


City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 7, 2006

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER 

SUBJECT: BUDGET MEMO #83 : LEGISLATION PASSED BY THE 2006 GENERAL ASSEMBLY ON TELECOMMUNICATIONS TAXES AND CABLE TELEVISION FRANCHISES

The following information summarizes two pieces of legislation that were enacted by the 2006 General Assembly and will have an impact on City revenues in future years.

Telecommunications Taxes. After several years of study, HB 568, passed by the 2006 General Assembly, rewrote the State’s tax laws pertaining to communications services, broadly defined to cover any electronic transmission of voice, data, audio, video or any other information or signal, and including local and long distance telephone, wireless telephone, voice over internet telephone, cable television, satellite television, satellite radio, and pagers. Customers of each of these services will be required to pay a 5 percent communications sales tax on all their communications services. Each telephone line will also be assessed a 911 fee of 75 cents per month. Finally, cable companies will, for the first time, pay rights-of-way fees, as land line telephone companies already do.

Except for the 911 fee assessed on *wireless* telephones, all revenues from these new taxes and fees will be placed in a special state “Communications Sales and Use Tax Trust Fund.”¹ After paying the cost of the Virginia Relay Center (the Relay Center assists individuals with hearing or speech disabilities so that they can communicate via the telephone, and has a budget of approximately \$10-12 million annually) and the administrative costs incurred by the Department of Taxation, all other revenues will be distributed to localities monthly, using a formula that is based on the amount of revenue each locality received immediately prior to the passage of this

¹The 911 fee assessed on wireless telephones is deposited in the State’s Wireless E911 Fund, and used primarily to provide equipment needed by the industry and local governments to be able to identify the exact origin of a wireless 911 call.

legislation.² The State Auditor of Public Accounts reported to the 2006 General Assembly that Alexandria's revenues from these taxes and fees for FY 2005 totaled \$10,137,096. When the Auditor reports on Alexandria and other localities' FY 2006 revenues from communications taxes and fees, this number will likely show an increase of more than \$2 million, primarily as a result of the cell phone tax adopted by Council as part of last year's budget process. The City will then receive from the new Trust Fund an amount that equals the proportion of these taxes and revenues it received with respect to the total statewide tax and fee revenues.³

The new tax system goes into effect on January 1, 2007. Taxes that will be discontinued then are the local consumer utility taxes, certain gross receipts taxes, and cable franchise fees (although cable franchise fees will continue to be paid to a local government until the expiration of an existing franchise).

For the next fiscal year, the City will continue to receive consumer utility taxes, gross receipts taxes, and 911 fees (for land lines only) through early in calendar year 2007. Beginning in March 2007, the City will receive a monthly check from the Virginia Department of Taxation for its share of the new communications sales tax revenues that were remitted to the Department during the previous month.

In summary, while the system for taxing communications services will be changing over the next year, the City expects to be held relatively harmless in terms of the revenues it will receive.

Cable Television Franchises. Legislation was also passed in the 2006 Session that significantly revises the way television cable franchises will be negotiated and overseen by local governments.

Proponents of this legislation (HB 1404 and SB 706, identical bills) were seeking to encourage greater competition among cable television providers than currently exists in Virginia (there are few if any opportunities currently for customers to choose between competing cable companies). The legislation allows companies entering a locality with an existing cable franchise to offer their services without negotiating a locality-specific cable television franchise agreement if they already have a telephone franchise to use the locality's right-of-way. Instead, the new entity would offer services under what the legislation calls an "ordinance" cable franchise. An ordinance cable franchise is one governed solely by a local ordinance adopted under the provisions of this new law. We expect Verizon to request such a franchise from the City in the

²The State Auditor of Public Accounts has been directed to determine the amount of revenue each county, city, and town will receive during the current fiscal year, which ends June 30, 2006, using the tax rates in effect in the localities on January 1, 2006, for the following taxes and fees levied on telephone and cable television providers: the local consumer utility tax; the gross receipts tax in excess of .5 percent; the cable franchise fee; and 911 taxes and fees. The Auditor will then determine and report the locality's percentage share of the total statewide collections of these taxes and fees in FY 2006. Once the new telecommunications taxes are collected and deposited into the new state Communications Sales and Use Tax Trust Fund, the locality will receive the same percentage share of these new revenues as that identified in the Auditor's report.

³For example, in FY 2005, approximately \$426 million was collected statewide from these taxes and fees; Alexandria had received \$10.14 million, or 2.38 percent of the total. If the total increased to \$475 million for FY 2008, and Alexandria's share remained at 2.38 percent, Alexandria would receive 2.38 percent of \$475 million, or \$11.31 million.

next 12 months, unless federal national franchise legislation is approved by Congress.

An ordinance cable franchise, which is good for 15 years, must include the following:

- The new cable operator must provide the same number of public, educational, and governmental (PEG) access channels provided by any existing cable operator, with a minimum of 3 such channels. A locality can require all cable operators to provide additional PEG channels, up to a total of 7, if the existing PEG channels are “substantially utilized.”⁴
- The locality or its designee assumes responsibility for the management, operation, and programming of PEG channels.
- The new cable operator must pay a franchise fee equal to that paid by any existing cable operator, so long as the fee does not exceed 5% of gross revenues.
- The new cable operator must pay a PEG Capital Fee to support the capital costs of PEG channel facilities, including institutional networks. This fee cannot exceed that imposed on an existing cable operator to support PEG capital costs. If the existing cable operator has paid a capital grant or is providing in-kind equipment in lieu of such a capital grant, the locality must also impose an additional PEG Capital Grant Surcharge Fee on the new cable operator. This fee must equal the lower of (i) 1.5% of the new cable operator’s gross revenues; or (ii) the lowest amount of capital contribution paid or provided in-kind by the existing cable operator. Both the PEG Capital Fee and the PEG Capital Grant Surcharge Fee may only be collected for the remainder of the franchise term of any existing cable operator. After this, the locality may negotiate with all cable operators to set a new, recurring fee to cover capital costs of PEG facilities, including institutional networks. If the cable operators and the locality cannot agree on a fee, the locality may impose a fee, which cannot exceed the previously imposed PEG Capital Fee.
- A locality can require a cable operator to comply with the customer service requirements imposed, although these requirements will primarily be dictated by federal law.
- A locality can require cable operators to provide, without charge, within the area actually served by the cable operator, one cable service outlet activated for basic cable service to each local government building (including schools).
- Cable operators must make cable service available to all of the occupied residential dwelling units in the initial service area selected by the cable operator within 3 years after the franchise begins. Within 7 years, the cable operator must make service available to 65 percent of the residential dwelling units in the area of the locality in which the cable operator has its telephone facilities; and within 10 years, a locality can require a cable

⁴The law says that a channel is substantially utilized when 12 hours are programmed on that channel each day, and at least a third of the 12 hours of programming is non-repeat programming. Non-repeat programming includes the first three videocasts of a program. Alphanumeric scrolling can be counted as non-repeat programming on only one channel per system.

operator to make its services available to 80 percent of the residential dwelling units in the area of the locality in which the cable operator has its telephone facilities.

Once a locality has granted a negotiated (traditional) or ordinance franchise to a new cable operator, an existing cable operator (i.e., Comcast in Alexandria) can demand to come under the terms of the new operator's franchise. The existing operator cannot use this provision to reduce the geographic area which it serves.

As a result of this legislation, the City is likely to receive less revenue from Comcast once the current franchise expires (2009), or when an additional cable operator begins offering services in the City, whichever occurs first.

Under the current franchise, the City receives the following:

- The franchise fee, which produces \$1.2 million per year.
- Capital grants, which have been used primarily to support the City I-Net and PEG-related expenses. The City receives in excess of \$1 million annually from these grants.
- Unlimited free cable drops for all City agencies, including those in leased space.
- An I-Net to City facilities, using Comcast cable fiber.
- Operation of the PEG channels by Comcast at no expense to the City.
- PEG programming produced by Comcast (City Council, Planning Commission, BZA, School Board, and operation of the community channel), also at no cost to the City.
- Six free 30-minute cable productions annually.

Under the new legislation, the City will continue to receive revenues from the cable franchise fee (albeit, through the new Communications Sales and Use Tax Trust Fund), free cable drops to City agencies, and some funding to pay for PEG channels and the I-Net (although the funding may not be enough to fully cover these costs). Comcast will not be obligated to operate the PEG channels or produce PEG programming, nor will it be required to any other free cable productions.

If you would like to receive a copy of these two pieces of legislation (House Bill No. 568 (Taxation of Telecommunications Services) or House Bill No. 1404 (Regulation of Cable Television Systems), please contact Bernie Caton.