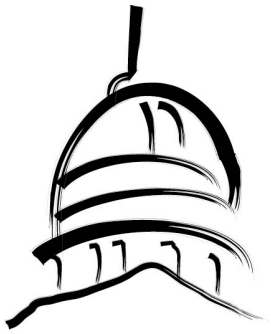
Taxation and Regulation of Public Utilities



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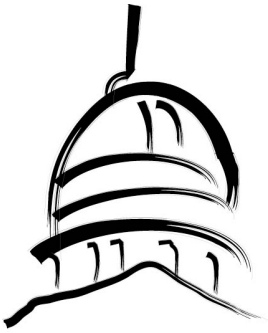

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Taxation and Regulation of Public Utilities

Introduction

This paper provides information on the taxation of regulated public utility corporations in Wisconsin. The focus is on the separate state taxation of utilities on the basis of gross receipts or property value (ad valorem), in lieu of local property taxation. In addition, information is provided on the utility sector generally, regulatory treatment, and other relevant tax provisions.

Several factors combine to make the economics and taxation of the public utility sector different than that of most other corporations. The public services provided are relatively exclusive in nature and the component industries are dominated by a relatively few, large corporations. One consequence of these characteristics is that each industry is subject to a regulatory system that, in turn, has significant implications for their tax treatment. In addition, rapid economic, technological, and regulatory changes, alterations in the energy use mix due to price changes and conservation efforts, and changes in company ownership or company structure all have major effects on the taxation of different types of utilities.

Over the years, significant changes have occurred in telecommunications. While the 1984 court-ordered break-up of AT&T was responsible for dramatic changes in the telecommunications sector, the decision can be characterized as a response to major changes that were already occurring. The general trend was, and continues to be, towards greater competition in offering telecommunications service and in the provision of telecommunications equipment.

Change has occurred in the electric industry as well. The federal Energy Policy Act of 1992 and subsequent orders by the Federal Energy Regulatory Commission paved the way for the development of a competitive interstate wholesale power market. A number of states have since taken steps to implement restructuring at wholesale and even retail levels. However, in the wake of the California energy crisis and concerns about the possible manipulation of power markets under deregulation, some state governments have reversed the trend toward less regulation and are moving, instead, toward greater control of their local utilities.

Amidst the uncertainty of the future structure of the industry, policy makers are concerned about the adequacy of investment in generation and transmission facilities. As the industry evolves, further legislative or administrative decisions at both the federal and state levels are possible regarding the classification of taxable revenues and the treatment of different types of utility companies. To the extent that the electric industry remains in flux, projections of utility company taxable revenues and resulting tax collections will contain an element of uncertainty.

State Utility Taxes

Historical Development

Public utilities in Wisconsin are subject to state taxation in lieu of local general property taxation.

The state tax takes one of two general forms, depending on the type of company: (a) an "ad valorem" tax based on the state-assessed value of company property, which is generally multiplied by the statewide average property tax rate; or (b) a tax or license fee based on a percentage of gross revenues or receipts of the company. The history of these tax provisions is varied for each type of company, but generally represents a movement from local to state assessment and taxation to take advantage of the state's greater ability to assess and tax utilities operating across municipal boundaries.

State ad valorem taxation began with the taxation of railroads in 1905; they had previously been subject to a local license fee based on gross earnings. Light, heat, and power companies connected to street railway companies came under state assessment in 1908; most other power companies were brought under the system in 1917. Beginning with the 1985 assessment, light, heat, and power companies were subject to a license fee based on gross revenues. Rural electric cooperatives were subject to local property taxation until 1939, when state gross revenues taxation was imposed. Most power companies that are located and operating in a single municipality are subject to local taxation. However, 1995 Wisconsin Act 27 (the 1995-97 biennial budget) included a provision that imposed the state gross revenues license fee for light, heat, and power companies on all qualified wholesale electric companies.

Conservation and regulation companies (owners of dams and reservoirs used for hydroelectric power generation) were brought under state ad valorem taxation in 1915. Commercial airlines became subject to state taxation in 1946. Gas and oil pipeline companies have been subject to state assessment and taxation since they began operating in Wisconsin in 1950.

Car line companies (lessors of passenger and freight railroad cars) were brought under state gross receipts taxation in 1931; they were previously subject to state property assessment. In 1990, the Department of Revenue (DOR) stopped administering the utility tax on car line companies on advice of the Attorney General, who indicated that the tax probably violated the federal Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act). The federal act contains a broad prohibition against taxes that discriminate against railroads. However, in a U.S. Supreme Court case (Department of Revenue of Oregon v. ACF Industries, Inc., January, 1994) the Court ruled that the state of Oregon did not violate the provisions of the federal 4R Act by imposing an ad valorem tax upon all railroad property while exempting various other, but not all, classes of industrial and commercial property. Subsequently, 1995 Wisconsin Act 237 was enacted, which imposed a 3% gross earnings utility tax on car line companies beginning with earnings generated in 1996.

Gross revenues license fees had been imposed on telephone companies starting in 1883. The initial graduated tax rates on total revenues were separated into toll and local exchange rates in 1931. Specialized common carriers (such as microwave telecommunications firms) were explicitly brought under this tax in 1981. In 1986, telegraph companies were shifted from ad valorem to gross revenues taxation as a telecommunications service. In addition, all other companies providing telecommunications services to the public (such as resellers) were made subject to the gross revenues license fee. Since 1998, however, all telephone companies are taxed on an ad valorem basis. Unlike the ad valorem tax imposed on other types of utilities, which is based on the statewide average property tax rate, the ad valorem tax on telephone companies is based on the prior year's net property tax rate of the local taxing jurisdiction. A description of the major tax-law changes related to the telecommunications industry from 1985 through 1995 is provided in the Appendix to this paper.

Table 1 summarizes the type of utility tax, the tax base, and the tax rate that currently apply to each type of Wisconsin utility company.

Table 1: Summary of Utility Tax by Type of Utility

Utilities Subject to Ad Valorem Taxes	Tax Base*	Tax Rate
Pipelines Municipal Electric Associations Conservation & Regulation Companies Railroad Companies Air Carrier Companies	Real Property, Tangible & Intangible Personal Property	Average Net Property Tax Rate in State
Telephone Companies	Real Property, Tangible Personal Property	Net Property Tax Rate in Jurisdiction Where Property is Located

*With the exception of telephone companies, utilities taxed on an ad valorem basis are generally assessed under a unit assessment process (under which the property is assessed at full market value if the property were sold as a unit). Telephone companies are assessed using methods used to assess manufacturing property, which do not require unit assessment. In the case of all ad valorem taxpayers, if a general structure is used for non-utility purposes, that portion of the structure is assessed locally.

Utilities Subject to Gross Revenues License Fee	Tax Base	Tax Rate
Car Line Companies	Gross Revenues	3.00%
Electric Cooperative Associations	Gross Revenues Less Certain Deductions	3.19**
Municipal Light, Heat and Power Companies	Gross Revenues from Outside the Municipality	3.19
Private Light, heat, and power Companies*		
Gas Revenues	Gross Revenues from Gas Sales	0.97
All Other Revenues	Gross Revenues from All Other Sales Less Certain Deductions	3.19**

*With certain exceptions, a private light, heat, and power company that is located entirely within a single town, village, or city is subject to local assessment and taxation.
**For gross revenues from 2004 through 2009, the tax rate on wholesale electricity sales is reduced to 1.59%.

Ad Valorem Group

Utilities subject to ad valorem taxation include municipal electric associations and the following types of companies: (a) pipeline; (b) conservation and regulation; (c) telephone; (d) railroad; and (e) airline.

Determination of Assessment. The ad valorem assessment is generally determined by deriving a unit value, equivalent to full market value if the utility were sold as a unit; allocating a portion of that value to Wisconsin where appropriate; and applying the statewide average property tax rate to the resulting value. State law excludes from ad valorem taxation the value of certain property that is also excludable from general property taxes: (a) certain motor vehicles; (b) treatment plant and pollution abatement equipment; and (c) computers. As provided under 2001 Wisconsin Act 16 (the 2001-03 biennial budget act), cash registers and fax machines are also exempt from both ad valorem and property taxes, effective with tax assessments as of January 1, 2003.

A fairly comprehensive valuation process is necessary to determine market value of the utility companies described above, since actual sales price

data do not generally exist. This process utilizes three distinct indicators of value--the cost, capitalized income, and stock and debt indicators--which attempt to take account of earning potential and are weighted differently according to the most appropriate indicator for a given type of utility.

In determining the cost indicator, the Department may consider four different types of costs: historical, original, reproduction, and replacement. To these costs, allowances are made for loss of value due to depreciation, functional and economic obsolescence, regulatory required write-offs, and utility plant acquisition adjustments. The capitalized income indicator is based on a company's operating income (before subtracting depreciation), capitalized at a rate based on market rates for equity, debt, and other factors. The premise behind this method is that the company is worth what it can earn--the purchase price of the company can be determined by estimating expected future earnings and a required rate of return for investors. However, determining the expected earnings and appropriate rate of return can be difficult and is the subject of some controversy. The third indicator, the stock and debt indicator, uses the market value of these two items and other current liabilities, which together are assumed to equal the market value of property and assets. As companies diversify or form conglomerates, the stock and debt method of valuation becomes more difficult. Other indicators are also considered, including company and independent appraisals, prior year assessments, shareholders reports, and, where available, comparable sales. Given these indicators, the Department uses its judgment to arrive at an estimate of fair market value.

As noted, telephone companies are subject to ad valorem taxation starting with taxes due for 1998. The Department of Revenue is required to assess telephone company property using the same methods the Department uses to assess manufacturing property. As a result, the value of intangible property is excluded from the company's value established by DOR. (Under the unit value methods of valuing property, used with other ad valorem taxpayers, the value of intangible property is generally included in the utility company's property value.) As with other utilities subject to ad valorem taxation, the value of certain motor vehicles, treatment plant and pollution abatement equipment, computers, and, effective with tax assessments as of January 1, 2003, cash registers and fax machines is specifically excluded from the company's property value.

In general, DOR uses a sales-based approach to assess manufacturing real property and the cost-based approach in assessing manufacturing personal property. The Department conducts a field review of the property once every five years. For real property, DOR makes annual adjustments to reflect the economic change in value and new construction. The method for determining the value of personal property is to establish the original cost of the equipment and multiply the cost by a conversion factor that adjusts the cost for the change in prices over time and for depreciation.

For companies subject to ad valorem taxation, if a structure is used in part for utility operations and in part for nonoperating purposes, the structure is generally assessed for taxation by the state at the percentage of its full market value that represents its operating purposes. The balance is subject to local assessment and taxation.

However, Act 16 modified this general approach for telephone companies. Under Act 16, the following approach applies for telephone companies having a structure used in part for operations and in part for nonoperating purposes, effective with tax assessments as of January 1, 2003: (a) if real or tangible personal property is used more than 50% (as determined by DOR) in its operation as a telephone company, then DOR assesses the property and the property is exempt from the general property tax; and (b) if real or tangible personal property is used less than 50% in the business's operation as a telephone company, then the property is assessed and taxed locally.

Payment of Tax. Ad valorem taxpayers make semiannual payments on May 10 and November 10. Under this payment schedule, the utility company must pay either 50% of its previous year's net utility tax liability or 40% of its estimated current year's liability on May 10. The utilities are notified of their tax liability for the current year on either August 10 (railroads and municipal electrics), October 1 (pipelines, airlines, and conservation and regulation companies) or November 1 (telecommunications companies). The remainder of the current year's assessment is due on November 10.

Utilities Subject to Ad Valorem Tax. The following section provides a description of the utilities subject to the ad valorem tax.

a. Pipeline Companies. A pipeline company is defined as any person that is not a light, heat, and power utility and that is engaged in the business of transporting or transmitting gas, gasoline, oils, motor fuels, or other fuels by means of pipelines. Of the group of utilities subject to ad valorem taxes prior to 1998, pipeline companies generated the most general fund utility taxes. However, revenue from the ad valorem tax on telephone companies now exceeds collections from pipeline companies. There were nine pipeline utility companies operating in Wisconsin in 2001. The largest carriers in Wisconsin, in terms of the allocated assessed value of their property, are the ANR Pipeline and Great Lakes Gas Transmission Companies, which transport natural gas, and Enbridge Energy (formerly Lakehead Pipe Line Company), which transports natural gas and oil products.

b. Conservation and Regulation Companies. A conservation and regulation utility is any person organized under the laws of the state for the conservation and regulation of the height and flow of water in public reservoirs in the state. This is done by impounding the rivers' headwaters into various reservoirs during times of heavy rainfall and then releasing the stored water during subsequent periods. These companies normalize river flow and the stored water is used for hydraulic power generation by various light, heat, and power companies. There are two such companies in Wisconsin, which have been established to conserve runoff waters in the Chippewa River and Wisconsin River watersheds: the Chippewa & Flambeau Improvement Company and the Wisconsin Valley Improvement Company.

c. Municipal Electric Associations. Under the state statutes, any combination of municipalities may contract to create a public corporation for the joint development of electric energy resources or for production, distribution, and transmission of electric power or energy, wholly or partially, for the benefit of the municipalities. Three municipal electric associations were subject to ad valorem utility taxes in 2001--Badger Power Marketing Authority of Wisconsin, Western Wisconsin Municipal Power Group, and Wisconsin Public Power, Inc.

d. Telephone Companies. A telephone company is any person that provides telecommunications services to another, including the resale of services provided by another telephone company. "Telecommunications services" means the transmission of voice, video, facsimile, or data messages. Telegraph messages are specifically included in this definition, while cable television, radio, one-way radio paging, and transmitting messages incidental to hotel occupancy are specifically excluded. A telephone company does not include a person who operates a private shared communications system and who is otherwise not a telephone company. As described above, the Department of Revenue is required to assess telephone company property using the same methods the Department uses to assess manufacturing property (which differs from how other utilities in the ad valorem group are assessed).

Prior to the imposition of the ad valorem tax on telephone companies with taxes due for 1998, telephone companies were subject to a 5.77% gross revenues license fee. As part of the shift to an ad

valorem tax, a transitional adjustment fee was imposed for 1999 and 2000 on licensed providers of commercial mobile services and companies that provide basic local exchange services. The fee was the difference between the taxpayer's ad valorem utility tax payment and the amount that the taxpayer would have paid if subject to a gross revenues tax of 5.77%. For telephone companies licensed to provide commercial mobile (wireless) services, the transitional adjustment fee applied only to the company's activities as a provider of such services. 1999 Wisconsin Act 9 provided that a credit could be taken against the transitional adjustment fee under certain circumstances.

In 2001, there were over 200 telephone companies with a Wisconsin public utility tax assessment. Some of these companies operate local exchanges. Others offer interstate service or intrastate service between local access and transport areas (LATAs). A third group consists of firms that resell long distance services. [Resellers purchase and resell bulk services from another telephone company; they own and operate switching facilities but do not have separate transmission lines.] Finally, commercial mobile telephone companies provide wireless services (cellular and personal communications services).

Even with the divestiture of AT&T, the telecommunications industry in Wisconsin is characterized by the dominance of a relatively few large companies. Three telephone companies were assessed approximately 48% of the total 2001 ad valorem tax assessment on telephone companies. These companies include Ameritech Wisconsin and Verizon North, Inc. (formerly GTE North), which provide local exchange services, and the long-distance company AT&T Communications, Inc.

e. Railroad Companies. A railroad company is any person (except a local unit of government) owning and/or operating a railroad in the state or owning or operating any station, depot, track, terminal, or bridge for railroad purposes. There are eleven railroad companies in Wisconsin. The major carriers are: the Burlington Northern Santa Fe Railroad Company; Canadian National; Canadian Pacific; and Union Pacific Railroad. Railroad utility taxes are treated as segregated funds and are deposited in the transportation fund.

f. Air Carrier Companies. The statutes define an air carrier company to be any person engaged in the business of transportation in aircraft of persons or property for hire on regularly scheduled flights. The major air carriers operating in the state are Midwest Express Airlines, Northwest Airlines, Mesaba Aviation, Inc., American Eagle Airlines, and Federal Express. Airline company utility taxes are also treated as segregated revenue and placed in the transportation fund.

Wisconsin 2001 Act 16 created an exemption, beginning in 2001, from ad valorem taxes for any air carrier that operates a hub facility in Wisconsin. For the purposes of this provision, a hub facility is defined as either one of the following: (a) a facility from which an air carrier company operated at least 45 common carrier departing flights each weekday in the prior year and from which it transported passengers to at least 15 nonstop destinations or transported cargo to nonstop destinations; or (b) an airport or any combination of airports in Wisconsin from which an air carrier company cumulatively operated at least 20 common carrier departing flights each weekday in the prior year, if the air carrier company's headquarters is in Wisconsin. Currently, Midwest Express Airlines and Air Wisconsin are the only two carriers that qualify for this exemption.

Gross Revenues Group

Utilities subject to the license fee on gross revenues include the following: private light, heat, and power companies; municipal light, heat, and power companies; electric cooperatives; and car line companies.

Determination of Assessment. Gross revenues utilities submit annual reports to the Department

of Revenue on the amount of taxable gross revenues for the preceding year. The gross revenue amount is multiplied by the applicable tax rate to determine the amount of taxes due. The Department later audits the reports for compliance.

Payment of Tax. The Department makes a tax assessment based on taxable revenues earned in the previous calendar year. Installment payments are made toward the tax in the year that the revenue is earned. A final payment is generally made in the following year, the assessment year, to reconcile the two installment payments with the final assessment. For light, heat, and power companies and electric cooperatives, semiannual installment payments of either 55% of the previous assessment or 50% of the estimated assessment are due on May 10 and November 10 of the year in which the revenue is earned. These utilities are notified of their actual license fee the following May 1. On May 10 of the year following the year in which the revenue was earned, the assessment year, either a final adjustment payment is made or a refund is issued to reconcile the two prior installment payments with the actual assessment.

For car line companies, at least 50% of the current or 50% of the subsequent year's liability is due on September 10 and the remaining liability is due on April 15. No final reconciliation is required, as the full assessment is known at the time the final payment is made.

Utilities Subject to the Gross Revenues Tax. The following section briefly describes each utility that is subject to the gross revenues tax.

a. Private Light, Heat, and Power Companies. In general, a light, heat, and power company is defined as a business enterprise engaged in the following businesses: (1) generating and furnishing gas for lighting or fuel or both; (2) supplying water for domestic or public use or for power or manufacturing purposes; (3) generating, transforming, transmitting, or furnishing electric current for light, heat, or power; or (4) generating and furnishing steam or supplying hot water for heat, power, or manufacturing purposes. The tax on light, heat, and power companies was converted from an ad valorem to a gross revenues tax by 1983 Wisconsin Act 27, beginning with the 1985 assessment.

Beginning in 1996, the definition of a light, heat, and power company was expanded to include qualified wholesale electric companies (also called independent power producers). A qualified wholesale electric company is defined as any person that: (1) owns or operates facilities for the generation and sale of electricity to a public utility or to any other entity that sells electricity directly to the public; (2) sells at least 95% of its net production of electricity; and (3) owns, operates, or controls electric generating facilities that have a total power production capacity of at least 50 megawatts.

As part of a broader effort to enhance electric reliability in the state, 1997 Wisconsin Act 204 authorized the construction and operation of a type of electric generating facility referred to as a wholesale merchant plant. Act 204 defined a wholesale merchant plant to be electric generating equipment and associated facilities in this state that do not provide service to any retail customer and that are owned or operated by: (1) either a person that is not a public utility; or (2) subject to PSC approval, an affiliated interest of a public utility. Act 16 clarified that a wholesale merchant plant with a total power production capacity of at least 50 MW is considered a qualified wholesale electric company for purposes of state utility taxes.

Under 1999 Wisconsin Act 9, transmission companies were added to the definition of light, heat, and power companies subject to the gross revenues license fee. The expansion of the definition was part of the Reliability 2000 Initiative, a series of law changes included in Act 9 that are described in this paper in the section on "Federal and State Regulation." Act 9 specified that a transmission company's revenues for transmission services to certain public utilities and electric cooperation associations are excluded from the

definition of gross revenues subject to the license fee, and specified other provisions related to the formation and operation of a transmission company. The tax provisions first apply to taxable years beginning January 1, 2000, which covers taxable gross receipts during calendar year 2000.

The assessment for a light, heat, and power company for each year is based on taxable gross revenues earned during the previous year. Gross revenues for a company other than a qualified wholesale electric company and a transmission company are defined as total operating revenues reported to the PSC, less interdepartmental sales and rents and the retailers' discount from the sales tax. A private light, heat, and power company may deduct from its gross revenue either: (1) the actual cost of power purchased for resale if that company purchases more than 50% of its electric power from a nonaffiliated utility that reports to the PSC; or (2) 50% of the actual cost of power purchased for resale if that company purchases more than 90% of its power and has less than $50 million in gross revenues. Certain grants and public benefit fees created under Act 9 are also excluded from the gross revenues of light, heat, and power companies.

For a qualified wholesale electric company, "gross revenues" means total business revenues from other businesses that are engaged in providing services as a light, heat, and power company. For a transmission company, revenues from transmission services to a Wisconsin public utility or electric cooperative are excluded from gross revenues for the purpose of determining the license fee.

Revenues from the sale of gas services are subject to tax at the rate of 0.97%. The tax rate on all other taxable revenues is 3.19%. However, as provided under Act 16, the tax rate on wholesale sales of electricity will be temporarily reduced to 1.59% for a specified period. The reduced rate will apply starting with the May 1, 2005, assessment, and ending with the assessment on May 1, 2010 (based on gross revenues from calendar years 2004 though 2009). The tax reduction for wholesale electricity sales was provided with the intention of encouraging the addition of generation capacity in the state.

An apportionment factor is applied to a company's gross revenues (less certain deductions, as described above) to determine Wisconsin taxable revenues, based on the shares of a company's total payroll, property, and sales that are in Wisconsin. Under Act 16, the payroll factor for a light, heat, and power company was modified. Act 16 provided that management and services fees paid by a light, heat, and power company to an affiliated public utility holding company would be included as part of the light, heat, and power company's payroll factor. Correspondingly, Act 16 also provided an exemption from local property taxes for that portion of a public utility holding company's property (other than land) that is used to provide services to a light, heat, and power company affiliated with the holding company. These modifications first applied with the May 1, 2002 assessment, which was based on gross revenues from calendar year 2001.

Of the 24 private light, heat, and power utilities operating in Wisconsin in 2001, including six qualified wholesale electric companies and one transmission company, 21 had Wisconsin taxable gross revenues from electric operations totaling approximately $3,788.2 million. The largest electric utility is Wisconsin Electric Power Company, serving most of southeastern Wisconsin, whose taxable gross revenues for electric services in 2001 of $1,721.1 comprised 42.0% of all electric service taxable gross revenues apportioned to the state. A total of five firms (Wisconsin Electric Power Company, Wisconsin Power and Light, Wisconsin Public Service Corporation, Excel Energy, and Madison Gas and Electric) generated 95.0% of taxable electric operating gross revenues in the state. Eleven private companies had taxable gross revenues of $1,842.3 million from natural gas operations; the two largest, Wisconsin Gas and

Wisconsin Electric Power, made up 56.4% ($1,038.7 million) of taxable revenues from natural gas operations. Eight private light, heat, and power utilities provided both electric and natural gas service.

b. Municipal Light, Heat, and Power Companies. A municipal light, heat, and power company is subject to state tax on its gross revenues for services provided outside of the municipality that owns the utility. Of the 82 municipal light, heat, and power utilities in the state, there are 77 municipal companies that pay this tax. These local government-operated firms had approximately $50.8 million in taxable gross revenues from electric and other non-gas operations in 2001. Of this amount, 74.8% ($38.0 million) is attributable to the ten firms with at least $1 million in taxable revenues. Only one municipal utility provides natural gas service (Florence Utility Commission), with taxable gross revenues from gas operations of $101,100 in 2001.

c. Electric Cooperative Associations. An electric cooperative association is an entity organized under state law that carries on the business of generating, transmitting, or distributing electric energy to its members at wholesale or retail. Electric cooperatives are taxed at a flat 3.19% rate on gross revenues. However, as with private light, heat, and power companies, Act 16 provided that the tax rate on wholesale sales of electricity is temporarily reduced to 1.59%, starting with the May 1, 2005, assessment, and ending with the assessment on May 1, 2010 (based on gross revenues from calendar years 2004 though 2009).

Similar to the treatment afforded light, heat, and power companies, gross revenues are defined as total operating revenues, less interdepartmental sales and rents and the retailers' discount from the sales tax. As for a light, heat, and power company, certain grants and public benefits fees associated with the Reliability 2000 Initiative under Act 9 are excluded from gross revenues. In addition, a deduction is allowed for the cost of power bought for resale if the cooperative buys more than 50% of the power it sells, or if the electric cooperative purchased more than 50% of the power it sold in 1987 from an out-of-state seller. For multistate associations, a share of total cooperative revenues are apportioned to Wisconsin using a three-factor formula based on the proportion of property, payroll, and sales in-state to the respective total of each factor.

The major electric cooperative association is Dairyland Power Cooperative, which supplies wholesale electricity to 25 rural electric distribution cooperatives in the upper Midwest, 18 of which are in Wisconsin. In 2001, Dairyland accounted for approximately 55.7% ($146.0 million) of total electric cooperative taxable gross revenues ($261.9 million).

d. Car Line Companies. A car line company is defined as any person, not operating a railroad, that is engaged in the business of furnishing or leasing car line equipment to a railroad. As noted, beginning with earnings generated in 1996, car line companies are subject to a 3% utility tax on gross earnings. Gross earnings are defined as all receipts by a car line company from the operation of equipment in the state. Earnings from interstate businesses are allocated to Wisconsin based on the ratio of Wisconsin car miles to total car miles. In 2001, there were 10 car line companies, with gross revenues of $16.1 million.

Tax Collections

Utility tax revenues are deposited in the state's general fund, except for those collected from rail-road and airline companies, which are segregated transportation fund revenues. General fund utility tax collections in fiscal year 2001-02 were $252.2 million, constituting about 2.5% of total general fund tax revenues. Transportation fund utility tax collections totaled $17.8 million, making up 1.4% of total transportation fund collections for 2001-02.

Table 2 shows the change in general fund utility

tax collections over the last seven fiscal years. Prior to 1997-98, collections from telecommunications companies had increased due to law changes in 1995 Act 351 and due to growth in the industry, particularly among cellular phone companies. The decrease in these collections from 1997-98 through 2000-01 reflects the transition to the ad valorem tax. The 1997-98 tax collections for telecommunications companies, shown as the gross revenues tax, include some collections for 1998 under the ad valorem taxation system. For 1998-99 and 1999-00, telecommunications tax collections include the transition fees imposed on local exchange carriers and commercial mobile telephone companies. As the final payment of such fees was due in May, 2000, telecommunications tax collections for subsequent years are entirely from ad valorem taxes.

Table 3 shows historical collections for the two transportation fund utilities. Railroad utility taxes for 1995-96 included taxes paid for previous years that had been the subject of litigation. However, a lawsuit by the railroads challenged the extra assessment reflected in the one-time revenues. In settlement of this lawsuit, the Department of Revenue refunded $10.8 million to nine railroads in November, 2000. The railroad utility tax figure shown in Table 3 for 2000-01 is net of the $10.8 million refund.

As noted, Act 16 created an exemption for air carriers with a hub facility in Wisconsin beginning in 2001. The first installment of taxes for 2001 was paid in fiscal year 2000-01, prior to the enactment of Act 16. The installment payments made by Midwest Express and Air Wisconsin did not reflect the tax decrease under Act 16. The two carriers were, therefore, refunded $1,265,200 in 2001-02, associated with the overpayment during 2000-01 The 2001-02 airline utility tax figure shown in Table 2 is net of this refund for the previous year.

Other State Taxes on Utilities

Corporate Income and Franchise Tax

In addition to the ad valorem and gross revenues taxes described above, Wisconsin public utilities are generally subject to the state corporate income and franchise tax on the same basis as other corporations. However, certain types of utility companies are exempt from this tax. Municipal light, heat, and power companies are exempt due to their status as agencies of local government. Electric cooperatives are exempt from the corporate income tax based on the general exemption for all cooperatives organized under Chapter 185 of the Wisconsin Statutes.

Taxable utility companies determine net corporate income tax liability in the same manner as most corporations. State corporate income tax provisions are generally referenced to federal law. Thus, the starting point for determining state income tax liability, net taxable income, is determined by subtracting allowable federal deductions from federal gross income. However, there are certain state adjustments that must be made in arriving at net taxable income for state purposes. (These specific adjustments are described in the informational paper on the state corporate income tax.) The state utility tax is specified as an allowable deduction in these adjustments. The state corporate income tax is imposed at a flat 7.9% rate on taxable income. If applicable, state tax credits are used to offset gross tax liability to arrive at net tax liability. More detailed information about the state corporate income tax may be found in Informational Paper #5, "Corporate Income Tax," prepared by the Legislative Fiscal Bureau.

Table 2: General Fund Utility Tax Collections (in Millions)

	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Ad Valorem Tax							
Telephone / Special Common Carrier	---	---	---	$149.4*	$114.7*	$80.4	$86.6
Pipeline	$9.2	$10.9	$7.6	9.5	11.9	10.4	10.3
Municipal Electric Associations	1.0	0.9	1.9	1.3	1.4	1.4	1.3
Conservation & Regulation	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total Ad Valorem Tax	$10.3	$11.9	$9.6	$160.3	$128.1	$92.3	$98.3
Gross Revenues Tax							
Telephone / Special Common Carrier	$160.1	$176.4	$158.5**	---	---	---	---
Electric Cooperative	7.5	7.9	7.5	$7.5	$7.8	$8.2	$8.6
Private Light, Heat & Power	106.0	107.8	110.4	117.1	121.1	136.4	143.1
Municipal Light, Heat & Power	1.4	1.3	1.4	1.5	1.5	1.6	1.6
Car Line Companies	---	0.7	0.6	0.6	0.6	0.5	0.5
Total Gross Revenues Tax	$275.0	$294.1	$278.4	$126.7	$131.0	$146.7	$153.8
Refunds of Interest & Penalty	---	0.2	0.4	0.1	0.9	0.2	0.1
General Fund Total Collections	$285.3	$306.2	$288.4	$287.1	$260.0	$239.2	$252.2

*Includes transitional adjustment fees assessed during the transition from gross revenues taxes to ad valorem-based taxation.

**Includes some collections of ad valorem tax during 1998 and transitional adjustment fees.

Table 3: Transportation Fund Utility Tax Collections (in Millions)

	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Ad Valorem Tax							
Railroad	$25.2*	$12.3	$10.0	$12.1	$11.5	$1.3	$12.0
Airline	8.7	8.7	6.3	8.6	9.0	9.3	5.7
Transportation Fund Total Ad Valorem Taxes	$33.9	$21.0	$16.3	$20.7	$20.5	$10.6	$17.7

*Reflects one-time revenue from the settlement of litigation related to previous years.

Sales Tax

Several sales tax provisions have a direct impact on utility companies. These provisions primarily affect the energy and telecommunications industries and are discussed below.

Energy-Related Provisions

Power companies are exempt from the sales tax on their purchases of fuel used to produce electricity, steam, or other power. In contrast, manufacturing businesses pay sales tax on fuel used in the manufacturing process, but are allowed a credit against state income tax liability for the

amount of tax paid. In addition, the sales tax exemption for purchases of residential fuel and electricity has an indirect impact on utilities, since the tax is imposed on consumer, rather than utility, purchases. Residential purchases of electricity and natural gas are exempt from November through April, and most other fuels purchased for residential use (such as coal, fuel oil, propane, steam, and peat) are totally exempt. Purchases of electricity and fuel, including natural gas, used in farming are exempt from the sales tax year-round.

As described above, 1999 Wisconsin Act 9 included the Reliability 2000 Initiative related to the creation of an electric transmission company. As part of this initiative, sales tax exemptions were provided for certain transfers of transmissions facilities to a transmission company and for the gross receipts of electric utilities and retail electric cooperatives from collections of public benefits fees.

Telecommunications-Related Provisions

Equipment. Prior to September 1, 1995, the sale and use of equipment and electrical instruments, other than station equipment, used by a telephone company in its central office for transmitting and operating signals generally were exempt from sales tax. 1995 Wisconsin Act 27 repealed this exemption, effective September 1, 1995. Thus, the above-identified items are now taxable. Further, as a result of the repeal, services (repair, alteration, fitting, cleaning, and the like) to such property also are now subject to the sales tax.

Services. Generally, sales of telecommunications services to consumers are subject to the sales tax. Conventional, wire-based telecommunications services that originate or terminate in Wisconsin and are charged to a service address in this state, including the rights to purchase telecommunications services (pre-paid calling cards and authorization numbers) as well as internet-access fees are taxable services in Wisconsin.

2001 Act 109 modified the sales tax treatment of mobile telecommunications services in Wisconsin, effective for bills issued after August 1, 2002, by bringing state law in to conformance with the Federal Mobile Telecommunications Sourcing Act (PL 106-252). Under the new law, the Wisconsin sales tax applies to cell phone calls and other mobile telecommunications services if the individual's or business' primary street address is in this state, regardless of where the services originate, terminate, or pass through. The great majority of other states have adopted the same change. Prior to the change, mobile telecommunications services were taxed in the same manner as conventional, wire-based services--that is, if the service originated or terminated in Wisconsin and was charged to a service address in this state.

The new mobile telecommunications sourcing policy was intended to clarify, particularly in light of substantially expanded cell phone usage in recent years, which jurisdiction has the right to tax services that may originate and terminate in different jurisdictions (as well as potentially pass through still other jurisdictions en route to completion). The change in federal law by itself effectively precluded Wisconsin from collecting sales tax on services provided in-state to roamers from out of state, regardless of whether the state would opt to incorporate the new sourcing guidelines into state law. By bringing its statutes into conformance with the federal law, however, Wisconsin gained the ability to tax cell phone calls that do not originate or terminate in Wisconsin yet that are billed to a Wisconsin address (for example, a phone call placed by a Wisconsin resident to San Diego from Chicago).

Finally, state law provides sales tax exemptions for county-wide "911" emergency phone systems and toll-free calls that originate outside this state and terminate in Wisconsin.

Federal and State Regulation

Since 1907, the state has assumed responsibility for regulation of most industries that provide relatively exclusive and essential services to the public, under conditions of generally noncompetitive natural monopolies. Historically, this regulatory focus has included telecommunications and light, heat, power and water utilities. State regulation of public utilities was initially the responsibility of the Railroad Commission, whose duties were subsequently revised and expanded into the current Public Service Commission (PSC).

In general, the primary responsibilities of the three appointed PSC commissioners, with the assistance of professional staff, are the following:

- Regulation of the construction, use, modification and financing of utility operating property, including regulation of the use of depreciation accounts for new construction;

- Valuation of such operating property;

- Oversight, including examination and audit, of utility accounts and record keeping;

- Response to complaints about utility operations and prices; and

- Setting the level and structure of rates for utility service based on allowable company rates of return on investment.

This last responsibility has been one of the more visible aspects of utility regulation. However, decisions regarding accounting issues and company structure and operations may also have significant consequences.

For utilities subject to PSC rate regulation, the rate-setting process has three basic phases: prehearing, public hearing, and decision-making. The process begins with a company request for a rate increase. The PSC staff analyzes the request and its impact and conducts a company audit, while interested parties prepare to participate in the public hearing on the rate request. The public or the PSC staff may challenge the rate request or suggest alternatives at the public hearing, which is an investigative and fact-finding process, rather than a decision-making forum. Following the public hearing, an open meeting is held by the commissioners on each rate case. The commissioners make their decision, based on the information presented at the earlier hearing.

The basic criteria for decision include: (1) the amount of company revenue necessary to operate, pay debts and meet the allowable rate of return on investment (this is a target figure and not a guarantee); (2) the projected rate levels needed to generate that amount of revenue; and (3) the appropriate distribution of the rate increase across the categories of service.

While PSC decisions are generally final, they can be challenged by the company or other interested parties, first at a PSC rehearing, then in state Circuit Court.

Underlying the rate of return criteria in rate-setting decisions is an attempt to set prices in a monopoly market at approximately the level they would reach in a competitive market. A complicating factor is that generally a company's natural interest is to have prices set at a level that will maximize profits. The utility regulatory process acts to provide a counterbalance. It begins by determining the company revenue requirement and the implied allowable rate of return on investment, which is based on an overall estimate of revenues and expenses. Then, prices are set that will generate the company's revenue requirement, allocated across categories of service according to relative costs and other factors for each category. Most directly relevant for utility tax purposes is the fact that all taxes paid, including corporate income, utility (ad valorem or gross revenues) and sales taxes, are

treated as expenses, and are generally fully recovered through the rates allowed by regulatory authorities.

The PSC's authority extends to intrastate utilities, and the intrastate operations of multi-state utilities. At the federal level, regulatory responsibilities over interstate utility operations are divided between the Federal Communications Commission, for interstate services of telecommunications companies, and the Federal Energy Regulatory Commission, for interstate operations and wholesale sales by energy service companies. The line between state and federal regulatory authority is not always clear and, particularly in the telecommunications field and increasingly in the electric industry, relations between the two levels of regulations are in a state of flux.

The PSC has traditionally regulated public utilities under a flexible statutory approach, which grants the Commission broad jurisdiction to supervise and regulate public utilities and do all things necessary to exercise its authority. Under this approach, the PSC has had discretionary authority to adjust the degree of regulation of classes of public utilities, as needed. However, provisions of 1993 Wisconsin Act 496 authorized substantially reduced regulatory review of telecommunications utilities by imposing specific and detailed statutory limitations governing the extent of PSC regulatory authority over such utilities, as described below.

Recent Changes in State Regulatory Oversight of Utilities

Telecommunications

Under 1993 Wisconsin Act 496, the PSC is required to regulate telecommunications utilities with the goal of developing forms of regulation other than the traditional rate of return approach generally used for public utilities rate-setting. Local exchange telecommunications utilities are authorized to become "price-regulated" (a form of incentive regulation), under which the PSC may regulate the utility based only on the prices of basic services offered, instead of regulating the total earnings of the utility.

Once a telecommunications utility elects to become price-regulated, its basic rates must be frozen for three years. Thereafter, the telecommunications utility may change its rates for price-regulated services only as follows: the change in the revenue-weighted price indices for all services subject to price regulation may not exceed the most recent annual change in the gross domestic price index, less a productivity offset of 2% or 3%, depending on the size of the utility. After six years, and every three years thereafter, the PSC revises the productivity offset percentages based on a statewide productivity study. In addition, depending upon the size of the utility, a penalty of up to 1% or 2% may be added to increase the productivity offset (due to inadequate service provided by the utility), and an incentive of up to 1% or 2% may be subtracted to decrease the productivity offset (to encourage infrastructure development).

A price-regulated telecommunications utility may reduce the prices charged for any service subject to price regulation upon one day's notice to the PSC. The telecommunications utility may change its rate structure upon ten days notice, provided the previous rate structure continues to be offered to customers.

Following its first three years as a price-regulated telecommunications utility, a utility may alter its rate structure or increase rates for price-regulated services upon 120 days' notice to the PSC. The notice must be accompanied with documentation that the change is just and reasonable. The PSC is authorized to investigate the proposed rate change and may suspend the proposed change pending the conclusion of the Commission's inves-

tigation. During its investigation, the Commission may consider only the following before approving, modifying or rejecting the change: cost allocations by the utility for costs to price-regulated services that are beyond the control of the utility; competition; network and service quality, improvements and maintenance; changes in the costs of providing the service that are beyond the control of the utility; and the impact of the change on the public interest.

In addition to regulation of incumbent local exchange companies, the PSC regulates the entry of alternative telecommunications utilities (such as, reseller and facility-based providers) and telecommunications carriers into intrastate local and toll telecommunications markets. These entities are generally referred to as competitive local exchange carriers. Most provide a wide range of services including local, long distance and internet access. The level of regulation for the competitive local exchange carriers is typically lower than for the incumbent local exchange companies and is specifically set forth in statute, administrative code or PSC order. For example, the PSC does not regulate the rates of competitive local exchange carriers as it does for the incumbent local exchange companies.

The federal Telecommunications Act of 1996 sets forth the interconnection obligations and rights of both the incumbent local exchange companies and the competitive local exchange carriers. Under the federal Act, disputes over interconnection agreements are mediated and arbitrated by the PSC. The PSC must also approve interconnection agreements reached through voluntary negotiations between the parties. In addition, the federal Act permits the PSC to regulate the terms and conditions of competitive entry into rural telephone company exchanges.

Finally, the federal Act stipulates that before any company can enter the long distance market within its own region, it must first meet several requirements designed to foster competition. The Federal Communications Commission, the U. S. Department of Justice and the PSC share responsibility to make certain these requirements are met.

The PSC receives and resolves complaints against telecommunications providers from retail customers. These consumer complaints often involve billing disputes, service quality, out-of-service problems and disconnections. The PSC also receives and resolves complaints between providers. These complaints center on the terms and conditions of interconnection at the wholesale level that if left unresolved, can adversely affect retail customers.

The PSC determines the scope of local calling areas and participates in the creation of new area codes.

The PSC also administers a variety of universal service programs that relate to the affordability of telecommunications service. All of these programs are paid for by telecommunication providers through assessments made by the PSC.

Universal Service Fund (USF). The USF was established under 1993 Wisconsin Act 496 to ensure that all state residents receive essential telecommunications services and have access to advanced telecommunication capabilities such as the Internet. The Act authorized creation of a Universal Service Fund Council. The Council provides advice to the PSC on establishing programs that are funded from the USF to ensure essential services and advanced service capabilities anywhere in the state. Essential service includes: (1) single party service with touch tone capability; (2) line quality capable of carrying facsimile and data transmissions; (3) equal access; (4) emergency services number capability; (5) a statewide telecommunications relay service for the hearing impaired; and (6) blocking of long distance toll services. To implement this general statutory directive, the PSC was authorized to develop programs to be funded from the USF by administrative rule.

To fund the new programs, the PSC assesses telecommunications utilities that have gross intrastate telecommunication revenues of greater than $200,000. Act 496 initially authorized the PSC to set the level of assessments sufficient to fund the programs to be developed by the PSC. These programs were designed to ensure telecommunications access for low-income residents, provide assistance to disabled residents, provide safeguards against fluctuations in price, and provide grants to institutions for advanced telecommunication services.

Subsequent to the creation of the USF by Act 496, 1997 Wisconsin Act 27 established two additional programs to be funded from the USF. As part of the larger Technology for Educational Achievement in Wisconsin Board (TEACH) initiative, a USF funded telecommunications access program was created. The TEACH access program provides funding to eligible entities for access to new telecommunication data lines and video links. Examples of eligible entities include school districts, technical college districts, private schools, cooperative educational service agencies (CESAs) and public library boards.

In addition to the TEACH access program, Act 27 also established a USF funded program to provide the UW System with funds to reimburse the Department of Administration for BadgerNet telecommunications services provided to the UW campuses at River Falls, Stout, Superior, and Whitewater. BadgerNet is the state's telecommunications network that transports voice and data video, and eventually broadcast formats, statewide.

Funding for both of these new programs is generated from separate assessments on the telecommunications utilities. For all three sets of programs, the PSC is responsible for determining and collecting the assessments and administering the USF.

Electric Utilities

In the fall of 1994, the PSC opened a docket to consider approaches to restructuring electric utility transmission, generation and distribution operations. In October, 1995, an advisory committee issued a report detailing the various restructuring options that appeared to be feasible in these areas and described the types of legislative and policy changes that would be required to implement each option. Then, in February, 1996, the PSC submitted a report to the Legislature advising that any conversion from regulated to competitive markets must be contingent on a series of electric industry and regulatory reforms. The Commission indicated that it intended to proceed incrementally through the restructuring process. The Commission's view at that time was that full retail competition would occur only if prerequisite reforms in the industry's generation, transmission and retail sectors were implemented.

Disruptions to the state's electric power supply during the summer of 1997 subsequently led to the Legislature's involvement in the discussion of electric utility restructuring and deregulation. During the following spring, legislation that was designed to increase electric power reliability in the state was considered and approved. While 1997 Wisconsin Act 204 ostensibly addressed electric power reliability issues, it also impacted electric industry restructuring.

Act 204 required electric utilities with a transmission infrastructure to follow procedures to transfer control of such facilities either to an independent system operator or to divest the ownership of such facilities to an independent transmission owner. The Act authorized the operation of independently constructed wholesale merchant plants and limited the circumstances under which an affiliate of a utility could own such merchant plants. The Act also required the PSC to study existing transmission line capacity and order additional construction, if necessary. Finally, effective January 1, 1999, the Act repealed the

biennial advance planning process for power plant siting and construction and replaced that process with a strategic energy assessment, to be prepared biennially by PSC staff.

Provisions of 1999 Wisconsin Act 9 significantly advanced the electric utility restructuring effort begun by 1997 Wisconsin Act 204. The principal electric utility restructuring provisions of Act 9 (called "Reliability 2000") created a nonprofit corporation to control the high-voltage transmission lines that move bulk electricity across the state. Act 9 also included new requirements concerning the use of renewable energy resources, encouragement of conservation efforts and the provision of financial assistance for low-income energy customers.

Act 9 provided for the transfer of ownership and control of the high-voltage transmission lines currently held by Wisconsin-based companies operating principally in the eastern part of the state to a nonprofit, independent transmission company called the American Transmission Company (ATC). Public utilities were required to make this transfer by September 30, 2000, while cooperatives and municipal utilities had until September 30, 2001. The privately-owned companies and cooperatives received stock in the ATC to compensate them for their divested assets. In turn, the ATC provides them with equitable access to the transmission grid at fair rates, and is responsible for constantly monitoring the flow of electricity and reallocating supplies between service areas to alleviate spot shortages. The ATC is also be responsible for the planning, construction, operation, maintenance and expansion of the grid.

In turn for surrendering ownership and control of transmission lines, Act 9 exempted holdings in diversified investments, including associated energy, environmental or water businesses; customer metering and billing; and telecommunications from statutory provisions limiting non-utility assets to not more than 25% of total holdings.

Provisions of 1997 Wisconsin Act 204 previously required eastern Wisconsin utilities to develop new generating capacity to produce 50 megawatts of electricity from renewable energy sources (wind, water, solar or biomass) by December 31, 2000. Subsequently, 1999 Wisconsin Act 9 required any electric utility or cooperative to generate an escalating portion of its retail electricity sales through renewable resources, increasing to 2.2% by the end of 2011.

Act 9 also created two public benefits programs to: (1) provide assistance to low-income households for weatherization and other energy conservation services, payment of energy bills and the early identification and prevention of energy crises; and (2) award grants for energy conservation and efficiency services and for renewable resource programs. These programs are currently being implemented. They are administered statewide by the Department of Administration for most utility customers. Municipal utilities and retail electric cooperatives have the option of implementing either or both of the public benefits programs for their own customers or members, or supporting the statewide effort.

Funding to support these public benefits programs derives from all of the following sources: (1) a new flat fee ($45.4 million for 2002-03) assessed on customers' electric service bills that through June 30, 2008, may not exceed the lesser of 3% of the monthly electric service bill or $750; (2) public benefits revenues currently collected by electric and natural gas utilities in customer rates and transferred into the Department of Administration (an annual amount of $67.2 million); and (3) federal funds received by the state for low-income home energy assistance and weatherization programs (approximately $68.4 million for FFY 2002).

Provisions of 2001 Wisconsin Act 16 authorized public utilities and the affiliated interests of those utilities to enter into long-term leased generation contracts with one another. Act 16 also authorized a public utility to transfer, at book value, real estate

used for providing utility service to an affiliated interest in order to of implement an approved leased generation contract.

Under a leased generation contract, a utility's affiliated interest agrees to construct or improve electric generating equipment and associated facilities. The public utility then leases the land, equipment and facilities and operates the facility. The lease must be at least 20 years in length for gas-fired facilities and 25 years for coal burning facilities. After this initial lease, the public utility, has the right to renew the lease or purchase the facility at fair market value. Commission approval of either action is required. The cost of the project must be at least a $10,000,000 improvement in order to qualify as a leased generation contract.

Act 16 prohibits the PSC from increasing or decreasing the retail revenue requirements of a utility on the basis of any income, expense, gain or loss incurred or received by the utility's affiliated interest due to its ownership of equipment and facilities under a leased generation contract. The PSC must allow a utility to recover in rates all costs related to a leased generation contract.

Electric cooperatives or municipal electric utilities may acquire an interest in equipment, facilities or land under a leased generation contract. Nuclear powered and wholesale merchant plants are not subject to leased generation contracts.

Act 16 also required an electric utility that has received a certificate of public convenience and necessity from PSC for constructing facilities rated at a capacity of 100 megawatts or more to begin construction within one year of the latest of: (a) the date the Commission issues the certificate; (b) the date on which the electric utility has been issued every required federal and state permit, approval, or license; (c) the date on which every deadline has expired for requesting administrative review of such permits and licenses; and (d) the date on which the electric utility has received the final decision, after exhausting every proceeding for judicial review. Act 16, authorized the Commission to grant an extension of this deadline upon a showing of good cause by the electric utility.

If the electric utility did not begin construction of electric generating equipment and associated facilities within the one-year period, unless extended, the original certificate voided.

APPENDIX

Telecommunications Companies

Operations of Telecommunications Companies

The 1984 court-ordered divestiture of American Telephone and Telegraph Company (AT&T) and the provisions of 1993 Wisconsin Act 496 have had a significant effect on the operations of telecommunications companies in the state. As a result of divestiture, the Bell operating companies, other independent local service utilities, resellers and cellular phone companies provided services within LATAs (local access and transport areas). Inter-LATA telecommunications service was provided by AT&T, MCI, Sprint and other inter-LATA common carriers (including resellers), at the subscriber's option. The boundaries of each LATA follow preexisting local exchange boundaries and are determined by defining an area of "common social, economic, and other purposes" served by a Bell operating company. There are four LATAs entirely in Wisconsin, and a fifth that services a portion of northeastern Wisconsin and Michigan's upper peninsula (the Niagara Telephone Company).

Local exchange companies, including the Bell operating companies (the Wisconsin holdings of Ameritech and Verizon), must provide equal access to interexchange carriers who provide long-distance service. To provide such access to inter-LATA carriers, a system of access charges was instituted. These charges are collected from customers by interexchange carriers, through their rates, and paid to local exchange carriers.

Under the provisions of 1993 Wisconsin Act 496, the services that different types of telecommunications companies can provide are expanded, beginning in September, 1994. Telecommunications utility certificates of authority are not exclusive, thus allowing providers other than the Bell operating companies (Ameritech) and other independent local service utilities to offer local exchange service. The Public Service Commission can authorize any telecommunications provider to offer local exchange service in an area already served by a telecommunications utility. However, the federal Telecommunications Act of 1996 grants the PSC some latitude in defining how the competition will occur where a telecommunications utility with 150,000 or less access lines already operates in an area.

The federal Telecommunications Act of 1996 made many changes affecting the telecommunications industry. Some of these changes include: (1) preempting certain state and local laws and regulations that prohibit local competition; (2) prohibiting states from imposing entry barriers for providers of local service; (3) authorizing Bell operating companies to provide inter-LATA service upon FCC approval and if certain competitive requirements are met; (4) requiring local exchange carriers to provide equal access to interexchange carriers and information service providers; and (5) eliminating the ban on cable and telephone company cross-ownership in small communities.

Major Changes in State Taxation of Telecommunications Companies

Historically, telecommunications utilities had been subject to separate, graduated tax rates on local exchange and toll revenues. Local exchange revenues are generally those derived from local exchange services and reported to and regulated by the Public Service Commission; toll revenues are generally derived from long-distance services and include all intrastate toll revenues reported to and regulated by the PSC, as well as the portion of interstate toll revenues attributable to the state, which are not regulated by the PSC.

Since 1985, the Legislature has repeatedly acted to reduce the utility tax rates on telecommunications companies. In 1985 Wisconsin Act 29, the tax rates on larger companies were somewhat reduced for future years. In addition, Act 29 included a nonstatutory provision stating that the Legislature intends that: "the telephone gross receipts tax rates be phased down over a period of six years to a level which is comparable to that which other businesses pay in property taxes and that these reductions be passed through to telephone customers in lower rates." Subsequently, the gross receipts tax was further reduced in 1987 Wisconsin Act 27 and in 1989 Wisconsin Act 31.

1991 Wisconsin Act 39

The periodic reduction in the gross revenues tax on telecommunications companies was continued in 1991 Wisconsin Act 39. Under the provisions of Act 39, local and rural exchange service revenues and toll service revenues were taxed at flat rates. Local and rural exchange revenues were assessed at 5.8% on May 1, 1994, and 5.75% on May 1, 1995. Toll service revenues were assessed at 6.6% on May 1, 1994, and 5.8% on May 1, 1995. Both types of telecommunications revenues were to be taxed at the same rate of 5.7% on May 1, 1996, and 5.4% on May 1, 1997. In addition, Act 39 contained nonstatutory language stipulating that the Legislature intends that the tax reduction, when fully and completely implemented, constitutes the refund of taxes (sales taxes on access charges) that could be claimed by telecommunications companies pursuant to the 1990 court decision in GTE Sprint vs. Wisconsin Bell, Inc.

Beginning with taxes due May 10, 1997, Act 39 provided that the gross revenues tax would be eliminated for interexchange carriers and resellers. These companies would, instead, be subject to an ad valorem tax. All other telecommunications companies (cellular and local exchange companies) would continue to be subject to the gross revenues utility tax.

1995 Wisconsin Act 351

Act 351 increased the gross revenues tax rate for all telecommunications companies to 5.77% for the 1996, 1997, and 1998 license fee assessments. On May 15, 1998, the gross revenues license fee and provisions governing administration, collection, and enforcement were repealed. Instead, all telecommunications companies (including cellular and local exchange companies) are subject to an ad valorem tax, beginning with taxes due for 1998. The ad valorem tax is imposed on the real and tangible personal property of every telephone company and is deductible for state corporate income and franchise tax purposes. The Department of Revenue assesses telephone company property using the same methods used to assess manufacturing property.

Act 351 also imposed a transitional adjustment fee for 1999 and 2000 on each cellular telecommunications utility and local exchange company. The fee was the difference between the taxpayer's monthly ad valorem utility tax payment and the amount that the taxpayer would pay during that month if subject to a gross revenues tax of 5.77%. Finally, Act 351 repealed a sales tax exemption for gross receipts from calls made from coin-operated telephones.

The provisions of Act 351 made a number of changes to state law that were estimated to impact tax revenues. It was estimated that revenues would be higher in the short run and lower in the long run as a result of Act 351. The Act increased the gross revenues tax rate from 5.7% for 1996 assessments and 5.4% for 1997 assessments to 5.77% for each year and extended the gross revenues tax to apply to 1998 assessments. This provision was estimated to increase utility tax revenues by $3.0 million in 1995-96 and $40.6 million in 1996-97.

Beginning with taxes for 1998, all telephone companies are converted to ad valorem taxation. However, because of the transitional fee imposed

on cellular and local exchange companies, the full effect of converting telephone companies was not reflected in utility tax collections until fiscal year 2000-01. Table 4 shows estimates made at the time Act 351 was being deliberated by the Legislature on the increase or decrease in state tax revenues for 1995-96 through 2000-01. In total, it was estimated that general fund revenues would be increased by $43.6 million in the 1995-97 biennium and by $31.1 million in the 1997-99 biennium. At the time that Act 351 was enacted, it was estimated that general fund revenues would be reduced by $101.3 million in the 1999-01 biennium.

Table 4: Estimated Fiscal Effect of Act 351 (in Millions)

Fiscal Year	Revenue Change
1995-96	$3.0
1996-97	40.6
1997-98	25.1
1998-99	6.0
1999-00	-37.9
2000-01	-63.4