of operating revenue could rise to 3.0 percent for 2007.⁸ Therefore, even after closing the telephone company tax loophole, Massachusetts’ state and local taxes for telephone companies, as a share of total revenues, would likely remain below the national average.

Despite this data, the Massachusetts Network Communications Council (MNCC) reports that Massachusetts telecommunications companies already contribute substantially to the state and local tax base, contributing \$492 million in state and local taxes in 2006. This total, however, includes taxes that are not paid by the companies but by their employees and customers.

According to the MNCC’s numbers, shown at right, about \$289 million in tax revenues “paid” by the telecommunications industry are income taxes paid by companies’ employees and sales taxes paid by customers.⁹ These tax revenues are related to the telecommunication companies’ business activities, but they are not paid for by the companies. Therefore, nearly two-thirds of the taxes and fees that the industry claims to be paying are actually being paid by the state’s residents who either work for or purchase services from the telecommunications industry.

Massachusetts’ telephone companies pay a much smaller share of their total revenue in state and local taxes when compared to other states and the amount they presently pay is smaller than has been suggested.

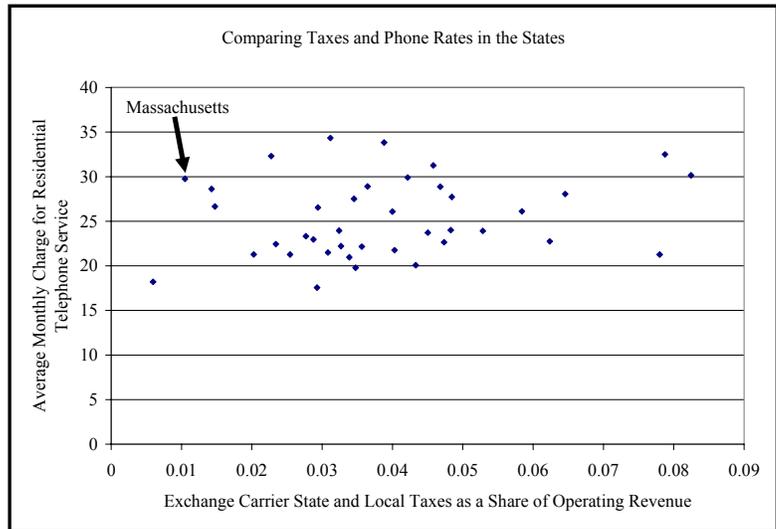
State and Local Taxes paid by Massachusetts Communications Industry, 2006		
(From materials of the Massachusetts Network Communications Council)		
	Total	Total Paid by Telecom Companies
2006 Local Taxes & Fees		
Personal property taxes	49,271,945	49,271,945
Franchise fees	56,574,535	56,574,535
Real estate taxes	18,006,480	18,006,480
Motor vehicle excise taxes	718,972	718,972
Sub-total	124,571,932	124,571,932
2006 State Taxes & Fees		
Customer sales taxes on services	221,000,000	0
State taxes (withholding paid by employees)	68,311,341	0
Sales/use taxes on equipment	34,641,935	34,641,935
Regulatory fees	43,198,112	43,198,112
Sub-total	367,151,388	77,840,047
Total 2006 Local and State Taxes & Fees	491,723,320	202,411,979

⁸ This is based on Verizon’s FY 2007 taxable property value of \$1.55 billion. At the suggestion of a local assessor, this is adjusted for the non-taxable portion of property by dividing by 0.45 and is then adjusted for new property by multiplying by 1.4. This yields an estimate of \$4.83 billion in taxable property. Applying a \$15 per \$1,000 of value tax rate we obtain an estimate of \$72.4 million in property taxes owed. Because Verizon has paid no Massachusetts corporate income tax in the last several years, this is a reasonable estimate of the company’s total state and local tax liability after the telecom exemption is eliminated.

⁹ This numbers are available at Verizon’s website: http://www22.verizon.com/about/community/ma/files/Taxes_paid_2006.pdf (as of June 19, 2007).

Will closing the loophole increase costs for consumers?

Even if closing the loophole does not dramatically increase telephone companies' tax bill, concern has been expressed that closing the loophole would increase costs for consumers of telecommunication services. Again comparing Massachusetts with other states, among the 39 states for which telephone rate data was available from the Federal Communications Commission, Massachusetts' local phone company had the next to lowest taxes as a share of



operating revenue and the eighth from highest average monthly residential rate for phone service. If state and local taxes were a significant driver of consumers' cost for phone service, one would expect states with high taxes as a share of revenue to have high rates for phone service.

Examining this last point further, among those 39 states with available data there is no statistically significant relationship between state and local taxes and average monthly rate for residential phone service.¹⁰ Based on this analysis, it would appear that state and local taxes paid by telephone companies is not a major factor in the determination of rates for local phone service; therefore, there is little reason to think that closing the telephone tax loophole *should* result in higher rates for consumers.

Will closing the loophole damage economic activity in the Commonwealth?

Finally, there is concern that closing the telephone tax loophole will reduce telecommunications investment in the state, thereby reducing overall economic activity. MNCC suggests that economic activity would be reduced by the amount of new property tax revenues, diverting investment "from highly productive communications infrastructure to much less productive spending." Property tax revenues in Massachusetts pay for services such as public safety and education, as well as infrastructure such as roads and sewers. This spending benefits all the residents and businesses of Massachusetts and numerous recent reports have suggested that under-investment in things like education and transportation is damaging to our state's business climate.¹¹ In the words of Massachusetts' Transportation Finance Commission, our transportation system, "is . . . vital for transporting goods and services. It provides the basic underpinning of our economy. . . . The Transportation Finance Commission has concluded that our system has been neglected for years, and that the system we take for granted will fail if we do not take

¹⁰ A simple linear regression of average monthly rate for residential phone service on state and local taxes as a share of operating revenue produces a regression model that is not statistically significant ($\alpha = 0.05$, $F = 1.406$, $p = 0.243$).

¹¹ For example please see: 1) Bluestone, B., Clayton-Matthews, A., & Soule, D. (2006). *Revenue Sharing and the Future of the Massachusetts Economy*. Boston, MA: Northeastern University, Center for Urban and Regional Policy. January. Or 2) Lynch, R.G., Schweke, W., Jenny, N.J., & Berger, N. (2007). *Building a Strong Economy: The Evidence on Combined Reporting, Public Investments, and Economic Growth*. Boston, MA: Massachusetts Budget and Policy Center.

prompt and decisive action.”¹² Given the strain municipalities are presently facing in providing the basic infrastructure necessary for business, it is not at all clear that tax loopholes for telephone companies would be the most productive use of resources.

Economic activity and growth is stimulated by business investment, but public infrastructure and services are necessary pre-conditions for that investment. Though Massachusetts telephone companies’ state and local tax liability is low compared to what is faced in a majority of states, it is possible that closing the telephone tax loophole will result in some loss of investment. However, providing the state’s municipalities with the resources necessary to improve investments in public infrastructure and services could result in greater economic activity and job growth across the entire economy.

Percent of Local Exchange Carriers' Total Operating Revenues paid in State and Local Taxes, 2006

State	Percent
1. RI	8.2%
2. NY	7.9%
3. DC	7.8%
4. KS	7.3%
5. MD	6.5%
6. AZ	6.2%
7. MT	5.8%
8. SC	5.3%
9. OK	5.2%
10. ME	4.8%
11. PA	4.8%
12. OR	4.7%
13. KY	4.7%
14. WV	4.6%
15. TX	4.5%
16. IA	4.3%
17. MS	4.2%
18. MO	4.0%
19. CO	4.0%
20. WI	3.9%
21. GA	3.6%
U.S. Avg.	3.6%
22. LA	3.6%
23. VT	3.5%
24. IN	3.5%
25. MI	3.5%
26. CT	3.4%
27. OH	3.3%
28. NM	3.2%
29. DE	3.2%
30. AK	3.1%
31. UT	3.1%
32. AL	2.9%
33. CA	2.9%
34. MN	2.9%
35. SD	2.9%
36. TN	2.8%
37. ND	2.7%
38. IL	2.5%
39. FL	2.3%
40. VA	2.3%
41. WA	2.0%
42. NC	1.5%
43. NE	1.4%
44. MA	1.1%
45. NV	1.0%
46. ID	0.9%
47. NJ	0.6%
48. WY	0.0%
49. NH	-0.1%

Note: Data was not available for Alaska or Hawaii.
 Source: Federal Communications Commission, ARMIS Database.

¹² Massachusetts Transportation Finance Commission. (2007). *Transportation Finance in Massachusetts: An Unsustainable System*. Boston, MA: Massachusetts Transportation Finance Commission. March 28, 2007.