



DEPARTMENT OF AUDITS AND ACCOUNTS

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September 12, 2018

Honorable Jay Powell
Chairman, House Ways and Means
133 Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill (LC 34 5447)

Dear Chairman Powell:

The bill would revise the taxation of communication services in Georgia. It would eliminate state and local sales and use taxes and franchise taxes on most communication services, establish a 2 percent state tax and 2 percent local tax on telecommunications and cable services, establish a 4 percent state tax on direct broadcast satellite services, establish a 2 percent state and 2 percent local tax on specified digital goods and services, and make prepaid calling services subject to state and local sales taxes. These provisions would apply to sales on or after January 1, 2020. Finally, the bill would provide a state and local sales tax exemption for broadband equipment purchased and used by communication services providers between July 1, 2019 and December 31, 2021.¹

Impact on State Revenue

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would increase state revenue by \$89.5 million in FY 2021 (**Table 1** on the following page), the first full year that the new tax would be collected and current taxes would be repealed. The increase would grow to \$239.4 million in FY 2024. FRC estimated that local revenue would be reduced by \$41.1 million in FY 2021 but would be higher than current law by \$70.8 million in FY 2024. For both state and local governments, the revenue changes in FY 2020-2022 would be higher but are reduced by the temporary broadband equipment sales tax exemption. The attached appendix details the analysis.

While the bill includes a July 1, 2018 effective date for the broadband equipment sales tax exemption, the analysis assumes an effective date of July 1, 2019. The analysis assumes that the sunset date is correct as drafted, December 31, 2021.

¹ LC 34 5447 shows the effective date for the broadband equipment exemptions as July 1, 2018. This fiscal note assumes that the beginning date would be changed to July 1, 2019.

Table 1. Summary of Revenue Effects of LC 34 5447¹

(\$ millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Communications Service Tax					
Telecom CST					
State	\$113.0	\$227.0	\$228.7	\$230.8	\$233.2
Local	\$80.2	\$161.1	\$162.3	\$163.7	\$165.4
Digital Products CST					
State	26.3	56.0	59.6	63.9	69.7
Local	26.3	56.0	59.6	63.9	69.7
Total CST Revenue					
State	\$139.3	\$282.9	\$288.4	\$294.7	\$302.9
Local	\$106.6	\$217.1	\$221.9	\$227.6	\$235.1
Current Law Sales and Franchise Taxes Repealed					
State	(46.9)	(94.9)	(96.2)	(97.7)	(99.3)
Local	(88.6)	(180.6)	(184.3)	(188.4)	(192.5)
Prepaid Services Sales Tax					
State	16.8	33.8	34.4	35.1	35.8
Local	13.2	26.6	27.1	27.6	28.2
Net Change in Taxes on Communication Services					
State	\$109.2	\$221.8	\$226.6	\$232.1	\$239.4
Local	\$31.2	\$63.1	\$64.7	\$66.8	\$70.8
Broadband Equipment Exemption					
State	(131.0)	(132.3)	(66.5)	-	-
Local	(103.2)	(104.2)	(52.4)	-	-
Net Revenue Effects Including Temporary Exemption					
State	(\$21.85)	\$89.52	\$160.15	\$232.09	\$239.41
Local	(\$71.95)	(\$41.10)	\$12.30	\$66.84	\$70.80

1. Amounts may not sum due to rounding

Impact on State Expenditures

The Department of Revenue estimated that the bill would result in \$1.25 million in one-time costs and \$254,000 in ongoing, annual costs. The one-time costs are largely associated with changes to the IT system. The annual costs pay for two auditors and two revenue agents.

Sincerely,



Greg S. Griffin
State Auditor



Teresa A. MacCartney, Director
Office of Planning and Budget

Analysis by the Fiscal Research Center

Summary of Bill Provisions

LC 34 5447 modifies the current taxation of communications services. Under the proposed communications services tax (CST), the current state and local sales tax on local wireline and wireless telephone service and the current local franchise and public, education and government access (PEG) fees would be replaced by a uniform statewide tax on all communications services. The proposed state and local CST rates are as follows:

- 4 percent state rate on direct broadcast satellite services
- 2 percent state rate on communication services other than direct broadcast satellite
- 2 percent local rate on communication services other than direct broadcast satellite

There is no local rate applied to direct broadcast satellite services. Revenue from the new local CSTs would be allocated back to county and municipal governments first in an amount equal to their respective revenues in CY 2018 from the local taxes repealed by this act, with any additional CST revenues allocated to local governments based on population.

The tax base for the CST is the sale price paid for the retail purchase of communications services sourced in the state (sourcing rules are delineated in the proposed new Code Section 48-8-78 in this bill). Communications services, under the proposed law, include telecommunications services, video services, and digital goods or services, but specifically excludes internet access services. Digital goods or services, which are not currently taxed, are defined to include specified digital products and prewritten computer software delivered electronically to an end user. Specified digital products include the following (when delivered electronically):

Audio-visual works,
Audio works,
Books,
Artwork,

Photographs,
Periodicals,
Newspapers,
Magazines,

Video greeting cards,
Audio greeting cards, and
Video games.

Voice over internet protocol (VOIP), cable TV, and satellite TV services are included in the communications services tax base under the bill. Under current law, these services are not taxed in a consistent manner, with cable companies currently paying a franchise fee to local governments and satellite TV subject only to sales tax on equipment sales.

Internet access services, including communication services purchased as an input to the provision of internet access services, are specifically exempted from sales and use tax under the proposed paragraph (101) of Code Section 48-8-3. Note that internet access services are not currently taxable in Georgia, so this new exemption provision does not reduce state or local revenues relative to current law. Additionally, under the Internet Tax Freedom Act, the relevant provisions of which were made permanent by the Trade Facilitation and Trade Enforcement Act of 2015 (Pub.L. 114–125), state and local taxation of internet access services are preempted by federal law.

Another provision of the bill, proposed Code Section 48-17-3, caps the amount of CST collected from the sale of telecommunication services to call centers at \$12,500 of state and \$12,500 of local

CST per calendar year, and allows all centers wholly owned by the same person or entity to be treated as a single center.

Additional sales tax changes in the bill include creation of an exemption for broadband equipment purchased and used by communications services providers in Georgia, and the addition of prepaid telecommunication services, including prepaid calling and prepaid wireless calling services, to sales tax base.

Finally, LC 34 5447 provides for two types of holdbacks from the CST collected. First, communications services providers are allowed to retain up to 2 percent of total CST collected. Second, the state Department of Revenue is authorized to retain 1 percent of the CST remitted by the service providers to cover administrative costs associated with collection. This second amount is to be deposited into the general fund, so it does not reduce the amount of state CST revenues. However, because it applies to local CST collections as well, 1 percent of local CST collections are counted as state revenues for purposes of this note.

Current Law Revenue Analysis

Under current law, sales tax collections on wired and wireless telecom were about \$91.4 million for the state and \$70.4 million for local governments in CY 2017, down from \$98.0 and \$72.1 million the prior year. Under the proposed law, these services will no longer be subject to sales tax beginning January 1, 2020.

The amounts of forgone state sales tax revenues for FY 2020-24, assuming enactment of the proposed law, are projected from the CY 2017 base using IBISWorld forecasted industry revenue growth for CY 2018-23, assuming growth in 2024 continues at the rate for 2023, and converted to state fiscal years by averaging. Local revenue forecasts assume an average local tax rate of 3.15 percent, the population-weighted average as of Jan 1, 2018, according to the Tax Foundation.

Table 1A. Projected Sales Tax Revenues Subject to Repeal

(\$ millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Wired & Wireless Telecom:					
State	\$46.9	\$94.9	\$96.2	\$97.7	\$99.3
Local	\$37.0	\$74.8	\$75.7	\$76.9	\$78.2
Total	\$83.9	\$169.7	\$171.9	\$174.6	\$177.5

Local franchise fee collections from cable and telephone businesses in the state totaled \$93.1 million in FY 2016, according to data compiled by the University of Georgia Tax and Expenditure Data Center. Baseline projections for FY 2020-24 assume growth from FY 2016 levels at the rate of 2.6 percent annually. This rate is the average of the growth rates from FY 2011 through FY 2016 of total local franchise fees and county-only franchise fees, 92.5 percent of which was phone and cable TV franchise fees in 2016 (phone and cable franchise fees were only about 15 percent of city and consolidated governments' franchise fee revenues). The projected revenues subject to repeal are shown below in Table 2A, with FY 2020 reflecting the mid-FY effective date.

Table 2A. Projected Local Franchise Fee Revenues Subject to Repeal

(\$ millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Local Revenue Baseline	\$51.6	\$105.9	\$108.6	\$111.4	\$114.3

Communications Services Tax Revenue from Telecommunications Services

For purposes of estimating the CST base, IBISWorld forecast of national revenues for the relevant communications services industry sectors are first adjusted to remove service or product revenues that would not be subject to the CST and then the resulting net revenues are shared down to Georgia. The specific industry sectors, as identified by IBISWorld, the adjustments made, and the sharing-down methodology are as follows:

- Industry Sectors and Adjustments
 - Wired Telecommunications Carriers (51711c) – Internet access and carrier services are netted out assuming constant 51.0 percent and 13.3 percent shares of total revenues, respectively.
 - Wireless Telecommunications Carriers (51721) – Internet access services and sales to resellers are netted out assuming constant 37.7 percent and 17.1 percent shares of total revenues, respectively.
 - Cable Providers (51711a) – IBISWorld revenue estimates are for cable TV services only (cable-based telecom would be part of wired telecom or VoIP), so no adjustments are made.
 - Satellite TV Providers (51711b) – Also no adjustments.
 - Satellite Telecommunications Providers (51741) – Carrier and internet backbones services (at 32.1 percent) as well as internet access services and equipment sales (at 43.1 percent combined) are netted out.
 - VoIP Providers (51711e) – No adjustments.

Note that, where revenues are not adjusted for equipment or other tangible product sales, such sales were not among the revenue categories IBISWorld included in their estimates or were not material.

- Wireless sector revenues for prepaid wireless calling plans are subject to sales tax rather than the CST under the proposed law, and are thus deducted from the CST base.
 - Data from the Federal Communications Commission shows the share of prepaid-to-total wireless subscribers at approximately 23 percent as of 2016 while market research firm GSMA Intelligence puts the share at 22 percent as of the last quarter of 2017.
 - Limited data available from some of the larger carriers suggest that average revenue per user (ARPU) from prepaid subscribers tends to run around 83 percent or less of the postpaid average.
 - Combined, the prepaid share of subscribers and lower relative cost suggest that prepaid calling services account for about 19 percent of total wireless calling services revenue.
- Prepaid calling services in the wired sector consist of prepaid domestic and international calling cards sold by major carriers and resellers, which are also added to the sales tax base rather than the CST. Telecom Industry Association data on calling card sales from 2004-2013 (the latest data available) are projected forward to FY 2020-24 based on historical

trends, which show average declines in sales over the 20014-13 period of about 4.8 percent per year.

- Alternative methods considered for sharing revenues down to Georgia included the state’s share of U.S. population, the state’s share of GDP, or its share of personal consumption expenditures for the category of services (“other services” as reported by BEA) that includes telecom and cable/satellite TV services. These shares, respectively, were 3.20 percent (Census 2017 estimates), 2.88 percent (BEA 2017 estimates), and 3.41 percent (BEA 2016 estimates). As the population share was close to the middle of the range of options, that share was used.

Table 3A shows estimates of Georgia-sourced revenue for each sector that would be subject to the CST during FY 2020-24 before adjusting for the partial call center exemption.

Table 3A: Estimated Georgia Communications Services Revenues Subject to CST

(\$ billions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Wired Telecom	\$0.39	\$0.77	\$0.74	\$0.71	\$0.69
Wireless Telecom	\$2.08	\$4.20	\$4.29	\$4.39	\$4.49
Cable TV	\$1.70	\$3.40	\$3.39	\$3.37	\$3.36
Satellite TV	\$0.72	\$1.45	\$1.47	\$1.48	\$1.49
Satellite Telecom	\$0.03	\$0.06	\$0.06	\$0.07	\$0.07
VoIP	\$0.43	\$0.87	\$0.90	\$0.94	\$0.97
Less:					
Prepaid Calling (wired)	(\$0.03)	(\$0.05)	(\$0.05)	(\$0.05)	(\$0.04)
Prepaid Wireless Calling	(\$0.39)	(\$0.80)	(\$0.81)	(\$0.83)	(\$0.85)
Total Taxable Revenues	\$4.93	\$9.91	\$9.98	\$10.07	\$10.18

Sources: IBISWorld, U.S. Census Bureau, and FRC calculations

Projected gross tax from the proposed CST, based on projected industry revenues from Table 3A and applying the applicable state and local rates to each sector, are then adjusted as follows:

- The partial call center exemption is estimated to have only a marginal impact on CST revenues. Based on cost structure estimates from IBISWorld as well as a white paper from contact center consultants Strategic Contact, it is estimated that only large call centers (about 450 or more employees) can be expected to reach the level of telecom service purchases to benefit from the partial exemption, that is to exceed \$625,000 per year of otherwise-taxable spending. Census County Business Patterns data indicate that only 19 call center establishments in Georgia have 250 or more employees and only nine have 500 or more. Estimated telecom expenditures in excess of \$625,000 each for these centers amount to less than 0.1 percent of the estimated total CST base reported in Table 3A. Gross CST revenues are adjusted by this amount in each period.
- The 2 percent of collections provider holdback (a.k.a. vendor compensation) is deducted.
- Finally, to reflect the holdback for DOR administrative costs from local CST collections, this 1 percent holdback is deducted from local collections (after vendor compensation) and added to state revenues.

Table 4A shows the projected state and local CST collections, net of these adjustments, for FY 2020-24.

Table 4A: Net CST Revenues from Telecommunications

(\$ millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
State	\$113.0	\$227.0	\$228.7	\$230.8	\$233.2
Local	\$80.2	\$161.1	\$162.3	\$163.7	\$165.4

CST on Digital Products

Finally, LC 34 5447 applies the state and local communications services taxes, at rates of 2 percent, to digital goods and services, as defined to include prewritten software and specified digital products. The taxable base is the same as was proposed under previous legislation that was the subject of fiscal notes, including LC 43 0460 in the 2017 session.

Among the specified digital products (see above for list), no data are available for sales of electronically-delivered artwork, photographs, or greeting cards. For the other categories of digital products and for electronically-delivered prewritten software, data from IBISWorld, the U.S. Census Bureau, the Bureau of Economic Analysis (BEA), and other sources were relied upon in making revenue estimates. Data on digital goods purchased in Georgia were not separately available, so national data were used and scaled to Georgia based on the state's share of personal consumption expenditures on goods, 3.0 percent as of 2016.

The revenue estimates below assume that nexus issues that may have previously prevented the state from collecting sales tax on a portion of digital product sales, had they been taxable, are moot since the recent Supreme Court ruling in *Wayfair v. South Dakota*. Table 5A presents the estimated sales in Georgia of specified digital goods for which data are available and of prewritten software along with the estimated CST revenues derived from this base, projected by fiscal year and again reflecting the January 1, 2020, effective date.

Table 5A. Projected Georgia Digital Product Sales and CST Revenues

(\$ millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Apps/programs	\$34.0	\$78.3	\$90.0	\$103.5	\$119.1
Music	109.0	235.5	254.3	274.7	296.7
Video Games	247.7	554.8	621.4	696.0	779.5
E-Books	147.8	319.3	344.9	372.5	402.3
Periodicals	46.7	94.0	94.5	94.9	95.2
Movies & Videos	15.0	29.8	29.5	43.9	116.5
Software Publishing	716.0	1486.2	1547.4	1610.8	1676.6
Total	\$1,316.3	\$2,798.0	\$2,982.1	\$3,196.3	\$3,485.8
CST Revenues:					
State	\$26.3	\$56.0	\$59.6	\$63.9	\$69.7
Local	\$26.3	\$56.0	\$59.6	\$63.9	\$69.7

Sales Tax on Prepaid Calling Services

Table 6A presents the projected sales tax base and revenue from prepaid calling and prepaid wireless calling services for FY 2020-24, with the first year estimates reflecting the mid-FY effective date.

Table 6A. Prepaid Calling Services Base and Sales Tax Revenue Projections

(\$ millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Prepaid Services Taxable Base:					
Prepaid Calling (wired)	\$25.9	\$49.4	\$47.2	\$45.1	\$43.0
Prepaid Wireless Calling	394.2	796.4	813.2	831.9	852.1
Total Prepaid Services	\$420.0	\$845.8	\$860.4	\$877.0	\$895.2
Sales and Use Tax Revenue:					
State	\$16.8	\$33.8	\$34.4	\$35.1	\$35.8
Local	13.2	26.6	27.1	27.6	28.2
Total	\$30.0	\$60.5	\$61.5	\$62.7	\$64.0

Broadband Equipment Sales Tax Exemption

Drafting Note: The bill as drafted makes the broadband equipment exemption effective July 1, 2018. Per instructions from the Department of Audits, the effective date is assumed, for purposes of this note, to be July 1, 2019. The sunset date is assumed to be correct as written, December 31, 2021.

Broadband equipment is defined to include: purchases of communications equipment, machinery, supplies, software, and other equipment “capable of being used for or in connection with broadband services” by communications service providers. Given this broad definition, it is assumed that substantially all equipment purchases by communications services providers in the state would qualify for the exemption.

Data from the 2016 Annual Capital Expenditures Survey (US Census) were used to estimate annual equipment purchases by the relevant communications industries, including those listed above plus internet service providers. National estimates are shared down to Georgia based on the state’s share of employment for the industry (NAICS code 517 Telecommunications), 4.68 percent as of 2016. Growth in equipment purchases is assumed to follow growth in industry revenues, as projected by IBISWorld. Table 7A below presents estimates of eligible equipment purchases and current-law sales tax revenues for the periods during which the exemption would be available, July 1, 2019, through December 31, 2021.

Table 7A. Estimated Eligible Equipment Purchases and Current Law Revenue

(\$ millions)	FY 2020	FY 2021	FY 2022
Eligible Equipment Purchases	\$3,276	\$3,307	\$1,662
Current Law Sales Tax Revenue:			
State	\$131.0	\$132.3	\$66.5
Local	\$103.2	\$104.2	\$52.4