GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

Legislative Fiscal Note

BILL NUMBER: House Bill 2047 (Fourth Edition)

SHORT TITLE: Video Service Competition Act.

SPONSOR(S): Representatives Carney, Luebke, McComas, and Wainwright

FISCAL IMPACT

	Yes (X)	**No ( )**	**No Estimate Available ( )**		
	FY 2006-07	**FY 2007-08**	**FY 2008-09**	**FY 2009-10**	**FY 2010-11**
REVENUES:					
General Fund	**No Impact to General Fund**				
Local governments	Possible net gain up to $3.3 million; see Assumptions & Methodology				
EXPENDITURES:					
AG/Dept. of Justice					
Recurring	$0	$222,525	$222,525	$222,525	$222,525
Non-recurring	$0	$38,430	$0	$0	$0
POSITIONS					
AG/Dept. of Justice (cumulative):	0	3.0	3.0	3.0	3.0

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Revenue; Consumer Protection Division of the NC Office of the Attorney General; NC Secretary of State; NC Department of Revenue; e-NC Authority; local governments

EFFECTIVE DATE: January 1, 2007

BILL SUMMARY: The Consumer Choice in Cable and Uniform Taxation of Video Programming Services Act:

- Establishes a statewide video service franchising process;
- Makes changes to the regulatory treatment of existing local cable franchises;
- Eliminates local governments' authority to assess and collect cable franchise fees;
- Replaces local revenues from franchise fees with a new distribution of shared sales tax collections from telecommunications, cable service, and satellite television service;

- Removes the state tax credit for franchise fees paid to local governments;
- Provides for a proportional tax distribution to local governments based on previous revenues from cable, including franchise fees and per subscriber charges;
- Provides for public, educational, and governmental (PEG) channel funding via several mechanisms;
- Designates the North Carolina Secretary of State as the exclusive statewide video service franchising authority;
- Designates the Consumer Protection Division of the North Carolina Office of the Attorney General as the agency responsible for handling consumer complaints and creates reporting requirements for the Consumer Protection Division regarding the type and volume of complaints handled;
- Requires the Revenue Laws Study Committee to study the impact of this legislation and report finding to the 2008 session of the North Carolina General Assembly.

This bill does not raise taxes on cable service, telecommunications, or home satellite television services. All these services remain subject to the general shared sales tax rate of 7%. However, this bill significantly alters the calculation of the local share of shared sales tax and creates an entirely new distribution method for the local share of shared sales tax collections. The bill does four things that significantly alter the composition of the local share:

- Local governments will no longer be able to assess and collect cable franchise fees. This revenue will be replaced by the local distribution scheme set forth in the bill. Under this proposal, local governments will receive a portion of sales tax collections from cable service equal to 22.61%, an increased portion of the existing telecommunications sales tax, and a share of sales tax collections on satellite television service.
- The tax credit equal to the amount of franchise fees paid to local governments created in 2005 is eliminated.
- Local governments will effectively receive a larger portion of state sales tax collections on telecommunications. This new portion will be equal to 7.23% of total telecommunications sales tax collections, which is equivalent to 22.61% of total sales tax collections for telecommunications less the local share already received pursuant to G.S. 105-164.44F according to Fiscal Research estimates.
- Local governments will be granted a share of sales tax collections from home satellite television service equal to 2.5% of the 7% general sales tax, or approximately 37% of sales tax collections.

ASSUMPTIONS AND METHODOLOGY: Fiscal Research estimates that all North Carolina local governments will be effectively held harmless by this change. The sum of the local shares of these three industries (approximately $65.3 million) is estimated to exceed actual aggregate local collections of cable franchise fees and per subscriber charges by approximately $3.3 million.

Current Law and Estimated Tax Collections by Industry

During the 2005 session, cable service, telecommunications, and home satellite television service were brought under the general state sales tax rate of 7%.

The chart below shows estimated total sales tax collections for cable service, telecommunications, and home satellite television service for FY 2005-06. These amounts have been adjusted to reflect the 2005 rate changes. The municipal share amount shows the amount received or collected by local governments under current law.

Estimated Sales Tax Collections by Industry and State/Local Share under Current Law			
	2005-06 Adjusted		
	Net collections	State share	Local share*
Telecommunications sales tax	395,714,195	334,850,718	60,863,477
Cable service**	91,350,000	26,100,000	65,250,000
Satellite	43,220,000	43,220,000	N/A
Total, all industries	530,284,195	404,170,718	126,113,477

*Local share reflects 18.03% of total telecommunications sales tax less the "freeze deduction" as required in G.S. 105-164.44F
**Net collections for cable have been estimated from municipal share. The local share ($65.3 million) reflects estimated total cable revenues collected directly by local governments, not by the state.

- For telecommunications, the $60.9 million local share is the 18.03% of telecommunications sales tax less a "freeze distribution" created under G.S. 105-164.44F. <u>This portion of local share is not altered by this legislation.</u>
- For cable service, the local share shown ($65.3 million) is the estimated amount of cable revenues assessed and collected by local governments in 2005. Currently this money is collected directly by local governments, primarily in the form of cable franchise fees. Under federal law, local government units can assess a franchise fee of up to 5% on a locally negotiated definition of gross revenues. This is also the estimated amount of the cable tax credit.
- Sales tax collections from home satellite television service are not currently shared with local governments.

The following sections outline the change in calculation of the local share of cable, telecommunications, and satellite sales tax collections as well as the change in distribution to local governments as it pertains to each industry.

<u>Telecommunications</u>

In 2005, the tax on telecommunications was increased from 6.0% to the general sales tax rate of 7.0%. The change was effective Oct. 1, 2005. Under G.S. 105-164.44F local governments receive a per capita distribution of 18.03% of sales tax collections on telecommunications service less a "freeze deduction" of $2,620,948 on a quarterly basis. <u>This legislation does not alter this portion of the local government share of sales tax on telecommunications.</u> Under this bill, local governments will continue to receive a distribution of total sales tax collections on telecommunications pursuant to G.S. 105-164.44F, plus an additional share of collections equal to 7.23% of gross sales tax collections on telecommunications. This additional share of collections is estimated at $28.6 million based on 2005-06 estimated collections.

Cable Service

Effective January 1, 2006, the general sales tax rate of 7% was applied to cable service, which had previously only been taxed at the local level. Taxpayers also receive an approximate 5% credit against this tax for local cable franchise taxes paid,[1] which is removed by the bill.

At this time, collections data available for this tax expenditure are not sufficient to estimate the credit's actual cost, so this memo assumes an estimated $65.3 million for the cost of the cable tax credit.[2] However, survey research conducted by the Fiscal Research Division suggests that the actual amount of cable franchise fees and per subscriber charges collected by North Carolina local governments is approximately $62 million, which suggests that local governments may gain up to $3.3 million in new money from this legislation.

The local share of cable sales tax collections under the distribution established by this bill is estimated at $20.7 million based on 2005-06 estimated collections.

Satellite

The tax on home satellite television service was increased from 5.0% to 7.0% effective Oct. 1, 2005. Currently, all collections of this tax go to the General Fund. Under this legislation, 37% (or 2.5% of the 7.0% general sales tax rate) of satellite tax collections would be shared with local governments.

Based on early Department of Revenue data, satellite tax collections are exhibiting a rapid rate of growth, especially in relation to collections from cable service. This estimate for satellite uses a conservative annual growth rate of 8%.

Fiscal Research estimates that sales tax collections for satellite will be approximately $43.2 million for FY 2005-06. The 37% local share would be $16.0 million based on 2005-06 estimated collections.

Proposed Local Share of Sales Tax Collections by Industry

The chart below illustrates the local share of sales tax collections by industry. **This local share calculation is intended to hold local governments whole with the elimination of local franchise fees and to supply local governments with funds for PEG channel support.** The $65.3 million local share calculated through this distribution equals the estimated 2005 cable franchise fee revenues that would be foregone under this legislation.

[1] Federal law caps local franchise taxes at 5% of gross revenues, suggesting 2% of the 7% state sales tax goes to the state. Fiscal Research Division survey research suggests that not all North Carolina local governments with cable franchises assess franchise fees at the maximum 5% rate, and that the actual value of the tax credit may be somewhat less than 5% of cable's total sales tax liability.

[2] The cost of the cable tax credit was estimated at $65 million in the 2005 Tax Expenditure Report published by the North Carolina Department of Revenue

Proposed Local Share of Sales Tax Collections by Industry	
2005-06 Adjusted	
Industry	**Local share**
Telecommunications	28,607,502
Cable	20,654,235
Subtotal	***49,261,737***
Satellite	15,991,400
Total	**65,253,137**

Distribution of Sales Tax to Local Governments

Under this bill, the combined 7.23% of sales tax collections on telecommunications, 22.61% of state sales tax collections on cable service and 37% of sales tax collections on home satellite television service would be distributed to North Carolina local governments on a proportional basis. The proportionate share for each local government is calculated by dividing a local government's actual collections, including actual franchise fee collections and any per subscriber charges for PEG support, by the total of all local government cable revenues. The base amount of a county or city that imposed a cable franchise tax before July 1, 2006, is the amount of cable franchise tax and subscriber fee revenue the county or city certifies to the Secretary was imposed during the first six months of FY 2006-07 (July 1, 2006 through January 1, 2007). The purpose of this time period is to capture the effect of franchise fee rate increases enacted by local governments for the 2006-07 fiscal year. The bill also provides that counties or cities that did not impose a cable franchise fee before July 1, 2006, are entitled to a share equal to $2.00 times the most recent population estimate for the city or county in question. Fiscal Research estimates that sixty-five cities and two counties do not currently impose a franchise fee. The total population of those sixty-seven local governments is approximately 223,584, which at a $2.00 pro rata share creates a $447,168 addition into the distribution.[3]

In subsequent years, the proportionate share for each municipality will be recalculated to reflect per capita growth. The distribution would be effective January 1, 2007.

Based on available data, Fiscal Research believes that under this distribution scheme no municipality will receive less revenue than they would have received under the current system.

Public, Educational, and Governmental (PEG) Channel Support

This bill contains three mechanisms to provide financial support for public, educational, and governmental (PEG) channels. Local governments are required to certify revenues received from franchise fees and from per subscriber charges to the Department of Revenue. If a local government has been receiving per subscriber charges for PEG support, a portion of the revenue

[3] This change does not reduce the $2 million available for PEG funding via lump-sum payments and grants. It reduces the residual unreserved amount remaining after the subtraction of PEG lump-sum payments, the hold harmless local distribution, and the deposit into the PEG Grant Fund. The residual amount is the additional revenue that will be available for distribution directly to local governments.

that local government receives from the Department of Revenue via the distribution created in this bill equal to the amount of per subscriber fees collected must be used for PEG channel support.

In addition, the bill allows local governments that operate PEG channels providing local programming to collect $25,000 per channel, up to 3 channels, per year in the form of four quarterly installments of $6,250. These funds are to be deducted from the total local share of sales tax collections before the local distribution formula is applied. The bill caps the amount of annual PEG support to local governments at $2 million. Reliable data on the number of qualifying PEG channels in North Carolina is not available, but based on discussions with public programming interest groups, this memo assumes there are 36 PEG channels currently operating in North Carolina that would qualify for this funding. In total, the impact of this provision is estimated at $900,000 annually.

The bill also creates the PEG Grant Fund. Any funds not disbursed to local governments for PEG support ($25,000 per qualifying PEG channel), up to $2 million annually, are to be deposited in the PEG Grant Fund for the purpose of making grants to local governments to fund capital expenditures for PEG channels. The e-NC Authority is responsible for administering the fund and awarding grants subject to the following limitations:

- The size of a grant may not exceed $25,000
- The local government applicant must match the grant on a dollar-for-dollar basis
- The grant may only be used for capital expenditures necessary to provide PEG channels
- An applicant may only receive one grant per year

In addition, the e-NC Authority must publish an annual report on grants awarded. The report must list each grant recipient, the amount of the grant, and the purpose of the grant.

The chart below provides detail on the total amount of revenue set aside for PEG channel support pursuant to this legislation. **The per subscriber fee portion of these funds ($1,195,888) is included in the proportional distribution; therefore PEG funding does not utilize the entire $3.3 million possible gain to local governments.**

Total funds to local governments restricted for PEG support		
Per subscriber fees	$	1,195,888
PEG support funding ($25,000 per qualifying channel)	$	900,000
Grants from PEG Grant Fund	$	1,100,000
Total PEG funding	**$**	**3,195,888**

State Franchising Authority

The Secretary of State is named as the exclusive state franchising authority for cable service provided over a cable system. Applicants must file a notice of franchise with the Secretary and pay a filing fee equal to the filing fee for articles of incorporation, currently $125. A person who files a notice of franchise is required to begin providing service in the designated area within 120 days of filing. In addition, a person providing service must submit an annual service report on or before July 31 of each year and pay a $200 filing fee.

In lieu of earlier penalty provisions, a person who provides video service but fails to file a notice of franchise or a notice of service must forfeit all revenue received during the period of noncompliance. The forfeiture does not affect the liability of the service provider for sales tax. In the event of such forfeiture, the amount must be remitted to the Civil Penalty and Forfeiture Fund.

Based on the number of forms received by the Texas Utilities Commission since its establishment as franchising authority last fall, it is estimated that the Secretary of State may receive approximately 25-30 applications within the first six months of 2007. Although the impact on the Secretary of State will be minimal, costs incurred could be offset by the designation of fees for use by the Secretary of State.

Attorney General's Office/Consumer Protection Division

Section 1 designates the Consumer Protection Division (CPD) in the Attorney General's Office/Department of Justice (DOJ) as the State Agency to receive and respond to customer complaints regarding cable services. The Consumer Protection Division currently has 50 positions. To implement and carry out the new requirements, DOJ estimates that 15 new positions will be needed as shown in the table below. Because DOJ proposes to add the positions on June 1, 2006, the total estimated FY 2006-07 costs would be only $166,612. In FY 2007-08, the cost would increase to $892,844 for the full year.

DOJ Estimated Staffing Needs to Implement HB 2047

Grade	Position Classification	# Positions	$ Annual Salary
68	Consumer Protection Specialist	7	40,585
70	Consumer Protection Specialist Supv.	1	44.229
87	Attorney Supv. II	1	95.538
59	Office Assistant IV	3	28.375
65	Admin Assistant II	1	35.770
63	Admin Assistant I	2	33.049
	TOTAL	**15**	**$610,855**

The DOJ estimate is based upon the assumption that one additional consumer protection specialist position is required for every 270,000 cable consumers in the state. No explanation/justification was provided for the remaining positions. There is no further explanation of how DOJ derived the 270,000 figure. Thus, DOJ's estimate of staffing needs is not based upon a projection of additional complaints or other measurable workload increases that would be generated under the proposed bill. It is recommended that the Department use an alternative approach to estimate the number of positions needed, specifically one that attempts to project the increased number of consumer complaints that will be arise as a result of HB 2047.

Data from a national survey conducted by the NATOA indicates that in 2005, there were about 32,600 consumer complaints in jurisdictions representing a total of 7.4 million cable subscribers. This is equivalent to a "complaint rate" of 0.43 percent, or 1 complaint for every 30,000 subscribers. Using this factor, along with data on the number of cable subscribing households in

North Carolina, the Fiscal Research Division (FRD) projects that the Consumer Protection Division would receive up to 3,250 additional complaints in FY 2006-07 and up to 6,500 complaints annually in the following years as a result of HB 2047. The 3,250 estimate was calculated using the assumption that all current cable franchisees will choose to opt out of their local agreements and choose to provide services under the state contract in FY 2006-07. This is highly unlikely given that the bill does not become effective until January 1, 2007. A more probable projection is that CPD will receive about 260 new complaints in FY 2006-07, arising from 30 jurisdictions for which current franchise agreements have expired or will expire prior to June 30, 2007. Using the assumption that starting on July 1, 2007, all NC cable subscribers will receive services via a state-administered contract, and applying the 0.43 percent complaint rates, CPD would receive a projected 6,500 new complaints in FY 2007-08. However, this projection is highly unlikely, because many of the existing cable franchisees will choose to continue to provide services under agreements with local jurisdictions. In such situations, the cable service providers will continue to have the primary responsibility for handling consumer complaints under existing FCC requirements. The table below summarizes the assumptions discussed above:

ASSUMPTION	**FISCAL YEAR**	**PROJECTED # COMPLAINTS**
State-administered contract replaces all local franchise agreements by June 30, 2007.	2006-07	3,250
	2007-08	6,500
State-administered contract replaces all local franchise agreements that have or will expire by January 1, 2007.	2006-07	260
	2007-08	520
State-administered contract replaces 1) all local franchise agreements that have or will expire by January 1, 2007; **and** 2) all local agreements in all cities and counties with 25,000 or more residents.	2006-07	1,750
	2007-08	3,500

DOJ reports that in 2004 the Consumer Protection Division received about 17,000 written complaints and an estimated 75,000 telephone inquiries. Currently, each Consumer Protection Specialist handles an average of about 1,700 written and 7,500 telephone complaints for a total of 9,200 per year. Assuming the proposed bill generates 3,500 -6,500 additional complaints annually and the current productivity rate, CPD would need only one (1) additional specialist position. The survey results and other anecdotal data suggest that many of the new consumer complaints will require minimal handling by the CPD specialist. For example, many customer service complaints concern matters such as missed or late appointments; slow responses, poor attitudes, etc. Related to these were complaints about the cable companies' telephone customer service in which consumers were put on hold too long, got a busy signal, could not reach an actual person, etc. Other complaints are related to technical issues (outages, poor reception, equipment features) costs, or limited program options. In another example, DOJ submitted data showing that over 75 percent of the calls received by Charlotte's Office of Cable TV were from customers who had mistakenly called that office when they attempted to call the cable operator. For these types of complaints, the CPD specialists' primary function will be to forward the complaint to the cable companies for resolution and to follow up with the consumer to assure that the issue was resolved. These types of complaints will not involve complex analysis or information collection on the part of the CPD specialists. Many of these tasks will be handled via telephone, emails, and automated technology/processes that should 1) minimize the total time a specialist would spend on a complaint and 2) allow the specialists to process multiple complaints concurrently. For these reasons, one (1) additional Consumer Protection Specialist positions would be adequate to handle the expected workload increases generated from HB 2047.

FRD does not recommend any additional resources for DOJ in FY2006-07 because the projected CPD workload increase of 260 complaints, less than 1.0 percent, can be handled within the existing continuation budget. With only one more specialist position, there is no need for the additional supervisory and administrative positions proposed in the DOJ estimate. An Attorney III should be sufficient to provide legal support, rather than an Attorney III Supervisor. Eliminating 13 positions and substituting an Attorney III for the Attorney III Supervisor position will reduce the estimated annual staffing costs from $759,193 to $204,075, a decrease of $555,118. Adjusting the DOJ estimate to remove amounts for office space, equipment, supplies, computers, and other non-personal services line items associated with the 13 positions, will reduce costs by an additional $76,771. FRD estimates the fiscal impact of HB 2047 for DOJ in FY 2007-08 will be $260,955, including non-recurring start-up costs. In subsequent years, the cost would decrease to $222,525.

Section 17 of the bill acknowledges that, due to the nature of the changes proposed, it is difficult to project the potential impact of H 2047 on the Consumer Protection Division's workload. Therefore, the Attorney General is requested to monitor the number and type of cable service complaints to determine if additional staff is needed to implement the bill. Specifically, the report is to provide comparison data on the number and type of complaints received from cable customers in areas served by local franchise agreements versus those from customers in areas served under the state-issued franchise. In addition, the report is to include information on the methods employed to resolve customer complaints. The report is due to the Fiscal Research Division no later than April 1, 2007. The estimated fiscal impact of this section is negligible.

Section 18 requires the Consumer Protection Division to report to the Revenue Laws Study Committee on or before April 1 of each year, beginning April 2008, on the number and types of customer complaints and the different means of resolving the complaints. The estimated fiscal impact of this section is negligible.

Conclusion

The chart below contrasts current law with the proposed tax changes in this bill and illustrates how the total shared sales tax revenue to both the state and local governments is held the same.

Comparison of State and Local Share under Current and Proposed Law						
	(in millions)					
	Current law		Proposed		Change	
	State	Local	State	Local	State	Local
Telecommunications	334.8	60.9	306.2	89.5	(28.6)	28.6
Cable service	26.1	65.3	70.7	20.7	44.6	(44.6)
Satellite	43.2	-	27.2	16.0	(16.0)	16.0
Total	**404.1**	**126.2**	**404.1**	**126.2**	-	-

SOURCES OF DATA: North Carolina Department of Revenue, North Carolina Fiscal Research Division, North Carolina State Data Center, Federal Communications Commission, U.S. Census

Bureau, North Carolina Department of Justice, National Association of Telecommunications Officers and Advisors (NATOA)

TECHNICAL CONSIDERATIONS: None

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DATE: July 5, 2006

Official Fiscal Research Division Publication

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