

**STATE and LOCAL
REVISED FISCAL IMPACT**

(replaces fiscal note dated May 1, 2013)

Drafting Number: LLS 13-0409	Date: May 3, 2013
Prime Sponsor(s): Sen. Nicholson; Brophy	Bill Status: Senate Second Reading
Rep. McLachlan; Sonnenberg	Fiscal Analyst: Alex Schatz (303-866-4375)

TITLE: CONCERNING TELECOMMUNICATIONS.

Fiscal Impact Summary	FY 2013-2014	FY 2014-2015
State Revenue	Potential minimal reduction. See State Revenue section.	
General Funds		
Cash Funds		
Fixed Utilities Fund		
High Cost Support Mechanism	See State Expenditures section.	
State Expenditures		
General Fund		
Cash Funds		
High Cost Support Mechanism		
FTE Position Change		
Effective Date: Upon signature of the Governor, or upon becoming law without his signature.		
Appropriation Summary for FY 2013-2014: None required.		
Local Government Impact: See Local Government Impact section.		

The fiscal note is revised to reflect new information that results in a local government impact.

Summary of Legislation

This bill, as amended by the Senate State, Veterans, and Military Affairs Committee, exempts certain telecommunication services from regulation by the Public Utilities Commission (PUC). With certain limitations, the bill exempts from PUC regulation voice-over-internet-protocol service in competitive markets and internet-protocol-enabled service (collectively, "VoIP"), as well as competitive basic local exchange service in competitive markets. Under the bill, the PUC continues to have authority over wholesale interconnection obligations, dispute resolution between carriers, and compliance with federal regulations. The bill provides that the PUC has authority over certain limited aspects of the development and implementation of new technologies in 911 service.

In addition to modifying the scope of PUC telecommunication regulation, the High Cost Support Mechanism (HCSM) is modified to authorize the use of HCSM funding to build broadband networks in unserved and underserved areas of the state. HCSM funding is available for the purposes of broadband deployment to the extent that it is no longer necessary to support universal basic voice service. The PUC is authorized to continue HCSM surcharges at the rate in effect when the bill becomes effective.

Unserved and underserved areas of the state include rural areas, municipalities with a population of under 5,000 people, and major highway corridors in which significant geographic areas lack access to broadband service with download speeds of at least 4 megabits per second (Mbps) and uplink speeds of at least 1 Mbps (also known as the 4/1 Mbps standard).

Finally, the bill exempts from state sales taxation the provision of broadband service.

Background

Internet-based telecommunication services. Internet-protocol enabled services and VoIP are emerging telecommunication technologies that access the public switched telephone network from a broadband connection. Under current law, some, but not all, telecommunications providers with internet protocol and VoIP services operate according to certificates of public convenience and necessity granted by the PUC, have tariffs and rates set by the PUC, and make contributions to various telecommunications funds governed by the PUC. The fiscal note assumes that current certificates of public convenience and PUC surcharges and revenue involving VoIP providers are concentrated in urban areas with competitive telecommunications services.

Broadband service mapping. Based on previous efforts supported by federal funding, the Office of Information Technology (OIT) has map coverage of broadband access in the state categorized by 3 megabit per second (mbps) ranges. The OIT is also responsible for the state's digital trunked radio telecommunications infrastructure and is therefore in possession of mapping or other data related to broadband-capable components of this system. The OIT is currently engaged in a one-time statewide inventory of broadband service coverage. This broadband inventory project is funded by a federal grant and follows standards established by the National Telecommunications and Information Administration (NTIA). This mapping does not establish a boundary for 4/1 Mbps service.

PUC funds - Fixed Utilities Fund. Based on the Department of Revenue's calculation of the gross intrastate operating revenue of each public utility, the PUC receives in the Fixed Utilities Fund (FUF) an assessment to offset its costs of regulation. These assessments, known as the Fixed Utility Fee, are capped at a uniform rate of 0.2 percent of the gross operating revenue of each utility. In FY 2011-12, the Fixed Utilities Fund collected \$11.6 million in fees and assessments, of which \$1.8 million was paid by telecommunications providers.

PUC funds - High Cost Support Mechanism. The PUC also administers the High Cost Support Mechanism (HCSM), through which the PUC subsidizes telecommunications providers in high cost areas (typically rural areas) based on an assessment on all telecommunications providers. The HCSM is collected exclusively from telecommunication providers. Based on cash flow analysis and other economic factors, the PUC recently took action to reduce from 2.9 percent to 2.6 percent the surcharge on intrastate telecommunications services. Telecommunications providers pass on HCSM surcharges on ratepayers' phone bills. The HCSM collects and distributes approximately \$60 million from surcharges each year. Pending further PUC assessment, up to \$30 million of annual HCSM funds may no longer be necessary to support universal voice service.

Taxation of broadband services. Various statutes under current law prohibit state and local governments from assessing sales or use taxes on internet access services. However, under current law, telecommunications providers pay sales and use tax on equipment (e.g., lines, towers, switches) used to extend broadband service into unserved areas.

State Revenue

In FY 2013-14 and future fiscal years, the bill requires fee adjustments to maintain current levels of state revenue funding for PUC programs. Exempting some providers without changing operational costs of PUC programs will require an increase in fees paid by other regulated utilities. Beginning in FY 2015-16, the bill also reduces state sales taxes on the provision of broadband service.

Sales tax. The sales tax exemption for provision of broadband services in unserved areas may reduce state General Fund revenues minimally. Based on the bulk and location of materials involved with extension of broadband service into unserved areas, it is estimated that very few materials will be procured from retailers that collect sales taxes. The estimated minimal impact of this bill on state sales taxes depends on the interpretation of Section 6 of the bill, discussed in the Technical Notes section below.

Fee Impact on Public Utilities and Telecommunications Service Ratepayers. Section 2-2-322, C.R.S., requires legislative service agency review of measures which create or increase any fee collected by a state agency. Fee adjustments affecting the Fixed Utilities Fund and the High Cost Support Mechanism are described below.

Fixed Utilities Fund. Exempting VoIP telecommunication providers from PUC regulation will reduce revenue to the FUF by \$400,000, but because the PUC's costs are unchanged, this amount must be recovered through higher fees on telecommunications companies that remain subject to PUC assessments, as well as other public utilities (e.g., gas and electric providers; according to statistics compiled by the PUC there are 440 telecommunication providers, 5 natural gas utilities, and 2 electric utilities subject to PUC regulation).

Currently, the Fixed Utility Fee is periodically adjusted but remains at a level near the statutory cap. To the extent that the adjustment required by this bill is limited by the cap, the FUF will see a reduction in revenue. However, other changes in intrastate revenue from public utilities also could affect FUF revenue.

High Cost Support Mechanism. To replace the \$5 million reduction in annual HCSM surcharge collections resulting from the elimination of VoIP telecommunication providers from PUC regulation, the HCSM surcharge rate will be adjusted from 2.6 percent to 2.9 percent. Between 6 million and 7 million affected telecommunications service ratepayers contribute to the HCSM.

State Expenditures

The bill results in a minimal increase in the workload of state agencies in FY 2013-14. These agencies include the PUC, the OIT, and the Department of Revenue.

PUC. Following enactment of the bill, workload of the PUC increases to implement the bill. Specifically, in FY 2013-14, fees and rules affected by the bill will be modified. This temporary workload will be accomplished without requiring additional PUC meetings and will not require new appropriations. Due to the continued limited regulation of VoIP, the bill assumes that ongoing workload of the PUC is not significantly reduced by the bill.

Workload of the PUC will also increase to develop guidelines and criteria for HCSM awards supporting broadband deployment. Determination of areas of the state unserved and underserved by broadband service will not be complete until FY 2014-15. Following this determination, the PUC will review proposed broadband projects and redirect expenditures of up to \$30 million from the HCSM to broadband deployment.

Increased workload for broadband deployment under the bill is offset by reduced costs to administer support for universal voice service under the HCSM. As a result, no new appropriations will be required for the PUC to implement the bill.

Office of Information Technology. The bill does not directly assign OIT any responsibilities for implementation. However, OIT has completed several studies of broadband service and is generally responsible for broadband initiatives in the state. The fiscal note assumes that existing products of OIT will be available for the use of the PUC in determining the geographic extent of areas of the state underserved and unserved by broadband providers. To the extent that OIT is required to furnish additional data or analysis (e.g., the boundaries of 4/1 standard service), it may be necessary for OIT to seek additional resources in the annual budget process.

Department of Revenue. Broadband providers may apply for a tax refund if they believe sales or use tax was improperly charged. While the fiscal note assumes the tax exemption applies to few retail transactions, a small increase in tax processing workload is anticipated at the Department of Revenue (DOR) due to the possibility that retailers and providers fail to correctly apply or claim the exemption.

Local Government Impact

This bill has a minimal impact on local government revenue. Under current law, state sales tax exemptions located in Part 7 of Article 26, Title 39, Colorado Revised Statutes, are also applicable to local governments. Based on the limited amount of retail sales anticipated for telecommunications equipment, the bill reduces by a minimal amount sales tax revenue collected by cities, towns, certain counties, and certain special districts.

Technical Notes

Applicability of the tax exemption. Based on interpretation provided by the Office of Legislative Legal Services, the fiscal note assumes that sales taxes applicable to "the provision of broadband service" are taxes collected on the retail sale of telecommunications equipment to broadband providers. The bill does not include an exemption for use taxes, which are paid by providers following wholesale or interstate procurement of equipment. Due to the continued applicability of state and local use tax, most taxes paid by broadband providers to extend service into unserved areas are not exempt under the introduced bill.

Broadband funding allocation. The bill instructs that HCSM funding available for broadband projects will be allocated 75 percent to qualifying advanced service and broadband projects in years 1 through 6 of the broadband program, and 50 percent in years 7 through 12. As drafted, it is unclear if these provisions on page 9 of the introduced bill serve or guarantee or restrict HCSM funding for any particular purpose other than broadband projects in general.

Departments Contacted

Regulatory Agencies	Office of Information Technology	Revenue
Local Affairs	Office of State Planning and Budgeting	Law
Public Safety	Human Services	Counties
Sheriffs	Municipalities	Treasury