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SFA BILL ANALYSIS

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Senate Bill 1238 (Substitute S-1)
Sponsor: Senator Joanne G. Emmons
Committee: Finance

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CONTENT

The bill would amend Public Act 282 of 1905, which provides for the assessment and taxation of the property of telephone, telegraph, and railroad companies, to provide that the property of telephone and telegraph companies would be assessed in the same manner as property assessed under the General Property Tax Act. The bill would apply to tax years beginning after December 31, 2002.

Under Public Act 282, each year the State Board of Assessors must determine the true cash value and taxable value of property having a situs in the State that is owned, operated, or conducted by the following types of companies: railroad, union station and depot, telegraph, telephone, sleeping car, express, car loaning, stock car, refrigerator car, and fast freight line. The Act prescribes the methods the Board must use to make its determinations of the property of the various entities. For telephone and telegraph companies, the Board must consider the number of miles of telephone and telegraph lines controlled or used by a company in the State, in proportion to the total number of miles controlled or used by the company in and outside the State. Under the bill, this would apply to tax years beginning before January 1, 2003.

For tax years beginning after December 31, 2002, the bill would require the Board to determine the true cash value and taxable value of telephone and telegraph company property that had situs in the State, in the same manner as property assessed under the General Property Tax Act. The bill specifies that, for these companies, "property having a situs in this state" would mean only the tangible real and personal property a company owned, used, and occupied within the State.

MCL 207.4 et al. Legislative Analyst: George Towne

FISCAL IMPACT

The bill would affect State revenues by an unknown and potentially significant amount. The magnitude of the bill's impact depends heavily upon certain factors that are unknown and largely not able to be forecasted, as well as the interpretation of the effect of the constitutional cap on increases in taxable value in the first year in which the bill would be effective. Factors significantly affecting the estimate include the rate at which taxpayers retire existing property or acquire new property, the depreciation tables used to compute the current value of property subject to tax, property values and/or the cost of property acquired in the future, the future income stream and value of stock shares for taxpayers, and the methods by which property would be valued under the bill.

To estimate the impact of the bill requires estimating the property tax assessments on telephone and telegraph companies under both the current system and the system proposed by the bill. However, because of the current assessment method, no depreciation tables exist to indicate how the property would be depreciated. Similarly, no accurate information exists on the future stock price or net income of taxpayers affected by the bill.

Furthermore, the assessments under either method depend upon the rate at which taxpayers acquire or dispose of property and whether the bill is interpreted to disallow evaluation under a "unit value" or "going concern" method. In many other states where intangible telecommunication property must be excluded from the tax base, assessors have been permitted to examine the effect of intangibles on tangible or real property when assessing the value of that property, and frequently allowed to continue to use unit valuation. This fiscal impact assumes that the State Board of Assessors would shift to a cost-plus-depreciation approach, and would not include the indirect effect of intangibles when determining the value of property taxed under the bill.

The only data available to estimate the impact are from the Federal Communications Commission (FCC) and reflect the largest telecommunications provider in Michigan. According to these data, that provider represents approximately 68% of the telecommunications activity in Michigan. The fiscal impact assumes that the bill's effect on that provider would be the same on all telecommunications providers affected by the bill. However, information from some of those firms with a smaller presence in Michigan indicates that they expect the bill to have different effects. No data are available at this time to estimate those different effects.

The impact of the bill depends significantly upon the assumption of how much investment taxpayers make in new plant and equipment. If between FY 2001-02 and FY 2003-04 taxpayers acquired property at the rate reported in Securities and Exchange Commission (SEC) filings through the first six months of 2002, the bill would increase revenues by $11.3 million in FY 2002-03 and by $6.2 million in FY 2003-04. If average historical rates of property acquisition and retirement are used, the bill would increase revenues by $20.1 million in FY 2002-03 and $24.0 million in FY 2003-04. The reported telecommunications overbuilding of the last few years, a sluggish economy, low stock prices, and the WorldCom bankruptcy suggest that the average rates of property growth are too high and that even the rates reported in the SEC filings may be excessive. If total property falls, as occurred in 1991, when the largest telecommunications provider in Michigan reported a 2.3% decline in total plant in service and 2.1% decline in total plant, the bill could reduce revenues, even under this analytical approach.

The analysis is very sensitive to the vintages of equipment that is retired. The preceding analysis assumes that all retirements come from the oldest property. However, the growth and retirement rates computed from the FCC data are not based on this assumption. If retired property is prorated across all vintages, consistent with the FCC data, then the bill would reduce revenues by $5.5 million in FY 2002-03 and $13.1 million in FY 2003-04 using rates consistent with the data reported in the SEC filings. As a result, simply varying the vintage of property retired from service can cause the fiscal impact of the bill to vary by $19.3 million in FY 2003-04.

The estimates above assume that the constitutional cap on increases in taxable value between one year and the next is evaluated using the same assessment methodology in both years. If the cap is applied based on the actual methodologies used and only involves assessing the type of property that may be taxed under the bill, then the bill could cause revenues to fall by an unknown and significant amount. Based upon publicly available data, the revenue loss could be between $15 million and $45 million if the taxable value cap is treated this way.

The tax credit created in Public Act 50 of 2002, regarding the deployment of broadband equipment, would not be affected by this bill. Any credits under that legislation would be applied after the effects of this bill. Public Act 50 of 2002 was estimated to reduce revenues by $27.0 million or more in FY 2003-04. That $27.0 million reduction would be from whatever levels revenues would be after the bill was enacted. Consequently, if revenues under the bill were to increase by $6.2 million in FY 2003-04, revenues from the tax still would decline by approximately $20.8 million because of the broadband credit. Similarly, if revenues were to decline under the bill by $13.1 million, the combined effect would be to reduce revenues by $40.1 million.

The literature regarding other state's experiences with the issue of removing intangibles from the tax base suggests that the bill's impact would likely be negative, even without the assumption of a poor economic climate and low rates of property replacement and acquisition. A similar change in Oregon was estimated to reduce revenues by approximately $10 million per year, although the change affected more than just telecommunications companies. Other states, where the prior method of taxing telecommunications firms may have differed from Michigan's current method, also have shown revenue reductions. For example, removing intangibles from Utah's property tax system (which affected all public utilities, not just telecommunications firms), was estimated to reduce revenues by between $45 million and $90 million per year.

No systematic reason appears in the data as to why Michigan's experience should differ from that of other states, nor do the data suggest that there is some fundamental difference in the telecommunication firms in Michigan that would result in a different fiscal impact. As a result, the fiscal impact may be incorrect, most likely because of inadequate data or because of incorrect assumptions in the analysis.

This fiscal impact is preliminary and will be revised as additional information becomes available.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.