

The Next Step for Cities Considering Franchise Fees for Telecommunications Companies

In June we notified members of the victory our cities experienced in the *Kentucky CATV Association Inc. v. City of Florence et al.* case. To recap, the Kentucky Supreme Court decided that cities can opt-in to the telecom tax scheme under KRS 136.660(1)(a-c) to continue receiving disbursements from the state pool OR the cities can exercise the power granted under the Kentucky Constitution to impose franchise fees on telecommunications companies.

Since we published the article explaining this case in June, KLC has been working with the Kentucky Department of Revenue to figure out how to move forward after this ruling. As you can imagine, there are many logistical issues including: When to opt-out? Who to notify if the city decides to opt-out? What factors should cities consider in deciding whether to opt-in or opt-out? What is the process for notifying companies? Is it final once a city decides?

The Kentucky Department of Revenue has developed a fact sheet with KLC's assistance that is attached to this article. It explains some of the above questions and provides a lot of information. KLC recommends that each city take some time in deciding what the next steps are. While many cities were not receiving revenue to which they were entitled under the Constitution, some cities may benefit for remaining in the telecom tax scheme. Carefully calculating current receipts from the telecom tax scheme and balancing those against the potential receipts under a franchise fee as well as whether the funds would exceed the property tax and franchise fee components of its 2005 tax base, may take time and will require careful consideration.

If you have any questions regarding this or any other issues please contact Morgain Sprague at msprague@klc.org

Local Jurisdictions Considering Implementation of Utility Franchise Fees

On June 15, 2017, the Kentucky Supreme Court (*Kentucky CATV Association Inc. v. City of Florence*, 520 S.W.3d 355, (Ky. 2017)) determined that the General Assembly did not have the power under Ky. Const. §181 to prohibit municipalities from collecting franchise fees from utilities in exchange for use of their rights-of-way, as that power was constitutionally granted to local municipalities pursuant to Ky. Const. §§ 163 and 164.

The telecom taxes imposed under KRS 136.604 and 136.616 were originally enacted as part of Tax Modernization in 2005 (HB 272). Effective January 1, 2006, the bill replaced the franchise value property tax and franchise fees on telecommunications companies with a 3% excise tax on multichannel video programming services and separate gross revenues tax rates on multichannel video programming services and communications services (2.4% and 1.3% respectively). With this legislation, existing local franchise fee collections were purportedly prohibited.

Because of this Supreme Court decision, some local jurisdictions are considering whether to renew or establish a franchise fee on cable service and/or communications service instead of relying on

receipts from the state telecom taxes. Below are some key points cities and other jurisdictions should consider before activating any franchise payment provisions.

- Since 2006, cities, counties and other local jurisdictions throughout the Commonwealth have received monthly distributions of state telecom receipts electronically deposited into their bank accounts. The combined amounts for all jurisdictions annually totals \$36.4 million.
- According to the provisions of KRS 136.660(4), any political subdivision that chooses to impose a franchise fee on any cable or communications service will forfeit distributions of all state telecom receipts (3% excise and 2.4% and 1.3% gross revenues taxes) during the time that any franchise fees are being collected. While each franchising jurisdiction should carefully evaluate its own unique situation, in many cases, the current distributions of state telecom taxes are and will continue to be *greater than* any revenues that might be generated from local franchise fees on cable services.
- Before a political subdivision begins a franchise fee imposition, it must notify the Department of Revenue in writing of the effective date of the franchise fee and that it is revoking its certified participation in the state telecom distribution fund. The Department requests a ninety-day notice before franchise fees begin.
- Cable companies and other utilities will need advance notification so they can perform any database changes needed to comply with new franchise fee requirements. Depending on the terms of the franchise, providers may also need time to communicate billing changes to the affected customer base. A ninety-day notice is a recommended minimum, but please consult with local providers to coordinate implementation details.
- Overall, cable receipts are in gradual decline statewide. In contrast, the annual state telecom distributions to local jurisdictions remains fixed at the statutorily set threshold of \$36.4 million. While this amount does not fully cover the 2005 baseline, *it will not decline* under current law regardless of any further erosion of cable receipts.
- The repealed franchise value property tax component of cities' historical tax base comprised, on average, at least 20% of their total collections amount. If a local jurisdiction elects to activate a franchise fee, the local jurisdiction would likely want to determine whether any new collections would exceed both the property tax and franchise fee components of its 2005 tax base to verify whether the decision to opt-out of participation with the state makes sound financial sense for the local jurisdiction.

If there are additional questions, please contact the Department of Revenue at 502-564-5170, option #2, or send an email to DOR.WEB.Response.Telecom@ky.gov.