REPORT TO
GOVERNOR MARIO M. CUOMO
ON THE
TAXATION OF TELECOMMUNICATIONS PROPERTY

STATE BOARD OF EQUALIZATION AND ASSESSMENT

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INTRODUCTION

On August 5, 1984, Governor Cuomo approved chapter 895 (Senate Bill No. 9992-A) which provides that telephone and telegraph equipment subject to the assessment ceiling provisions of section 470 of the Real Property Tax Law and taxable on 1983 assessment rolls remains taxable real property for purposes of assessment rolls completed and filed in 1984. In his approval message, the Governor stated that chapter 895 was "neither a panacea nor a permanent solution. For the 1985 tax year, a comprehensive approach to the real property taxation of the telecommunications industry must be devised that will treat all competitors in this increasingly competitive marketplace equitably." To assist him in his goal, Governor Cuomo "asked the State Board of Equalization and Assessment to analyze this problem and provide * * * recommendations for such a comprehensive solution."

It now seems apparent that chapter 895 was not even a temporary solution. Couched in ambiguous language, it has done little more than create confusion and generate litigation.* (See, Appendix D, "SBEA Memoranda to Local Assessment Officials.") Telecommunications owners and local officials alike remain uncertain as to their duties under the law with respect to apportionment of assessments and tax liabilities.

In an effort to develop a recommendation which is both rational and acceptable, State Board staff met with representatives of the telecommunications industry, academia, and State and local government officials. This Report incorporates the comments, criticisms and suggestions of those participants and offers our staff analysis of the various positions adopted.

The Report is limited, however, to what we perceive to be our area of expertise: the assessment and taxation of real property. Some participants have suggested that the State Legislature substitute another type of tax (such as one on gross receipts) in place of the local property tax. That may very well be an appropriate course for the State. However, we must leave the study of such alternative forms of revenue raising to those responsible for the administration of those revenue sources, such as the Department of Taxation and Finance.

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* In AT&T Information Systems v. Tax Com'n of the City of New York, (Sup.Ct., New York Co., commenced October 24, 1984), the company seeks judgment declaring chapter 895 unconstitutional, and the certification of the Tax Commission as a class action defendant to represent all municipalities in which the company owns property.

By proceedings commenced pursuant to both Article 7 of the RPTL and Article 78 of the CPLR, and filed against every municipality in the State in which it owned or owns station equipment, New York Telephone Company seeks relief similar to that requested by AT&T Information Systems.

Comparable litigation has been commenced by AT&T Communications of New York against those municipalities in which is located its central office equipment. Local governments are requested to stipulate to be bound by the judgment rendered in the AT&T Information Systems litigation.

EXECUTIVE SUMMARY

The issue of the definition of elements of the telecommunication industry as real or personal property has been of concern for several years. State Board staff have researched the issue, met with representatives of local government and the industry, and have prepared this Report.

The State Board concludes that the trend of judicial construction of section 102(12)(d) of the Real Property Tax Law has sorely undermined the in rem concept of real property taxation in New York State. This situation is further aggravated by the ceiling assessment provisions of RPTL, section 470 which are artificial and without logical basis. The solution is the Legislative restoration of common law notions of real property to this statutory definition of taxable real property (see, Appendix C, "Recommended Legislation").

After conducting its own hearing and reviewing the findings of staff, the State Board reached the following policy conclusions:

1. The definition of real and personal property for certain elements of telecommunications property has become confused over the years. The State Board believes that, consistent with New York's long established tradition of not taxing personal property, only "real" property should be subject to property taxation. Statutory clarification and definition is needed for the telecommunications industry of what is real property.

2. Section 470 of the Real Property Tax Law, enacted in 1973, places a ceiling on taxable assessed value of certain telephone property. With each passing year, this section has become more unmanageable. With divestiture, section 470 becomes impossible to interpret and administer. We believe section 470 should be repealed.

3. The taxation of certain telecommunications property has been based on ownership rather than use. The State Board believes this to be both bad policy and discriminatory. Property taxation should be based on type and use of property, not on ownership.

Our specific recommendations are based on these policy determinations, and are as follows:

1. Central office equipment which is located in telephone company buildings and used to switch or route transmissions between customers should no longer be construed as taxable real property. Recent changes to the nature of the telecommunications industry in general and to central office equipment in particular are so significant, that we consider it inadvisable to continue to tax this equipment as real property.

2. Station equipment, also referred to as customer premises equipment or CPE, should also be excluded from the definition of taxable real property. This type of equipment which includes telephones, switchboards and associated wiring has undergone an even greater change in form and ownership in recent years than central office equipment.

3. Lines, wires, cables, poles and other such property which is not located on a customer's premises, known in the industry as "outside plant," including similar property owned by cable television companies, should be taxed as real property.

4. There should be no change in the taxation of land, buildings and special franchises of the telecommunications industry.

5. We believe section 470 should be repealed. If the Board's first two recommendations are adopted, section 470 becomes moot. However, even if section 470 is not repealed, the Board believes that the date when property is or was installed (i.e., pre- or post-1975) should not determine its taxable status.

6. Chapter 895 of the Laws of 1984 should not be extended; the issue of the taxation of telecommunications property should be comprehensively resolved in 1985.

7. The fiscal impact analysis is limited to the New York Telephone Company, which has substantial property and is the primary franchisee in 586 assessing units (59% of all cities and towns). The local revenue loss from New York Telephone will in a limited amount be offset by basing taxation on type and use, rather than ownership.
In terms of New York Telephone property 85% of the 586 assessing units would suffer a post-divestiture tax base loss of less than 1%. The average percent lost for these assessing units is six-tenths of one percent. Ten percent would have a tax base loss between one and two percent. Five percent would have a tax base loss in excess of 2%, with the largest tax base loss approximately 4.5%. For New York City and Nassau County the tax base loss and impact would only occur within the utility class due to the redistribution provisions of RPTL, Article 18.

I. LEGISLATIVE ANALYSIS

Real Property Tax Law, §102(12)(d)

Prior to 1828, there existed no statutory definition of real property for purposes of taxation. When necessary, the courts resorted to common law notions of realty. With the 1828 enactment of section 2 of Title 1 of chapter 13 of part 1 of the Revised Statutes, the State Legislature created the first statutory definition of taxable real property:

> The term "land," as used in this Chapter, shall be construed to include the land itself, all buildings, and other articles erected upon or affixed to the same, all trees and underwood growing thereon, and all mines, minerals, quarries and fossils, in and under the same, except mines belonging to the state; and the terms "real estate," and "real property," whenever they occur in this Chapter, shall be construed as having the same meaning as the term "land," thus defined. (Effective, January 1, 1828)

Fifty-three years later, in 1881, the Legislature expanded this simple codification of the common law definition of real property to include such items as "wharves and piers," "bridges," "railroads" and "mains, pipes and tanks" (L.1881, c.293). More important for this Report, however, was the inclusion at that time of "telegraph lines, wires, poles and appurtenances," within the same definition. The codification of the Tax Law in 1909 (c.62) incorporated this definition in subdivision 6 of section 2. In 1958, with the recodification of the Real Property Tax Law (c.959), the definition received both its current designation as section 102(12)(d) and its first amendment since its enactment 77 years earlier: "telegraph" became "telephone and telegraph". However, this was merely legislative recognition of the long-held judicial construction that the use of the word "telegraph" in Tax Law, section 2(6), includes "telephone" (Hudson River Telephone Co. v. Watervliet Turnpike & Railway Co., 135 N.Y. 393, 32 N.E. 148 [1892]; Holmes Electric Protective Co. v. Williams, 228 N.Y. 407, 127 N.E. 315 [1920]; New York Telephone Co. v. Ferris, 257 App.Div. 415, 13 N.Y.S.2d 359 [4th Dept. 1939], aff'd 282 N.Y. 667, 26 N.E.2d 805 [1940]).

In 1977, the Legislature amended section 102(12)(d) to provide that the term "appurtenances" not include machinery and equipment used by a radio or television company to furnish programming free of charge to the public (L. 1977, c.829). Practically speaking, an exemption from the definition of appurtenances was created for a specific industry. Moreover, the exemption was limited to companies providing free radio and television programming, thereby excluding cable television companies. To date, this is the only substantive change in the definition in its 103 year history.

Real Property Tax Law, §470

Section 470 of the Real Property Tax Law, added by chapter 1019 of the Laws of 1973 and amended by chapter 1044 of the Laws of the same year, establishes a ceiling assessment for certain types of telephone and telegraph property. It does so by limiting the taxable assessed value of this property to the amount which appeared on the last assessment roll completed prior to December 31, 1974, unless there is a "tax

district-wide revaluation." In the event that a revaluation occurs, the statute provides for a change in the ceiling assessment corresponding to the change in the ratio of the equalization rates.

The specified categories of property subject to the section 470 ceiling are:

central office equipment
station equipment*
station apparatus
station connections
private branch exchanges

With the exception of "station equipment," these are terms of art derived from the Uniform System of Accounts established for telephone and telegraph companies by the New York State Public Service Commission (16 NYCRR, Chapter VI, Subchapter E; see also, 5 Op.Counsel SBEA No. 10).

The effect of section 470 has been to wholly exempt all of the enumerated equipment installed since 1974.

Chapter 895 of the Laws of 1984 was an attempt to forestall, for one year, any effect the AT&T divestiture may have upon the classification and taxable status of telephone and telegraph equipment subject to the provisions of RPTL, section 470.

Section one of the law amended section 470 by designating the then current language as subdivision 1 and adding a new subdivision 2. Our interpretation of the new subdivision 2 is that section 470 equipment as assessed on 1983 final assessment rolls, which is transferred to an owner in the telephone or telegraph business or in the business of selling or leasing this equipment, would be carried over to 1984 final assessment rolls as taxable real property under RPTL, section 102(12)(d), notwithstanding any transfer to an entity which is not a utility (see, Section II, "Legal Analysis" [pp. 6-7], for a discussion of the significance of the utility/non-utility distinction). The assessor may enter an assessment of both transferred and retained property in the name of the transferor while entering an assessment of the transferred property in the name of the transferee. In the event that a transferee pays taxes attributable to any equipment for which it is assessed, a corresponding reduction in the assessment and taxes of the transferor would be required.

Subsequent sections of chapter 895 provide for the administrative and judicial review of assessments made in accordance with the act; the inclusion of property subject to section 470 within class three utility property for special assessing units; and a direction to the Temporary State Commission on the Real Property Tax to conduct a technological, legal, economic and fiscal analysis of the taxation of telecommunications equipment. The present Report is our response to the request in approval message #110 for chapter 895 that the State Board analyze this problem and provide recommendations for a comprehensive solution.

* The term station equipment is an "umbrella term" which includes the three types of equipment listed below it. It was in use before the time that the three other categories were separately identified.

II. LEGAL ANALYSIS

Paragraph (d) of subdivision 12 of section 102 of the Real Property Tax Law defines as real property (in pertinent part) "[t]elephone and telegraph lines, wires, poles and appurtenances * * * ". Until 1975 the term "telephone * * * appurtenances" had been broadly construed to include virtually all equipment requiring use of telephone or telegraph lines and wires (e.g., the central office equipment of a telephone company [Matter of New York Telephone Co. v. Ferris, 257 App. Div. 415, 13 N.Y.S.2d 359 (4th Dept. 1939), aff'd 282 N.Y. 667, 26 N.E.2d 805 (1940)]; station apparatus, station installations and private branch exchanges located on private property not owned or leased by the telephone company [Matter of New York Telephone Company (Canough), 264 App. Div. 937, 26 N.Y.S.2d 263 (4th Dept. 1942), aff'd 290 N.Y. 537, 49 N.E.2d 997 (1943)]; and switchboards and associated wiring in the central office of a burglar and fire alarm company, together with drop lines and burglar alarms located on subscribers' premises [People ex rel. Holmes Eletcric Protective Co. v. Chambers, 1 Misc.2d 990, 125 N.Y.S.2d 245 (1st Dept. 1955), aff'd 285 App.Div. 1023, 139 N.Y.S.2d 906 (1st Dept. 1955), aff'd 1 N.Y.2d 760, 135 N.E.2d 56, 152 N.Y.S.2d 304 (1956)]). Administratively, the term was interpreted to include accessory apparatus essential for receiving, relaying and distributing broadcasts by cable television companies to their subscribers (4 Op. Counsel SBEA No. 24).

The first indication of a judicial rethinking of this all-inclusive interpretation of section 102(12)(d) occurred in 1975. In Crystal v. City of Syracuse, Department of Assessment, 47 A.D.2d 29, 364 N.Y.S.2d 618 (4th Dept. 1975), aff'd 38 N.Y.2d 883, 346 N.E.2d 546, 382 N.Y.S.2d 745 (1976), the Appellate Division, Fourth Department (as subsequently affirmed by the Court of Appeals), held that portable plug-in telephones owned by a subscriber to a telephone service and located on the subscriber's premises are personal property and not real property. The decision implied, however, that the same equipment located on a subscriber's premises but owned by a telephone company would continue to be classified as real property.

In its brief memorandum in affirmance, the Court of Appeals in the Crystal case, included the following ambiguous comment:

> it is noted that the court does not have before it a situation in which the owner of the real estate has incorporated as part of the real estate a telephone or telegraph system.

The implication of this opinion seems to be that where the equipment is not readily detachable but is part of an "integrated and extensive communication system," it will be taxable real property as "telephone appurtenances," regardless of who owns the equipment.

In subsequent cases, the Court declared section 102(12)(d) to be "aimed principally at expanding the definition of real property with respect to utility companies" and applicable to other equipment only to the extent that it is "incorporated as part of the real estate" (Matter of Crossman Cadillac v. Board of Assessors of County of Nassau, 44 N.Y.2d 963 at 964, 965, 380 N.E.2d 157, 408 N.Y.S.2d 326 [1978]).

The courts have continued to taper the bounds of this statute. Most recently, the Court of Appeals found "significant differences, in both structure and function" between cable television equipment and that of "telephone and telegraph" systems and, therefore, held section 102(12)(d) inapplicable to cable television equipment (Manhattan Cable TV Services v. Freyberg, 49 N.Y.2d 868, 405 N.E.2d 178, 427 N.Y.S.2d 933 [1980]). The Court concluded that the equipment was neither "telephone and telegraph" equipment per se nor appurtenant to telephone lines, wires, poles, etc. More specifically, the Court declared non-taxable "the movable equipment in petitioner's facilities and in the home of subscribers to petitioner's cable television service."

The Freyberg holding has recently been extended to cable television main transmission cable located on private property (Cablevision Systems Development Co. v. Bd. of Assessors of County of Nassau, 98 A.D.2d 818, 470 N.Y.S.2d 37 [2d Dept. 1983]; American Cablevision of Rochester, Inc. v. Jacobs, 101 A.D.2d 65, 474 N.Y.S.2d 653 [4th Dept. 1984]). Similarly, in Quotron Systems, Inc. v. Irizarry, 48 N.Y.2d 795, 399 N.E.2d 948, 423 N.Y.S.2d 918 (1979), the Court of Appeals concluded that a company engaged in the business of purchasing, compiling and editing stock market data for transmission of raw data, is not a "utility," and, therefore, its transmission equipment is not taxable real property under the meaning of section 102(12)(d). (The latter opinion relied heavily upon the Court's earlier decision in Quotron Systems, Inc. v. Gallman, 39 N.Y.2d 428, 348 N.E.2d 604, 384 N.Y.S.2d 147 [1976]), which construed the application of section 186-a of the Tax Law to the service provided by Quotron.)

Although the application of the statute has been narrowed in recent years, administrative problems continue because of some artificial distinctions drawn by the courts (e.g., between identical equipment of utility companies and private vendors). The artificiality of these distinctions has only been exacerbated by the increasingly competitive market for customer premises equipment.

III. DIVESTITURE AND DEREGULATION ANALYSIS

Divestiture

The court-ordered breakup of the Bell System by Federal District Court Judge Harold H. Greene (United States v. AT&T, 552 F.Supp. 131 [D.D.C. 1982], aff'd sub nom. Maryland v. United States, _ U.S. _, 103 S.Ct. 1240, 75 L.Ed.2d 472 [1983]) went into effect on January 1, 1984 and required AT&T to divest its 22 Bell Operating Companies (BOCs) and reconfigure them into seven independent regional holding companies. This restructuring has resulted in the separation of local telephone service from long-distance service. Property and equipment previously used for both local and long-distance calling has been divided between the BOCs and AT&T based upon a determination of whether the "predominant use" was a local or long-distance service.

Consequently, long-distance service in New York is provided by two different AT&T entities. First, service originating and terminating within the State is provided by AT&T Communications of New York, a wholly-owned subsidiary corporation. Second, service originating within New York but terminating without is provided by AT&T-Interstate Division (formerly "Long Lines"), not a separate corporate subsidiary but simply a department of AT&T "Corporate."

Divestiture has also resulted in keener competition for the long-distance market among AT&T, MCI, Sprint and other independent telephone companies. However, competition is not restricted to this market. The breakup of the Bell System has given greater impetus to two major developments in the telecommunications industry: shared use and bypass.

Shared use occurs when commercial tenants share switching facilities or resell the services that these facilities provide and which were formerly available only from the local telephone company through its central offices. Such arrangements have long been in use by hospitals and airports, and whose experiences have shown that tenants can save up to 30 percent of their local telephone costs. The so-called "bypass" technology permits telephone subscribers to make local calls without using the local public telephone network and to reach a long-distance carrier's facilities directly (see, Section IV, "Technological Analysis" [pp. 10-13]).

Deregulation

Although it is generally believed that the current confusion over the taxable status of telecommunications property is due solely to the AT&T divestiture, a series of judicial decisions and regulatory actions preceding and concurrent with divestiture have had an equally direct impact upon real property tax administration. When coupled with technological change, it is fair to conclude that had divestiture never occurred, a very serious problem would exist with telecommunications taxation.

The first ruling was the landmark Carterphone decision (13 F.C.C.2d 420; 14 F.C.C.2d 571; 15 F.C.C.2d 605 [1968]), which allowed commercial and residential telephone subscribers to connect non-Bell customer premises equipment (CPE) to the local telephone network. It was this decision by the Federal Communications Commission (FCC) which created the circumstances which led to the Crystal and Crossman Cadillac cases reviewed in Section II, "Legal Analysis" (p. 6).

The deregulation of the CPE market was soon followed by the deregulation of long-distance transmission services. In 1977 and 1978, the Execunet decisions (MCI Telecommunications Corp. v. FCC, 561 F.2d 365 [D.C. Cir. 1977], cert. denied 434 U.S. 1040 [1978] [Execunet I], and MCI Telecommunications Corp. v. FCC, 580 F.2d 590 [D.C. Cir.], cert. denied 439 U.S. 980 [1978] [Execunet II]) allowed MCI to compete with AT&T for the long-distance market. Since then, many other common carriers such as Sprint, Satellite Business Systems, and other resellers of AT&T lines have entered the marketplace, resulting in reduced long-distance communications costs.

The most comprehensive deregulatory action taken by the FCC is its Computer Inquiry II ruling (77 F.C.C.2d 384, reconsid. 84 F.C.C.2d 50 [1980], further reconsid. 88 F.C.C.2d 512 [1981], aff'd sub nom. Computer & Communications Industry Association v. FCC, 693 F.2d 198 [D.C. Cir. 1982], cert. denied 103 S.Ct. 2109 [1983]). The Computer Inquiry II ruling allowed AT&T to enter the competitive CPE market through its unregulated, fully separated subsidiary, AT&T Information Systems (ATTIS).

Subsequent to Computer Inquiry II, the FCC, in a decision and order issued October 26, 1984 (FCC 84-483), held that the independent telephone companies, such as Rochester Telephone and Continental Telephone, would not be required to establish a separate subsidiary in order to participate in the CPE market. If such a company does not provide for this subsidiary, "it must use separate books of account for its unregulated activites." Thus, in the case of those independent companies which choose not to establish a separate subsidiary, leased CPE will continue to be owned by a "utility" and will be considered taxable real property under the case law construction of section 102(12)(d). Comparing this classification to that of the equipment transferred to ATTIS, it is difficult to conceive of another situation so at odds with the "in rem" concept of real property taxation.

IV. TECHNOLOGICAL ANALYSIS

The types of equipment which are currently subject to real property taxation are described in Section V, "Conclusions and Recommendations" (pp. 14-16). In this section of the Report, the future of telecommunications technology and its applications are analyzed.

The large number of private firms entering the telecommunications industry is the direct result of both deregulation and recent technological changes. These changes and newly developing technologies will continue to complicate the description and identification of telephone equipment. The distinction between telephone and other telecommunications services will be increasingly difficult to ascertain. For example, traditional notions of central office equipment will have to be revised because of the multiple use, miniaturization, and mobility of new switching, receiving, and transmission devices.

Bypass

Any discussion of future technology must include the subject of "bypass". While this term does not admit of a simple definition that covers all terminology in use today, for our purposes we offer the following: bypass is the use of nontelephone company facilities to provide telecommunications.

Bypass is not a new phenomenon. It has been practiced for well over a decade in the interstate long distance area, primarily as a result of FCC actions to promote competition in the telecommunications industry (see, Section III, "Divestiture and Deregulation Analysis" [pp. 8-9]). These have led to a growing number of long distance carriers, in addition to AT&T. Local bypass, however, is a relatively recent phenomenon which has occurred for two reasons, both of which have as a common denominator the price a customer pays for telecommunications services.

The first reason is the cost trend in bypass technology; that is, the reduction in the cost to the customer of alternatives to services previously provided only by the local telephone company. This cost reduction has been very dramatic and is expected to continue.

The second reason is competition among carriers of long distance telecommunications between points within a state, rather than between states. This is also known as intercity competition. In a competitive market place, the providers of service compete for business on the basis of price and part of the price the intercity carriers charge reflects their costs of access to the local telephone network to originate or terminate the intercity call. In the interest of holding down or reducing those local access costs, the intercity carrier can take advantage of the same bypass technology which is available to those customers who have already provided their own bypass facilities. Thus, instead of merely holding down or reducing access costs, the intercity carrier can eliminate them altogether and pass that savings on to its own customers.

Therefore, while encouraged by a decade of dynamic deregulation and technological advance, bypass largely owes its proliferation to economic considerations. Users of bypass facilities, especially large business users who are

subject to forces which have increased their communications costs as they operate in an increasingly complex information environment, are attempting to gain more efficient control over these costs and operations by greater use of customer-owned telecommunications networks. (According to the FCC, "[t]o date [December 22, 1982], we have not discovered any established forms of household bypass in the U.S." [Matter of MTS and WATS Market Structure, Third Report and Order, FCC 82-579, p. 2, n. 2].)

While rising costs are a major impetus in the increase in bypass, users consider a number of additional factors concerning whether to abandon the local telephone company for local service or AT&T for long distance communications: quality of service; availability and reliability of service; ability to quickly adopt innovations; and the vendor's reliability.

As befits a competitive, rather than regulated marketplace, the growing demand for customer-owned networks has been met by an array of suppliers, services and technologies.

> The expanding utilization of user-owned networks is a fact. There is little chance that the trend toward these networks can be reversed because most of the forces which encouraged their development are still operating. Various forms of local bypass will also become part of the large business and government user environment. Whether local bypass will be extensive and whether the local telephone companies will suffer much harm as a result are still open questions.

(Matter of MTS and WATS Market Structure, at 2-3).

It is interesting to note the response of a panel featured at a recent program on telecommunications when asked the question of whether bypass was a phenomenon to be practiced only against local telephone companies. The program, "Regulation and Deregulation after the AT&T Divestiture" was presented on December 13-14, 1984, in Washington, D.C., by the Practising Law Institute and Federal Communications Bar Association.

The panel consisted of the president of the trade association which represents local telephone companies; president of the management services subsidiary of one of the regional holding companies created as a result of divestiture; a senior policy advisor to the Assistant Secretary of Commerce for telecommunications matters; and a senior legal advisor to the FCC bureau chief for telecommunications. Excepting the regional holding company representative, who provided management services to the local telephone companies owned by his employer, the panel unanimously agreed that by 1990, local telephone companies would be in the business of providing long distance service to their local service customers. That portion of the divestiture order which prohibited this type of activity was not viewed as an insurmountable obstacle. The regional holding company representative, while not adding his vote to make the panel's response unanimous, did not disagree with its prediction.

Those categories of customers that have been identified as local bypassers are: federal, state and local governments; finance, insurance and transportation industries; industrial organizations with widespread distribution systems; and large educational institutions. The FCC has considered customers most likely to consider some form of local bypass during the next several years to be those characterized by:

1. high communications and information system costs ($30 million to $300 million per year);
2. a need for high-speed data communication networks;
3. sophisticated in-house communications planning;
4. use of large scale private line switching services such as those provided by the local telephone company as Centrex;
5. management which supports large scale private communications planning development; and
6. the ability to raise large capital outlays under high interest conditions.

Technology

The function of a telecommunications transmission system is to transmit information between two or more points. Transmission technologies can be distinguished in several ways:

1. type of medium used, such as copper wire pairs, coaxial cable, optical fibers or microwave (radio);
2. capabilities provided, such as voice or data or both, either by analog or digital transmission; and
3. capacities supported, that is, the amount of traffic which can be carried and which can be enhanced by the use of digital rather than analog transmission.

The availability of technologies for local bypass systems is beyond question. Moreover, it is expected that the media used will continue to benefit from advances resulting from all electronic research and development.

Copper Wire Pairs

This technology is the mainstay of the local telephone network. All customers have a wire pair or a number of wire pairs dedicated to their service connecting them directly to the central office. The arrangement is sometimes referred to as a "star network" in that there are lines going out like spokes from the central office to each customer location. When a customer's service terminates in a location outside the area served by its central office, the interoffice network, similarly connected by copper wire pairs, is used to carry the transmission to the terminating central office.

Coaxial Cable

This technology is commonly used for cable television applications but is increasingly applied for bypass. Rather than having a bundle of wire pairs carrying discrete transmissions to and from customers, a common cable is routed past customer locations and individual connections are made onto this single cable. The cable alone is sufficient to support the one-way transmission used by cable television companies. In order to use coaxial cable for bypass purposes, that is, two-way transmission,

additional electronics are needed at each customer location. Note, however, that this does not require separate cables for one-way and two-way transmission. Where a cable television system has two-way potential, and the entertainment services use only a portion of the band width or capacity (large as compared to copper wire pairs), the remaining capacity may be used for business bypass applications.

Optical Fiber

Fiber optic links is the newest bypass technology and has several characteristics worth noting. First and foremost, its mode of transmission is optical, rather than electrical; pulses of light are transmitted over glass fibers rather than electric current over metallic wires. It is also far more efficient than copper wire in terms of bandwidth capability for any particular distance. Extreme compactness allows it to fit where larger cables may not. This is particularly advantageous in a congested environment such as Manhattan where these tiny cables can be threaded through the existing underground duct system, thereby providing a greater number of circuits than currently exist without costly street excavation.

Microwave (radio)

The technology most often used for local bypass consists of some form of microwave system which transmits information by radio waves. This is probably due to the fact that no physical transmission medium is necessary. This, however, has its drawbacks. A line-of-sight path is essential between the transmitting and receiving points of the microwave link. Accordingly, microwave local bypass systems are sensitive to terrain, building profiles and weather. Furthermore, the reliability, security, and privacy of microwave systems are generally more difficult and expensive to ensure than are solid media transmission systems. Frequency availability and coordination present problems as well.

Bypass systems based on microwave transmission and used for long distance purposes are able to minimize line-of-sight problems by using satellites to relay communications. However, congestion of available transmission frequencies and the limited number of orbital slots for satellites limit the number of satellite channels.

As stated earlier, microwave systems are currently the most common form of bypass. In addition to the lack of a solid medium, the transmitting and receiving earth stations used have become smaller and now require dish antennae only 15-20 feet in diameter which can easily be located on a customer's premises.

V. CONCLUSIONS AND RECOMMENDATIONS

The Report has analyzed in detail the legal implications, the effects of divestiture, and the impact of technological change. From this review, it has become clear that the existing approach to valuation of telecommunications property no longer has relevancy. The conclusions and recommendations are based on the telecommunications industry as it exists in 1985 and the technological changes likely to occur in the years immediately ahead.

The definition of taxable real property for certain elements of telecommunications property has been of concern for several years, a situation only exacerbated by divestiture. The categories constituting the sum total of all property owned by various segments of the telecommunications industry and currently defined as taxable real property are separately discussed with respect to real property taxation; the State Board's conclusion and recommendation follow. In addition, we address: the continuation of RPTL, section 470; ownership as a criterion for the definition of taxable real property; and the fiscal impact of our recommendations.

A loss of property tax base is inevitable. In most instances we believe the tax base loss to be within acceptable limits. Where the loss is deemed to be significant, transition approaches or other revenue sources may need to be developed.

In addition, if property tax payments are being reduced for portions of the telecommunications industry, this needs to be reflected in the rate determinations of the Public Service Commission, so that consumers receive the benefit of the lower tax burden.

Central office equipment

Discussion

Central office equipment is the switchgear located in the central office buildings of the companies providing telecommunications services. Its function is to take calls placed by subscribers and route or complete the connection to the party being called. Central office equipment tends to be physically large and, as noted in Section II, "Legal Analysis" (p. 6), has been construed as taxable realty in the past on the basis that it is appurtenant to telephone lines pursuant to RPTL, section 102(12)(d).

The nature of central office equipment has lately been changing in several respects. Whereas it was formerly owned almost exclusively by local, national and international telephone companies, in recent years ownership of central office equipment has proliferated to a great many different types of owners. MCI, Sprint and other companies which provide transmission services to customers, as well as companies which acquire the equipment exclusively for their own use, now own significant amounts of central office equipment. Furthermore, the equipment itself is becoming more and more like a computer. The switching or routing of calls was an electromechanical operation as recently as the late 1960s and early 1970s in many central offices; that is, there were actual moving parts used to route calls to the correct lines. New central office switching is accomplished exclusively through electronic routing in a manner very similar to the electronic functions performed by large computer main frames.

Conclusion

Central office equipment has historically been taxed as realty on the basis that it was appurtenant to a complete telephone system. However, it does not comport with the common law notions of real property, i.e., land and structures affixed to the land. The recent changes in the telecommunications industry in general and to central office equipment in particular have been significant enough to question the advisability of continuing to tax central office equipment as realty.

Its ownership by a variety of companies subject to varying levels of regulation, the ease by which it can be moved (including out of state, presumably) and the rapidly changing technology with corresponding shortened service lives all are factors which favor the removal of central office equipment from the definition of taxable real property.

Recommendation

The State Board recommends that central office equipment no longer be defined as taxable real property.

Station Equipment

Discussion

Station equipment, also referred to as customer premises equipment, includes telephone instruments, private branch exchanges and the wiring associated with these items on the customer's premises. These items have also been taxed as real property on the basis they are appurtenant to a telephone network and are currently subject to the ceiling assessment provisions of RPTL, section 470.

Telephone instruments and private branch exchanges have undergone an even greater change in form of ownership in recent years than central office equipment. They are now available from any number of suppliers which are not utility companies, and little argument can be made for continuing their designation as realty. Since only those items owned by a utility are currently being taxed as realty, the State Board is of opinion that the nature of the item, not the owner, should be the determining factor in defining taxable real property.

Recommendation

The Board recommends that station equipment no longer be defined as taxable real property.

Outside plant

Discussion

Outside plant consists of the poles, wires, cables and conduits through which are transmitted the signals from sender to receiver. These have also been historically taxed as real property. Recently, the courts have construed the cable owned by cable

television companies that is not special franchise as not being taxable real property (see, Section II, "Legal Analysis" [p. 7]). Most of the new installation of this type of property is underground pursuant to PSC rules. Poles, being affixed to the realty and underground installations being placed in the land seem to satisfy the traditional definition of taxable real property.

Conclusion

The argument that overhead wires and conductors would not be taxable real property at common law while their underground counterparts would be so, does not warrant taxing the one and not the other.

Recommendation

The State Board recommends that outside plant, however located and by whomever owned, be taxed as real property. Accordingly, we further recommend that through legislation similar property owned by cable television companies be defined as taxable real property.

Land and buildings; special franchise

Discussion and conclusion

Land and buildings and special franchises are not controversial with respect to their definition as taxable real property; their status is well-settled.

Recommendation

The State Board recommends that land and buildings and special franchise property continue to be taxed as real property.

Continuation of Real Property Tax Law, section 470

Discussion

Section 470, enacted in 1973, places a ceiling on the taxable assessed value of central office equipment, station connections, station apparatus and private branch exchanges equal to the 1974 assessed value on these items. Therefore, any additions to these categories since the 1974 assessment rolls have been exempt from taxation.

Conclusion

If the State Board's recommendations above are accepted, the continuation of section 470 becomes moot, since each of the categories covered by section 470 would no longer be construed as taxable real property. The impact of these recommendations is reduced to the extent section 470 has exempted the value of these categories added since 1974.

Even if these recommendations are not followed, little basis exists to support the continuation of section 470 since its actual impact has exceeded the stated purpose of

its sponsors and has had untoward effects on local tax bases. The apparent intent of the statute was twofold: (1) to lessen the impact of the pre-1974 case law (see, Section II, "Legal Analysis" [p. 6]) by returning to a common law concept of real property, and (2) to relieve providers of telecommunications services of a tax burden not imposed upon property of companies engaged solely in the sale and lease of telecommunications equipment.

With respect to the latter point, central office equipment was never of the type with which local telephone companies (even in the predivestiture environment) had to compete for sales with private vendors unlike the customer premises equipment or station equipment also subject to the provision of section 470.

The administrative difficulties in interpreting and applying section 470 have long been noted (see, e.g., 6 Op. Counsel SBEA No. 7). However, with each year since 1974, assessments made pursuant to this section become further divorced from reality. For example, in 1974, New York Telephone reported the original cost of its central office equipment as approximately $3.3 billion. By 1983, this figure had increased to over $5.6 billion, an increase of $2.3 billion or nearly 70 percent, all of which is wholly exempt as a result of the operation of section 470.* If central office equipment is to be taxable, it should be taxable both for the period after 1974, as well as the period before 1974.

Recommendation

The State Board recommends the repeal of section 470.

Definition by ownership

Discussion

The taxation of some telecommunications property is currently a function of ownership. For example, some items of property if owned by a utility are taxable and if owned by anyone else they are non-taxable (see, Section II, "Legal Analysis" [pp. 6-7]). Also, recent lower court decisions have held that cable owned by a cable television company is non-taxable and if owned by anyone else, it is taxable.

Conclusion

The State Board believes that ownership should not be a criterion for taxable status. Rather, the nature of the property as it relates to the historical definition of real property should be the basis of the determination of the taxable status of real property. Our previous recommendations are consistent with this conclusion.

Recommendation

The State Board recommends that ownership not be a criterion for defining the taxable status of telecommunications property.

* Clearly, original cost balances are not equal to assessed values. However, by the consistent use of original cost, the scope of the increase is demonstrated.

Fiscal Impact

Discussion

All estimates of fiscal impact to date have been concentrated on the property of the New York Telephone Company. This is due to the ubiquity of their property and the availability of information concerning it. The tables included in Appendix A, "Fiscal Analysis", to this Report show our current best estimates of the property tax impact of the State Board's recommendations on New York Telephone. These impacts have not been translated into municipal tax base impacts. The indicated reduction from 1983 property tax payments for New York Telephone is $197.2 million. To some limited degree this would be offset by additions of property not currently taxable to the tax base. The $197.2 million, as a maximum property tax loss, is approximately 1.7% of existing tax levies.

Given the effects of Article 18, however, the $159.0 million property tax loss in New York City and Nassau would merely be redistributed within the utility class. Thus, the New York Telephone Company would absorb a significant percentage of the indicated property tax reduction.

The property tax loss for the remainder of the State is $38.2 million. This represents 0.65% of the $5.859 billion in property taxes levied in 1983.

Summary

The reported 1983 New York Telephone taxes by type of telecommunications property, along with the simulated impacts on assessing units using original cost data as a surrogate for assessments produces the following results:

1. The distribution of percentages of the telecommunications tax base lost into percentages of the total municipal tax base approximates:

0.5% or less lost	55% of assessing units
0.5 - 1.0% lost	30% of assessing units
1.0 - 2.0% lost	10% of assessing units
2.0% or more lost	5% of assessing units

2. The average loss in total municipal tax base, by assessing unit, is approximately 0.6%.

3. Larger, more urban locales are more likely to have greater fiscal impacts in terms of lost tax base and shifted tax burdens due to the locations of telecommunications investment (especially central office equipment).

Conclusion

The fiscal impacts of change in telecommunications tax policy are extremely difficult to estimate. Furthermore, the State Board recognizes that there will be concerns about any proposal which effects a reduction in the local real property tax base.

Appendix A

FISCAL ANALYSIS

FISCAL ANALYSIS

It cannot be overstated that it is extremely difficult to determine the impact upon the property tax base, either Statewide or by municipality, of the AT&T divestiture or FCC deregulation, let alone any amendment by the State Legislature of the definition of taxable real property. The lack of reliable inventories certainly contributes to this problem. Yet, even where information is forthcoming, difficulties remain.

The process by which information for this Report was gathered is described in Appendix B, "Comment from Interested Parties". Although many representatives of the telecommunications industry participated, only the New York Telephone Company complied to any extent with the request for data necessary to perform this Analysis. Accordingly, the fiscal impact of recent changes in the industry and recommended legislation is necessarily limited to the effects upon New York Telephone and those municipalities in which it is the predominant service provider. Note, however, that nearly 94% of the property taxes paid by the telecommunications industry are paid by New York Telephone.

Data provided by the New York Telephone Company is based upon the original cost reporting system prescribed for ratemaking purposes by the Public Service Commission; this valuation methodology is of questionable validity for property tax purposes. However, information shortcomings are not restricted to the industry. Entries of telecommunications property on local assessment rolls are often inconsistent or misstated; where they are not, their description is not helpful. Especially with respect to customer premises equipment, assessments of telephones, switchboards and inside wiring are invariably combined and entered as "station equipment." The difficulty this presents to the analyst now that the effects of divestiture and deregulation have vested ownership of these properties in two wholly unrelated corporations should be apparent to all. Nevertheless, an effort has been made to reconstruct as well as possible a breakdown of New York Telephone telecommunications property for assessing units. In about 60% of New York's assessing units the telephone company franchise is held by New York Telephone.

Before proceeding with the details of this Analysis, several statements can be made with some certainty:

(1) property tax levies in New York State are currently in excess of $11 billion;

(2) as a result of the adoption of the State Board's recommendations (see, Section V, "Conclusions and Recommendations"), some $210 million in taxes would be shifted away from the telecommunications industry (to some limited degree these tax losses would be offset by levies against additions of property not currently taxable, i.e., cable television transmission lines located on private property);

(3) of this $210 million, approximately $197 million is attributable to New York Telephone;

(4) of this $197 million, approximately $159 million is shifted within the utility class in New York City and Nassau County pursuant to RPTL, Article 18. (Under this class tax share system, each class is responsible for a

percentage of the total tax levy. Where the taxable assessed value of one class member's property is reduced, the other members of the class [including the first member] are responsible for the deficiency to enable the class as a whole to satisfy its share of the total tax levy.)

(5) of the $197 million, approximately $38 million is lost in the rest of the State; and

(6) for assessing units where New York Telephone is the primary franchise and has significant property, the average tax base loss is 0.6%.

The testimony of the New York Telephone Company to the State Board of Equalization and Assessment on November 7, 1984, included a breakdown of tax payments for counties and selected cities for the 1983 calendar year. Data were presented in terms of the Public Service Commission accounting categories, listing the tax liability in 1983 (pre-divestiture) for each. The six accounting categories are: central office equipment, station equipment, land, buildings, outside plant, and special franchise. We requested and received information from New York Telephone on the original cost (book value) of telecommunications equipment in these jurisdictions in order to construct a 1984 value for the following components:

1. Central Office Equipment Original Cost, 12/31/73 (section 470).
2. Station Equipment Original Cost, 12/31/73 (section 470).
3. Land Original Cost, (PSC)
4. Buildings Original Cost, 1/1/84.
5. Outside Plant Original Costs, 1/1/84.
6. Special Franchise Assessments, SBEA, 1984 Effective Full Value.

The first five of these data categories were supplied by New York Telephone and will not match existing assessed values. Due to appreciation of parts of this "original cost" inventory and depreciation of other parts, it is likely that the parts of the market value redefined as personalty by this proposal (i.e., values frozen by section 470) will be overestimated relative to the other categories of data provided by New York Telephone. The "original cost" of land and buildings is more likely to underestimate current full value, with the result that the procedure will overestimate the percent of current value lost by the redefinition of realty.

Offsetting this overestimate of the impacts of redefining central office equipment and station equipment as personalty is the observation that the data analyzed are post-divestiture. That is, telecommunications assessed value may have been reduced from the values on the rolls on December 31, 1983, as a result of divestiture. In the main, this telecommunications property would have been station equipment and central office equipment, thereby producing an underestimate of effects caused by redefining realty alone. The coincidence of these overestimation and underestimation effects in this analysis, to some extent, should balance out.

Two additional data components were added in order to judge the effects of redefinitions more comprehensively:

7. 1983 Municipal full value by assessing unit, SBEA.
8. 1983 effective full value tax rate, by assessing unit, Audit and Control.

With municipal full value we can judge the percentage of the tax base in each municipality shifted by the redefinition of realty. Applying that number to the effective tax rate in full value terms will produce the dollars "lost" to the municipalities.

Analysis

Data for over 800 assessing units were provided by New York Telephone. These units were reduced to 596 when places where New York Telephone does not possess the primary franchise for operating the telephone company were omitted. Another ten were excluded from the analysis where the total taxable telephone full value (as reconstructed) did not reach $100,000. With this, 586 assessing units (59% of those in the State) were retained for further study.

With the full value of telecommunications property reconstructed for these 586 assessing units, we can calculate the offset caused by the redefinition of realty to exclude central office and station equipment. That is, the full value of New York Telephone telecommunications property as of January 1, 1984, is assumed to be the sum of the six categories previously listed. Subtracting out central office and station equipment, allows us to find the percent of overall tax base lost, post-divestiture, as result of redefining real property for the New York Telephone Company.

A majority of places lose less than one-half of one percent of the municipal full value through this redefinition, about 85% lose less than one percent. More fully, we find the following losses from the municipal rolls:

Percent of Total Tax Base Lost	Number	Percent	Cumulative %
0.0 - 0.5%	318	54.3%	54.3%
0.5 - 1.0%	178	30.4%	84.7%
1.0 - 1.5%	47	8.0%	92.7%
1.5 - 2.0%	14	2.4%	95.1%
2.0 - 3.0%	20	3.4%	98.5%
3.0 - 4.0%	4	0.7%	99.1%
4.0 - 5.0%	4	0.7%	99.8%
8.0 - 9.0%	1	0.2%	100.0%
Mean Percent Lost = 0.6%			

Those places with larger telecommunications investment bases have greater losses:

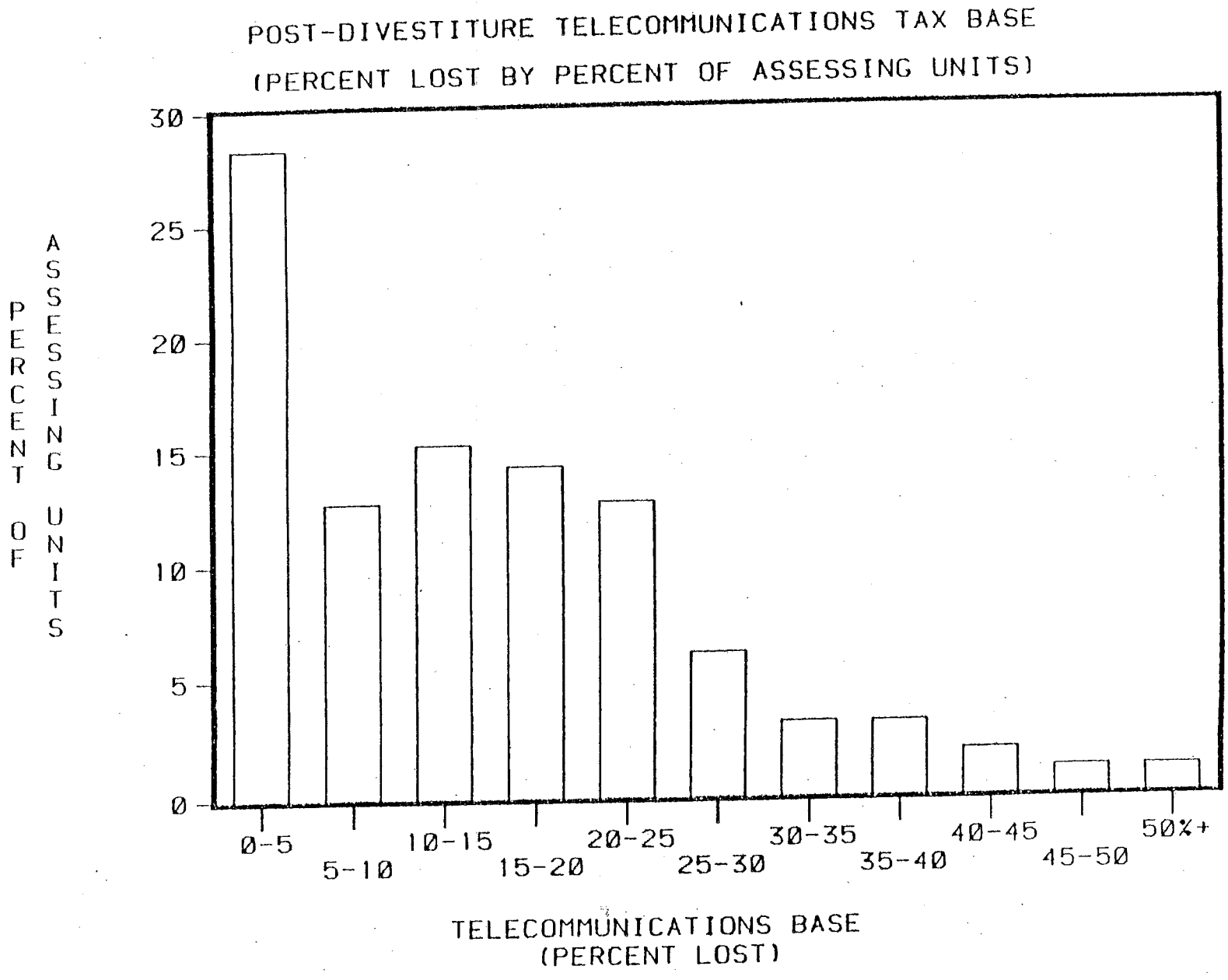
Size of Telecommunications Investment	Percent of Total Base Lost					
	0.0-0.5%	0.5-1.0%	1.0-1.5%	1.5-2.0%	Over 2%	Total
$1 m. or less	88.6%	9.6%	1.8%	0.0%	0.0%	100%
$1 - $10 m.	51.4%	35.1%	9.1%	2.3%	2.1%	100%
$10 m. or more	21.8%	36.8%	11.5%	5.8%	24.1%	100%

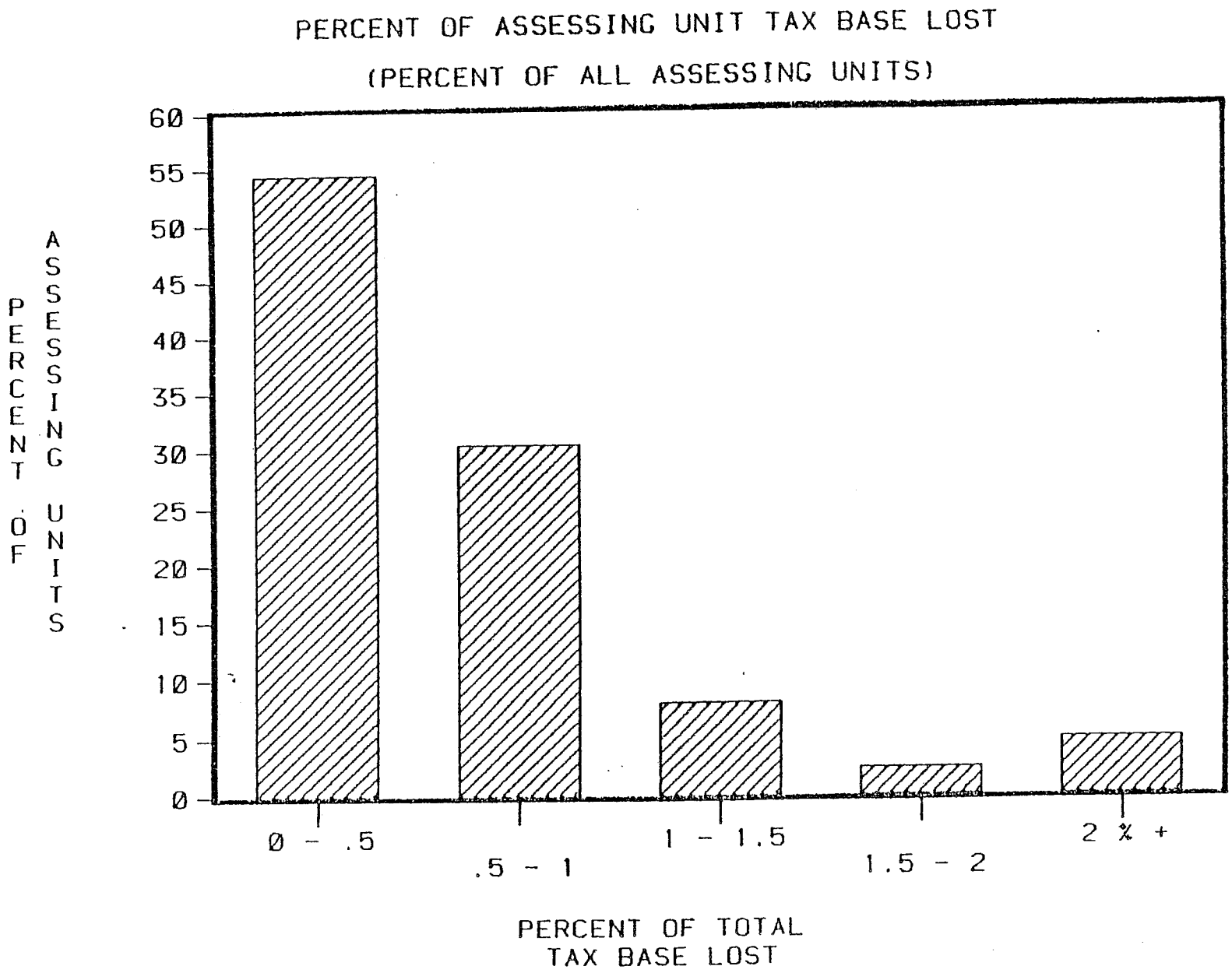
Figures illustrating these results are attached. It is evident in the figures that the smaller telephonic installations, totalling less than $1 million in full value, are not likely to make up more than one-half of one percent of municipal assessed value. Only one assessing unit in nine having a reconstructed base of one million dollars or less exceeds 0.5%. In the intermediate range, with reconstructed full values of one to ten million dollars, we still find six out of seven assessing units having a total tax base offset of less than one percent. This category makes up approximately two-thirds of the assessing units analyzed.

One final view of the distribution of fiscal impacts in the State isolates large dollar effects, by assessing unit. The listing below depicts the overall size of the 1983 tax levy by the size of the tax shift in dollars:

OVERALL TAX LEVY	TAX DOLLARS SHIFTED (000s)				
	1/less	1-10	10-100	100-1000	1000/more
1,000,000/less	92	78	5	0	0
1 - 10,000,000	28	123	152	14	0
10 - 100,000,000	1	4	30	46	4
100,000,000/more	0	0	0	2	8

Outside of New York City and Nassau County, which have the tax base impact limited to the utility class, the municipalities with the largest dollar impact are the cities of Albany, Buffalo, Mount Vernon, Syracuse, White Plains and Yonkers and the Towns of Babylon, Huntington, Islip, Smithtown.


POST-DIVESTITURE TELECOMMUNICATIONS TAX BASE
(PERCENT LOST BY PERCENT OF ASSESSING UNITS)
PERCENT OF ASSESSING UNITS
30
25
20
15
10
5
0
0-5
5-10
10-15
15-20
20-25
25-30
30-35
35-40
40-45
45-50
50%+
TELECOMMUNICATIONS BASE
(PERCENT LOST)


PERCENT OF ASSESSING UNIT TAX BASE LOST
(PERCENT OF ALL ASSESSING UNITS)
PERCENT OF ASSESSING UNITS
60
55
50
45
40
35
30
25
20
15
10
5
0
0 - .5
.5 - 1
1 - 1.5
1.5 - 2
2 % +
PERCENT OF TOTAL
TAX BASE LOST

Appendix B

COMMENT FROM INTERESTED PARTIES

COMMENT FROM INTERESTED PARTIES

Background

In order to describe the present components of the telecommunications industry and its future development, as well as to analyze the fiscal implications of a range of possible legislative actions upon the industry and local governments (see, Appendix A, "Fiscal Analysis"), a program of staff education was necessary. Beginning in mid-October, 1984, legal and research staff conducted a series of meetings with interested parties to gather information and data concerning the telecommunications industry in general, and assessment and real property taxation in particular. On November 7, the State Board heard many of these participants formally present their views at its regularly scheduled meeting (see, this Appendix [p. 7ff]). The Board extends its appreciation to the representatives from the industry, local government, the New York State Public Service Commission and academia who participated in these efforts.

In this Appendix to the Report, the comments and recommendations made by each of the participants are summarized. The date of each meeting is indicated in the parenthetical following the participant(s).

The Industry

AT&T (10/25/84)

Participants were Richard Krol, Director of State and Local Taxes for AT&T "Corporate," Douglas Krey of AT&T Information Systems (ATTIS), and Ralph Meloro and Jack Butler of AT&T Communications of New York*. Their recommendations were the following:

(1) eliminate customer premises equipment from the definition of real property;
(2) repeal chapter 895 of the Laws of 1984;
(3) phase-out the real property tax on central office equipment over a twenty-year period;
(4) permit the industry to deduct from its gross receipts tax (Tax Law, §186-a) the phased-out property tax on central office equipment;
(5) make these changes effective January 1, 1984.

AT&T contends that were it not for its embedded base, ATTIS would not be in the business of leasing customer premises equipment and that if recommendations (1), (2) and (5) are not adopted, ATTIS will be the major, if not only, assessee for this type of property.

New York Telephone (NY Tel) (10/19/84)

Michael Fortier and Patrick Lee represented NY Tel, and subsequently submitted a position paper which was formally presented to the State Board at its November meeting. The rapidly changing nature of the industry, particularly "bypass" technology, was discussed at length (see, Section IV, "Technological Analysis" [pp. 10-13]).

* For a discussion of these entities see, Section III, "Divestiture and Deregulation Analysis" (p. 8).

They questioned the wisdom of replacing the property tax with a gross receipts tax or net income tax, noting that regulated and unregulated companies would not keep their books in the same manner and, thus, such a replacement tax might fall as unevenly as the property tax.

NY Tel estimated the fiscal impact upon the company of the following different types of (potential) property tax approaches assuming a 1984 tax year without the ownership effects of divestiture:

	"FACTS"	TAX LIABILITY
(A)	Chapter 895 not enacted (i.e., taxation of land and buildings, special franchise, outside plant [non-special franchise lines, wires and poles], station equipment and central office equipment)	$509 million
(B)	Repeal §470, without any change in the definition of real property	$654 million
(C)	Leave §470 as it is, but delete station equipment from the definition of real property	$492 million
(D)	Repeal §470 and delete station equipment from the definition of real property	$573 million
(E)	Amend the definition of real property to exclude station equipment, central office equipment and outside plant	$240 million

They recommended the last of these options, amendment of the statutory definition, subject to a gradual phase-out of such property from the tax base (over a five year period).

Continental Telephone of N.Y. (CONTEL) (10/31/84)

George W. Rodgers, Property Tax Administrator, presented the case for CONTEL, one of the "independent" local telephone service providers which does business in 37 counties in New York.

CONTEL objects to the property tax in New York because of the types of equipment included in the definition of real property. Mr. Rodgers stated that the company's total property tax liability in New York State was $7 million, about $1.5 million of which is "§470 property". He estimated that about one-third of the "§470" tax bill is attributable to customer premises equipment.

Mr. Rodgers stated that he works on behalf of his employer in 13 states and that the effective tax rates on his company range from 0.6% to 1.0% outside of New York State but is 2.4% within the State. (Mr. Rodgers did not elaborate on either the standards of assessment used in states other than New York or reveal whether the taxable real property included real or personal property or both.)

Rochester Telephone (11/7/84)

Richard Murphy, Manager - Corporate Taxes, represented Rochester Telephone, another independent local service provider which operates directly in nine counties, and which has several operating subsidiaries elsewhere (e.g., Highland, Sylvan and Ausable Valley).

Mr. Murphy stated that the technology exists now for cable television to compete directly with the telephone industry.

In terms of the telephone technology, he stated that the new central office equipment is essentially a computer and that there is more and more decentralization of this equipment, a statement heard frequently during the course of our meetings.

Rochester Telephone has been active in the sale of station apparatus to its customers - the number of stations still owned by the Company is 170,000 less than in 1974.

Mr. Murphy discussed the increasing use of microwave technology and fiber optics. In regard to the latter he noted that this technology will never entirely replace the copper cable currently in service since the glass fibers can be used only on straight runs, cannot go around corners, through buildings, etc.

He said his primary concern is that taxation not have an anti-competitive impact on his company.

N.Y.S. Telecommunications Association (10/29/84)

Keith J. Roland, Counsel and Executive Secretary, spoke on behalf of the Association which is composed primarily of manufacturers and distributors of customer premises equipment (e.g., Executone; Telecom Plus), and who deal almost exclusively with businesses. The members of the Association are collectively referred to as interconnect vendors.

In responding to claims by ATTIS that the current tax system puts it at a competitive disadvantage, Mr. Roland made the following observations:

(1) since January 1983, about one-half of all new systems installed were by private interconnect companies, but that this represents less than five percent of the total market due to ATTIS' embedded base;
(2) that while the interconnects generally pay a sales tax, when, prior to divestiture, NY Tel was in the business of providing CPE, it didn't "pay" its supplier, Western Electric, and, therefore, did not have an additional cost to pass on to its customers (this property has since been transferred to ATTIS); and
(3) beginning in the mid 1970s, NY Tel basically committed its customers to pay for equipment over a specified period, regardless of whether the equipment was actually used for the entire period. According to Mr. Roland, NY Tel built into its tariffs property taxes due on such systems, which continue to be collected whether or not the equipment is still taxable.

Cable Television Association (10/24/84)

Participants were Richard Alteri and Joshua Koenig, Esq., President and Vice President-Counsel, respectively.

These representatives stated that cable TV is increasingly a business of selling a product rather than a service; that it competes directly with entertainment such as live sporting events and theaters*. They disagreed with those who suggest that cable TV is or could be in the reasonably foreseeable future in direct competition with the two-way telephone transmission industry, contending that their clients do not have switching equipment and the type of plant needed to handle local loop bypass for use in long distance calling.

Local Governments

On October 25, thirteen representatives of local governments met with staff.** Their primary concern was maintaining the current revenue flow from the taxation of the telecommunications industry.

The following suggestions were made: an extension of chapter 895 for one more year; creation of a shared tax base among assessing units in which no central office equipment is located; and a gradual phase-out of the taxation of station equipment over a period of years, allowing the normal growth in the remaining tax base to pick up the consequent loss.

Several objections were raised to the possible substitution of a gross receipts tax, including the likely negative effect on tax and debt limits and the expense of collection and pass-through to the local governments if the State were responsible for its administration.

NYS County Directors Association (10/18/84)

The Association was represented by the following county directors:

Ronald Shetler (Association President), Chemung County;
Paul Burckard, Sullivan County;
Peter Ramundo, Rockland County; and
Ivan Moscrip, Broome County.

The Association did not present a recommendation or proposal for staff review, stating, instead, that their position would be one of reaction rather than initiation. The Directors spoke at length about their recent meetings with the Temporary State Commission and how alternative tax systems were being explored by Commission staff. The State Board was urged to keep an open mind to such revenue-raising alternatives.

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* We note that Messrs. Koenig and Alteri would - and did - object strenuously to characterizing cable TV within the telecommunications industry.

** City of Syracuse, Village of Scarsdale, NYS Assessors Association, Nassau County Village Officials Association, NYS Conference of Mayors, NYS Association of Counties, Association of Towns.

New York City (10/30/84)

Daniel Baumol spoke on behalf of Carol Kellermann, Assistant Commissioner for Planning and Research, New York City Department of Finance. The City's proposal concentrated on the City and Nassau County because of a lack of statistical information about the telecommunications industry in the rest of the State.

In summary, this proposal would provide the following:

(1) remove customer premises equipment from the definition of taxable real property;
(2) define as taxable real property the central office equipment owned by New York Telephone and AT&T and that of their direct competitors for local and long-distance service, respectively;
(3) repeal RPTL, section 470;
(4) exempt from real property taxation 20 percent of all nonspecial franchise telecommunications property (lines, wires, poles and central office equipment); and
(5) make inapplicable to class three utility property the transition assessment provisions of RPTL, Article 18.

NYS Public Service Commission

Meetings were held with representatives of the accounting (10/23/84) and systems planning (11/1/84) staffs of the PSC.

The consensus was that the technology is changing so rapidly that it is impossible to plan a property tax system for the industry for more than the next five years. In explanation, the systems planners pointed to facts such as the PSC allowing more compact depreciation schedules for new equipment because it seems unlikely that today's equipment will remain in place for any extended period due to the demands for increased and improved communication systems. They agreed with industry suggestions that there would be increasing decentralization of central office equipment.

Discussion was also had of terms such as "resellers", cellular radio services and radio telephone utilities. The suggestion was made that if the property tax on telecommunications equipment is continued in some form, "data" should be included as an item of transmission, since even ordinary telephonic communications are being converted into data streams.

PSC staff noted that resellers and bypassers will have a direct impact on investments otherwise made by traditional utility - telephone companies, but it is impossible to estimate the actual impact. They said there were significant fiscal incentives for users and service providers to decentralize, including:

(1) cost and capacity of outside plant;
(2) advances in technology;
(3) maintenance expenses; and
(4) building expenses.

These PSC staff disagreed with industry representatives on the classification of central office equipment, insisting instead that such equipment still satisfies the traditional concept of real property.

Academia

Rensselaer Polytechnic Institute (RPI) (11/14/84)

As with meetings held with the systems planning staff of the Public Service Commission, the purpose of the meeting with Dr. Lester Gerhardt, Professor and Chairman, Electrical, Computer, and Systems Engineering Department, was the continued education of staff on the future of the telecommunications industry. Dr. Gerhardt presented an interesting and somewhat unique background. Though unfamiliar with the real property taxable status of any telephone property other than land and buildings, Dr. Gerhardt claimed great familiarity with the court-ordered divestiture of AT&T through his appointment by Governor Carey to study and respond to the effects divestiture would have upon the State of New York.

On the issue of bypass technology, Dr. Gerhardt spoke of how RPI has built its own local area network, thereby entirely eliminating New York Telephone from any service functions on campus. The utility is limited to providing local service to off-campus locations and connections to long-distance carriers. With respect to the latter, there, too, RPI's network offers the possibility of bypassing AT&T's long distance service. Dr. Gerhardt explained that the large private branch exchange that serves as the "central office" for the local area network, is capable of routing a long distance call to the most beneficial (to RPI) carrier, be it AT&T, MCI, Sprint, etc.

Much of Dr. Gerhardt's discussion confirmed what staff had learned from the PSC as well as the industry. As noted above, there appears to be some dispute between the telephone and cable television industries as to the potential for the latter to compete for the former's traditional telephone service. Dr. Gerhardt claimed that the same technology that would allow such competition could also be used by a telephone company to offer traditional cable television services. He thought this unlikely for reasons other than technology, but the point was well-taken: the line between these traditional services is becoming more and more attenuated.

State Board Meeting

During the series of staff meetings with industry representatives and local government officials and organizations, many of the participants indicated a desire to formally present their views to the State Board. Accordingly, on November 7, 1984, at its regularly scheduled meeting, the Board received more than two hours of testimony.

The following are several of many salient points made during the meeting:

1. The municipal groups favor an extension of chapter 895 to allow for further study due to a desire to learn more about fiscal impact; the industry and the City of New York are generally opposed.

2. Divestiture and deregulation have inexorably altered the telecommunications industry.

3. Inequitable tax policies engender bypass of the local telephone network which leads to increased telephone rates for residential customers.

4. The fiscal impact of any solution is currently unknown and possibly unforeseeable.

The transcript of this testimony, including written submissions by several of the participants, is presented here as a permanent record of the meeting.

Appendix C

RECOMMENDED LEGISLATION

RECOMMENDED LEGISLATION

AN ACT to amend the real property tax law, in relation to the definition and treatment as real property of certain telephone and telegraph equipment

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Legislative findings. The law establishing the taxable status of telephone and telegraph equipment has been made inapposite by technology and judicial and administrative decisions. The development of electromagnetic transmissions by means such as satellite relays and fiber optics has made the terminology of section one hundred two of the real property tax law obsolete. Moreover, the deregulation of the telecommunications industry as a result of rulings of the federal communications commission and the court-ordered divestiture of the AT&T system requires review and revision of existing laws on the taxable status of telecommunications property.

In enacting this chapter, the legislature hereby finds and declares that it intends to establish predictable statutory definitions of the taxable status of modern telecommunications property. The act is intended to restore the in rem concept to the taxation of this type of property by taxation of the property necessary for transmission of the signal to the receiving building, whether home or office, and without regard to the content of the signal or whether the transmission equipment is owned by a public utility. Similar types of property will thereby have the same taxable status, regardless of ownership, and competitive industries will be treated alike. Moreover, the chapter is intended to establish in statute an appropriate limitation to the taxation of property without the expansive definition of appurtenance

as including equipment installed upon a customer's premises or that of the service provider. Instead, this definition is confined to a transmission medium which is located in, upon, above or under any private street or place.

§2. Paragraph (d) of subdivision twelve of section one hundred two of the real property tax law is REPEALED and a new paragraph (d) is added to read as follows:

I T A L I C S

(d) Lines, wires and poles used in the electromagnetic transmission of information or programming. For purposes of this paragraph, real property shall include such equipment regardless of whether its ownership is subject to the jurisdiction of the public service commission, but shall not include (1) any movable equipment or wiring installed upon a customer's premises for the purpose of originating, routing or completing such transmission; (2) any "central office equipment" as this term is defined for purposes of the uniform system of accounts prescribed for telephone and telegraph corporations by the public service commission, or any equipment used for a similar purpose but not limited to that owned by a corporation which is subject to the jurisdiction of such commission; and (3) machinery and equipment installed on the premises of a radio or television company and used in connection with furnishing radio or television programming.

§3. Paragraph (e) of subdivision twelve of section one hundred two of such law is amended to real as follows:

(e) Mains, pipes and tanks permitted or authorized to be made, laid or placed in, upon, above or under any public or private street or place for conducting steam, heat, water, oil, electricity or any property, substance or product capable of transportation or conveyance therein or that is protected thereby; <u>supports and inclosures for electrical conductors and other appurtenances, upon, above and under ground</u>;

§4. Section four hundred seventy is REPEALED.

§5. Section four hundred ninety of such law, as separately amended by chapters one hundred five and nine hundred nineteen of the laws of nineteen hundred eight one, is amended to read as follows:

Real property exempt from taxation pursuant to subdivision two of section four hundred, subdivision one of section four hundred four, subdivisions one and three of section four hundred six, sections four hundred eight, four hundred ten, four hundred twenty-a, four hundred twenty-b, four hundred twenty-two, four hundred twenty-six, four hundred twenty-eight, four hundred thirty, four hundred thirty-two, four hundred thirty-four, four hundred thirty-six, four hundred thirty-eight, four hundred forty-eight, four hundred fifty, four hundred fifty-two, four hundred fifty-four, four hundred fifty-six, [four hundred seventy,] four hundred seventy-two and four hundred seventy-four of this chapter shall also be exempt from special ad valorem levies and special assessments against real property located outside cities and villages and special ad valorem levies and special assessments imposed by a county improvement district or district corporation except (a) those levied to pay for the costs, including interest and incidental and preliminary costs, of the acquisition, installation, construction, reconstruction and enlargement of or additions to the following improvements, including original equipment, furnishings, machinery or apparatus, and the replacements thereof: water supply and distribution systems; sewer systems (either sanitary or surface drainage or both, including purification, treatment or disposal plants or buildings); waterways and drainage improvements; street, highway, road and parkway improvements (including sidewalks, curbs, gutters, drainage, landscaping, grading, or improving the right of way) and (b) special assessments payable in installments on indebtedness including interest contracted prior to July first, nineteen hundred fifty-three, pursuant to section two hundred forty-two of the town law or pursuant to any other comparable provision of law.

§6. Notwithstanding the provisions of any general, special or local law to the contrary, the assessor, or the person or body having custody and control of the assessment roll at the time that this act takes effect, may conform the assessments of property to comply with the provisions of this act, upon notice to the owners of such property. If the changes are made to the roll after the levy of taxes, corrected tax bills may be issued and, where appropriate, refunds made. Judicial review of any such changes shall be brought as provided in article seven of the real property tax law.

§7. This act shall take effect on January first, nineteen hundred eighty-five and shall apply to assessment rolls prepared on the basis of taxable status dates occurring on or after such date.

REPEAL NOTE: Paragraph (d) of subdivision twelve of section one hundred two of the real property tax law, proposed to be repealed by this act, defines as real property certain telephone and telegraph equipment. Section four hundred seventy of the real property tax law, proposed to be repealed by this act, provides a ceiling assessment on telephone and telegraph central office equipment, station equipment, station apparatus, station connections and private branch exchanges. The assessed value of such property may not exceed the assessment thereof as of December thirty-first, nineteen hundred seventy-four except in cases of tax district-wide revaluations.

Appendix D

SBEA MEMORANDA TO LOCAL ASSESSMENT OFFICIALS

Memorandum

STATE OF NEW YORK
STATE BOARD OF
EQUALIZATION AND ASSESSMENT

December 20, 1983

TO: County Directors of Real Property Tax Services

FROM: Robert L. Beebe, Counsel

SUBJECT: AT&T Divestiture

As you are undoubtedly aware, on January 1, 1984, the divestiture of AT&T will take effect. At this time, we do not have any documentation which provides information concerning the actual transfer of title of telephone property and equipment. Accordingly, it is not clear what effect this event will have on real property tax administration.

We are now reviewing the issues involved (e.g., the effect on the ceiling assessments imposed pursuant to section 470 of the RPTL), and we will be meeting with industry and local government representatives within the next few weeks.

In the interim, we recommend that there be no change in the assessment of telephone equipment, although some of it may be involved in the divestiture. If it is subsequently determined that the taxable status of some or all of the equipment in a particular assessing unit has changed, we will so advise you. The tentative assessments of this type of property will, of course, remain subject to administrative and judicial review.

Please advise all assessors within your County.

83-24

Memorandum

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
DIVISION OF EQUALIZATION AND ASSESSMENT

February 2, 1984

TO: County Directors and Assessors

FROM: Robert L. Beebe, Counsel

SUBJECT: Telephone Equipment

In my memorandum of December 20, we recommended no change in the assessment of telephone equipment pending further investigation by our staff. Based upon further research and a series of meetings with representatives of the industry, we now have information which may assist you in determining whether or to what extent you should assess telephone equipment.

I. BACKGROUND

On January 3, 9 and 30, our staff met with tax managers from New York Telephone (NY Tel), AT&T Information Systems (ATTIS) and AT&T Communications, Inc. (ATTCOM), respectively. From these meetings and our own research, we have learned that two contemporaneous developments are changing the telephone industry.

Divestiture

The first of these - divestiture - is one with which you probably have some familiarity. As a result of the judicially supervised break-up of the Bell System, the twenty-two Bell Operating Companies (BOCs), such as NY Tel, are no longer a part of that system. Property and equipment previously used for both local and long distance calling has been divided between the BOCs and AT&T based upon a determination of whether the "predominant use" was a local or long distance service.

In preparing the 1984 assessment roll, it will be necessary for you to take into account the fact that some of NY Tel's central office equipment has been transferred to AT&T Communications of New York, Inc. It is our understanding that NY Tel and ATTCOM of NY are in the process of identifying the jurisdictions in which NY Tel central office equipment has been transferred.

FCC Decisions

In addition to the divestiture, however, you should also be aware that there has been a series of decisions issued by the Federal Communications Commission (FCC) which may affect real property tax administration. Summarily stated, those decisions deregulated the sale and leasing of customer premises equipment (CPE), which includes "station apparatus" (the ordinary telephone handset and related equipment located on the subscriber's premises) and "private branch exchanges" (PBXs).

However, the FCC decisions also required AT&T to create a separate subsidiary if it wished to engage in deregulated, competitive marketing of CPE and enhanced services, such as electronic publishing. That subsidiary is ATTIS.

NY Telephone (NY Tel) and AT&T Information Systems (ATTIS)

Assessors in villages and cities with a January taxable status date have by now received memos from John Greene of NY Tel and Douglas Krey of ATTIS advising you of the recent transfer of ownership of some of NY Tel's equipment to ATTIS. It is our understanding that title was conveyed as of January 1, 1984. The equipment transferred included "station apparatus" and PBXs (collectively referred to as CPE, as noted above).

These types of equipment, together with "station connections" (drop wires from the telephone pole to the block and wires from the block to the house wire), were once referred to collectively as "station equipment". Note that ownership of the station connections was not transferred to ATTIS. Thus, it is imprecise to say NY Tel has transferred title to all of its "station equipment."

In the next several years, NY Tel will amortize "station connections" out of its rate base. Because of both this amortization and the transfer of the station apparatus and PBXs to ATTIS, it is the contention of NY Tel that the assessment of its telephone station equipment which is subject to the "470 ceiling" should be eliminated.

It is the position of ATTIS that the station apparatus and PBXs so conveyed are personal property because ATTIS is not a "utility" and, therefore, under a series of New York judicial decisions its equipment does not qualify as real property under section 102 of the RPTL.

RPTL, §102(12)(d)

Since 1881, the term "real property" has been defined to include certain telephone and telegraph equipment, namely "lines, wires, poles and appurtenances". Beginning in the late 1930's, the courts issued a series of opinions construing the word "appurtenances" as including central office equipment and equipment leased to and located on the premises of a subscriber to telephone service, including the ordinary wall or desk telephone instrument in the home.

That interpretation remained unchanged until 1976, when the Court of Appeals declared that portable plug-in phones owned by a subscriber and located on that

subscriber's premises are not real property subject to taxation. In subsequent cases, the Court has said that:

> (1) section 102(12)(d) is "aimed principally at expanding the definition of real property with respect to utility companies"; and
>
> (2) the only other telephone equipment which would constitute a telephone "appurtenance" within the meaning of the RPTL is that which is "incorporated as part of the real estate".

RPTL, §470

Section 470 establishes a ceiling or maximum taxable assessed value equal to the 1974 assessment, on specified categories of telephone equipment, namely:

> central office equipment
> station equipment*
> station apparatus
> station connections
> private branch exchanges

With the exception of "station equipment" (see footnote), these are terms of art derived from the Uniform System of Accounts established by the New York State Public Service Commission (PSC) for telephone and telegraph companies (16 NYCRR, Chapter VI, Subchapter E).

The exemption authorized by section 470 was enacted in 1973 in response to complaints of the telephone companies that they were being unfairly taxed for two reasons: (1) that the court decisions in the 1930's and 1940's had unjustly extended the definition of real property to include telephone equipment which would have been considered personal property at common law; and (2) that since 1968, the FCC had permitted private vendors (e.g. Tandy/Radio Shack; GTE) to sell CPE which often went unassessed. Since these competing vendors did not have to concern themselves with property tax liability, the telephone companies contended that they (the companies) were at a competitive disadvantage in the CPE market.

II. AT&T INFORMATION SYSTEMS (ATTIS)

ATTIS contends that it is not a "utility company" because it is not regulated and is not in the business of transmitting telephonic services. If ATTIS is correct, the case law described above with respect to section 102 of the RPTL requires that the telephone equipment of ATTIS located on a subscriber's premises be considered

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* As I have mentioned above, the term station equipment is, in fact, an "umbrella" term which includes the three types of equipment listed below it. This was confirmed by both industry reps and the PSC who said that the term was in use before the time that the three other categories were separately identified.

personal property. (Note that there can be no question that the telephone instruments sold by ATTIS - as opposed to those it is leasing to subscribers - are not real property).

In a December 1983 decision, the FCC concluded that the marketplace for CPE had become increasingly competitive and that continued regulation of CPE was not necessary and could impede the further growth of this competition. It also noted that in a prior (1980) decision, the FCC had required AT&T to establish a separate subsidiary if it wanted to engage in deregulated, competitive marketing of CPE and enhanced services, such as electronic publishing. ("Enhanced services" in very simple terms is combined data processing and communications services).

In the 1983 decision, the FCC declined to permit state regulatory bodies, such as New York's PSC to "tariff" or regulate ATTIS' participation in the CPE marketplace. However, the FCC itself imposed certain limitations on the rentals or prices chargeable by ATTIS for embedded (i.e., in place) CPE, for a two year "transitional" period (through 1985). In paragraph 80 of its decision, the FCC notes that "after the transition, ATTIS will be in a position to recover its costs in the competitive marketplace because it will have complete pricing flexibility".

Under New York law, a "utility company" is variously defined as one subject to the "jurisdiction, supervision and regulations" of the PSC (Public Service Law, §2(23)) one which "sells . . . telephony or telegraph . . . or furnishes . . . telephone or telegraph service" (Tax Law §186-a(2)). The Legislature has said that the scope of this latter definition was intended to cover non-regulated persons or companies "competition with ordinary utilities". Based upon the decisions of the FCC, it is clear that ATTIS is not subject to such regulation by the PSC. Similarly a "telephone corporation" is one which owns, operates or manages "any telephone line or part of telephone line used in the conduct of the business of affording telephonic communication for hire" (Public Service Law, §2(17); see also, Transportation Corporations Law, §25). It does not appear that ATTIS is a "telephone corporation".

Nevertheless, we note that ATTIS is a wholly owned subsidiary of AT&T; that its leased equipment had been real property in the hands of its parent company; that at least some of the directors of the two companies are the same; and that during the two-year transition period, ATTIS' participation in the CPE marketplace will remain subject to those restraints or regulations imposed by the FCC. Whether those would lead a court to define ATTIS as a "utility" for that period is unclear. Therefore, at this time, we are reluctant to say categorically that the CPE leased by ATTIS to subscribers is not real property. We recommend that you review the information in this memo with your municipal attorney and make a considered judgment as to how to proceed.

III. NEW YORK TELEPHONE (NY Tel)

The equipment still owned by NY Tel in your assessing unit remains subject - to some extent - to the assessment ceiling provisions of section 470. As we have

suggested in several of our Opinions, administration of section 470 has been a problem since its enactment (see, e.g., 6 Op.Counsel SBEA No. 7; 5 Op.Counsel SBEA No. 10). This can only be exacerbated by the divestiture and the FCC decisions, developments clearly not anticipated in 1973.

With respect to NY Tel, we are confronted with at least two specific and difficult questions. The first of these, already alluded to, is the taxable status of "station connections". The second is the application of the "470 ceiling" where some but not all of the property subject to the ceiling is transferred to another company (in the case of the central office equipment, the transfer is to a new entity, ATTCOM of N.Y.).

There are several situations which have been called to our attention. One is where separate ceilings were established in 1974 for each category of telephone equipment. Where that is the case, we believe that the leased station apparatus and PBXs located on subscribers' premises and transferred to ATTIS, if assessable at all, is to be assessed to ATTIS. (Whether the ceilings for those categories are then assigned to ATTIS or deleted entirely from your roll will depend upon whether you have concluded that ATTIS' equipment is real or personal property).

Another consideration will be the assessment of NY Tel station connections. If you concur in NY Tel's assertion that such equipment, which is in the process of being amortized out of the company's rate base, is not real property, there should be no assessment for station connections on your 1984 roll. Otherwise, the ceiling assessment for station connections should remain.

A third possibility is that of one aggregate ceiling having been established for all telephone equipment (or at least all "station equipment") in 1974. If that was the case, and some of that equipment has been transferred to ATTIS or ATTCOM of N.Y., we believe it is incumbent upon NY Tel to establish to what extent (if any) the value of its remaining equipment exceeds the ceiling assessment. To the extent that it does, the ceiling applicable to NY Tel would have to be reduced.

IV. CONCLUSION

We regret that we are unable to issue a definitive opinion resolving the myriad issues created by the break-up of the Bell System and the FCC decisions deregulating what was once the exclusive realm of the telephone companies (i.e., the selling and leasing of CPE). We have attempted here to frame the issues, provide some background and offer possible approaches. We are reluctant to reach a conclusion based upon case law and statutes issued and enacted at a time and under circumstances distinct from the unique factual situations at hand.

Whatever your decision, NY Tel and ATTIS, of course, retain their right to administrative and judicial review. There is likely to be litigation and there may be State legislation to resolve these issues. We will continue our efforts to keep you informed of any developments. If you have any further questions, please contact our Bureau of Legal Services at (518)474-8821.

DAVID GASKELL
EXECUTIVE DIRECTOR

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
DIVISION OF EQUALIZATION AND ASSESSMENT
AGENCY BUILDING #4-EMPIRE STATE PLAZA
ALBANY, NEW YORK 12223

ROBERT L. BEEBE
COUNSEL

May 4, 1984

TO: County Directors and Town Assessors

FROM: Robert L. Beebe, Counsel

SUBJECT: Telephone Equipment

As you are undoubtedly aware, the divestiture of AT&T took effect on January 1, 1984. As a result, New York Telephone and AT&T Information Systems are notifying local assessment officials as to their interpretation of the impact of divestiture upon the continued taxation of certain categories of telephone property. Based upon research and a series of meetings with representatives of the industry, we have information which may assist you in determining whether or to what extent you should assess telephone equipment.

I. BACKGROUND

On January 3, 9 and 30, our staff met with tax managers from New York Telephone (NY Tel), AT&T Information Systems (ATTIS) and AT&T Communications, Inc. (ATTCOM), respectively. From these meetings and our own research, we have learned that two contemporaneous developments are changing the telephone industry.

Divestiture

The first of these - divestiture - is one with which you probably have some familiarity. As a result of the judicially supervised break-up of the Bell System, the twenty-two Bell Operating Companies (BOCs), such as NY Tel, are no longer a part of that system. Property and equipment previously used for both local and long distance calling has been divided between the BOCs and AT&T based upon a determination of whether the "predominant use" was a local or long distance service.

In preparing the 1984 assessment roll, it will be necessary for you to take into account the fact that some of NY Tel's central office equipment has been transferred to AT&T Communications of New York, Inc. It is our understanding that NY Tel and ATTCOM of NY are in the process of identifying the jurisdictions in which NY Tel central office equipment has been transferred.

FCC Decisions

In addition to the divestiture, however, you should also be aware that there has been a series of decisions issued by the Federal Communications Commission (FCC) which may affect real property tax administration. Summarily stated, those decisions deregulated the sale and leasing of customer premises equipment (CPE), which includes "station apparatus" (the ordinary telephone handset and related equipment located on the subscriber's premises) and "large private branch exchanges" (PBXs).

However, the FCC decisions also required AT&T to create a separate subsidiary if it wished to engage in deregulated, competitive marketing of CPE and enhanced services, such as electronic publishing. That subsidiary is ATTIS.

NY Telephone (NY Tel) and AT&T Information Systems (ATTIS)

Assessors in towns with a May taxable status date have by now received a memo from Michael Fortier of NY Tel advising you of the recent transfer of ownership of some of NY Tel's equipment to ATTIS. Those of you who are village assessors as well, received from Douglas Krey of ATTIS in December notification of this transfer. However, at the present time, no similar notification has been made to town assessors by ATTIS. It is our understanding that title was conveyed as of January 1, 1984. The equipment transferred included "station apparatus" and PBXs (collectively referred to as CPE, as noted above).

These types of equipment, together with "station connections"*, were once referred to collectively as "station equipment". Note that ownership of the station connections was not transferred to ATTIS. Thus, it is imprecise to say NY Tel has transferred title to all of its "station equipment."

In the next several years, NY Tel will amortize "station connections" out of its rate base. Because of this amortization, the ownership by some customers of their station connections, and the transfer of the station apparatus and PBXs to ATTIS, NY Tel claims that its network terminates at the house block (regardless of the fact that it does own property on the customers' side of that block, i.e., the inside wire). Accordingly, it is the contention of NY Tel that the assessment of its telephone station equipment which is subject to the "470 ceiling" should be eliminated.

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* Until recently, the property reported as "station connections" included (1) the outside drop wire from the telephone pole or buried cable to the house block, and (2) the inside wire from the house block to the junction box (i.e., the box on the wall to which the phone wire is connected). However, on October 6, 1983, the FCC ordered the drop wire portion of "station connections" be reported as aerial or buried cable depending upon its point of origin. Therefore, only the inside wire remains subject to the operation of section 470 and the drop wire is now fully taxable.

It is the position of ATTIS that the station apparatus and PBXs so conveyed are personal property because ATTIS is not a "utility" and, therefore, under a series of New York judicial decisions its equipment does not qualify as real property under section 102 of the RPTL.

RPTL, §102(12)(d)

Since 1881, the term "real property" has been defined to include certain telephone and telegraph equipment, namely "lines, wires, poles and appurtenances". Beginning in the late 1930's, the courts issued a series of opinions construing the word "appurtenances" as including central office equipment and equipment leased to and located on the premises of a subscriber to telephone service, including the ordinary wall or desk telephone instrument in the home.

That interpretation remained unchanged until 1976, when the Court of Appeals declared that portable plug-in phones owned by a subscriber and located on that subscriber's premises are not real property subject to taxation. In subsequent cases, the Court has said that:

(1) section 102(12)(d) is "aimed principally at expanding the definition of real property with respect to utility companies"; and

(2) the only other telephone equipment which would constitute a telephone "appurtenance" within the meaning of the RPTL is that which is "incorporated as part of the real estate".

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private branch exchanges

With the exception of "station equipment" (see footnote), these are terms of art derived from the Uniform System of Accounts established by the New York State

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In a December 1983 decision, the FCC concluded that the marketplace for CPE had become increasingly competitive and that continued regulation of CPE was not necessary and could impede the further growth of this competition. It also noted that in a prior (1980) decision, the FCC had required AT&T to establish a separate subsidiary if it wanted to engage in deregulated, competitive marketing of CPE and enhanced services, such as electronic publishing. ("Enhanced services" in very simple terms is combined data processing and communications services).

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subscribers is not real property. We recommend that you review the information in this memo with your municipal attorney and make a considered judgment as to how to proceed.

III. NEW YORK TELEPHONE (NY Tel)

The equipment still owned by NY Tel in your assessing unit remains subject - to some extent - to the assessment ceiling provisions of section 470. As we have suggested in several of our Opinions, administration of section 470 has been a problem since its enactment (see, e.g., 6 Op.Counsel SBEA No. 7; 5 Op.Counsel SBEA No. 10). This can only be exacerbated by the divestiture and the FCC decisions, developments clearly not anticipated in 1973.

With respect to NY Tel, we are confronted with at least two specific and difficult questions. The first of these, already alluded to, is the taxable status of "station connections". The second is the application of the "470 ceiling" where some but not all of the property subject to the ceiling is transferred to another company (in the case of the central office equipment, the transfer is to a new entity, ATTCOM of N.Y.).

There are several situations which have been called to our attention. One is where separate ceilings were established in 1974 for each category of telephone equipment. Where that is the case, we believe that the leased station apparatus and PBXs located on subscribers' premises and transferred to ATTIS, if assessable at all, is to be assessed to ATTIS. (Whether the ceilings for those categories are then assigned to ATTIS or deleted entirely from your roll will depend upon whether you have concluded that ATTIS' equipment is real or personal property).

Another consideration will be the assessment of NY Tel station connections. If you concur in NY Tel's assertion that such equipment, which is in the process of being amortized out of the company's rate base, is not real property, there should be no assessment for station connections on your 1984 roll. Otherwise, the ceiling assessment for station connections should remain.

A third possibility is that of one aggregate ceiling having been established for all telephone equipment (or at least all "station equipment") in 1974. If that was the case, and some of that equipment has been transferred to ATTIS or ATTCOM of N.Y., we believe it is incumbent upon NY Tel to establish to what extent (if any) the assessment ceiling exceeds the value of its remaining equipment. To the extent that it does, the ceiling applicable to NY Tel would have to be reduced.

We are aware, however, of some reluctance on NY Tel's part to provide assistance in dividing a station equipment ceiling among the specific categories of telephone equipment. We offer, as one possible method, an allocation based upon the original cost balances in these accounts as reported to the PSC by the company. For example:

Year ended December 31, 1982 (latest data available)

Account 231	Station Apparatus	1,031,999,191	33.9%
Account 232	Station Connections	1,664,264,600	54.7%
Account 234	Large PBXs	345,754,281	11.4%
		3,042,018,072	100%

(Source: New York Telephone Annual Report to the PSC, p. 18, Sch.305)

or:

Year ended December 31, 1974 (basis for ceiling assessment)

Account 231	Station Apparatus	708,156,121	35.6%
Account 232	Station Connections	944,811,072	47.4%
Account 234	Large PBXs	337,958,380	17.0%
		1,990,925,573	100%

(Source: New York Telephone Annual Report to the PSC, p.18).

Thus, using the percentages derived from the 1982 New York Telephone Annual Report to the PSC, if your assessment for station equipment on the current roll was $10,000, that ceiling would be apportioned as follows:

Station Apparatus
$10,000 x 33.9% = $3,390 ceiling assessment;

Station Connections
$10,000 x 54.7% = $5,470 ceiling assessment;

Large PBXs
$10,000 x 11.4% = $1,140 ceiling assessment.

Of course, these allocation percentages are derived from Statewide figures; however until NY Tel comes forward with those on a tax district basis, you are left with little choice but to use what information is available to you.

IV. CONCLUSION

We regret that we are unable to issue a definitive opinion resolving the myriad issues created by the break-up of the Bell System and the FCC decisions deregulating what was once the exclusive realm of the telephone companies (i.e., the selling and leasing of CPE). We have attempted here to frame the issues, provide some background and offer possible approaches. We are reluctant to reach a conclusion based upon case law and statutes issued and enacted at a time and under circumstances distinct from the unique factual situations at hand.

Whatever your decision, NY Tel and ATTIS, of course, retain their right to administrative and judicial review. There is likely to be litigation and State legislation has been introduced to resolve these issues.*

We will continue our efforts to keep you informed of any developments. If you have any further questions, please contact our Bureau of Legal Services at (518)474-8821.

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*Both Assembly Bill No. 10664 (Hockbrueckner) and 11269 (Rules Committee at request of State Board) would amend section 102(12)(d) of the RPTL to remove station apparatus and PBXs from the definition of real property while repealing section 470 and thus eliminate the ceiling assessment on station connections and central office equipment.

Memorandum

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
DIVISION OF EQUALIZATION AND ASSESSMENT

September 18, 1984

TO: Assessors and County Directors

FROM: Robert L. Beebe

SUBJECT: Legislation re: Assessment of Telephone Equipment

This is to advise you of 1984 legislation (chapter 895) affecting the assessment and taxation of telephone equipment subject to the provisions of section 470 of the Real Property Tax Law.

Classification of telephone equipment

In previous memos (February 2 and May 4, 1984), we advised you of the uncertainty of the taxable status of telephone equipment transferred to a non-utility. The most significant change brought about by chapter 895 is a legislative declaration to the effect that "470 equipment" which was taxable real property on 1983 assessment rolls remains taxable real property for purposes of assessment rolls completed and filed in 1984, notwithstanding that there may have been a transfer of ownership (other than such property now owned by the customer). You will recall that the courts in New York have concluded that telephone and telegraph equipment is real property only if owned by a utility, and that AT&T Information Systems (ATTIS) - one of the transferee's of New York Telephone's telephone equipment - claims that it is not a utility and, accordingly, not subject to any real property tax on its equipment.

Changes to Rolls/Tax Payments

The new law authorizes assessors or other persons having custody and control of the assessment roll to "conform the assessments of property to comply with the provisions of this act." More specifically, to conform those assessments to new subdivision 2 of section 470 which reads as follows:

> 2. Any telephone or telegraph central office equipment, station equipment, station apparatus, station connections and private branch exchanges assessed subject to the provisions of this section which was taxable on assessment rolls completed, verified and filed in nineteen hundred eighty-three, which is transferred to an owner engaged in the telephone or telegraph business or in the business of selling or leasing said property, notwithstanding whether such transferee is considered a utility, shall be deemed taxable under the provisions of

> paragraph d of subdivision twelve of section one hundred two of this chapter on assessment rolls completed, verified and filed in nineteen hundred eighty-four. The pro rata portion of the transferor's nineteen hundred seventy-four assessment or assessments or revaluation adjusted nineteen hundred seventy-four assessment or assessments associated with such transferred property based on the percent of the total nineteen hundred eighty-four assessment attributable to the transferred property may be assessed to the transferee and the tax thereon shall then be paid by the transferee and upon payment of the tax by the transferee the assessment or assessments upon and tax payable by the transferor shall be reduced accordingly.

Thus, the new law authorizes the issuance of new tax bills if the assessor decides to apportion the assessment as set forth below. Furthermore, if payment in full from New York Telephone has already been received, pro rata refunds shall be made. For purposes of this act, the provisions of the "Correction of Errors Law" (RPTL, §§550-559) are suspended.

Apportionment of assessment/Pro-ration of taxes

Pursuant to section 932 of the RPTL, assessors may apportion an assessment of real property (and collectors may accept the corresponding pro-rated tax liability) "provided the person offering to pay such tax shall furnish a particular specification of such part" (RPTL, §932)*. For example, a person who has acquired or transferred part of a parcel after taxable status date, in order to ensure payment of his part of any tax liability, may seek such an apportionment.

The fact that the property in question may be unique (i.e., telephone equipment as compared to the ordinary land and improvement parcel) is irrelevant to the matter. Either the transferor (New York Telephone) or the transferee (in the case of station equipment, ATTIS; in the case of central office equipment, ATTCOM) might seek an apportionment of the assessed value of such equipment.

As we understand the current situation, New York Telephone has provided each assessor with the Company's proposed apportionments. According to information provided by Mr. Michael Fortier of New York Telephone, those apportionments are based upon total book cost of the equipment (as reported to the PSC) as compared to the book cost of the equipment transferred to either ATTIS or ATTCOM. With respect to central office equipment, because the PSC required the Company to report information on a municipal basis, the proposed apportionments are based upon book cost reported for each town or city. In the case of station equipment, however, which is reported as a mass account, the proposed apportionments are based upon a

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* Section 932 applies to apportionments involving municipal tax liability; section 1304 provides to the same effect with respect to school taxes.

Statewide* aggregate ratio of book cost of equipment transferred to total book cost of such equipment.

YOU ARE NOT OBLIGATED TO APPORTION THE ASSESSMENT IN QUESTION, IF YOU ARE NOT SATISFIED THAT THE PROPOSED APPORTIONMENT IS ACCURATE OR REASONABLE. However, if you are satisfied, you may proceed to an apportionment. You should notify your tax collecting officer(s), New York Telephone and the transferee(s) of the amount of the apportioned amounts.

As a result, we suggest the following step-by-step approach for the appropriate changes to of assessment and tax rolls in the event you decide to honor New York Telephone's request for apportionment. Since your most immediate concern is the current school tax levy, our example** assumes that these bills are already in the mail.

Step #1: Notify the appropriate school district and its tax collecting officer of the request for apportionment;

Step #2: Transmit to the district and its tax collecting officer a statement of the apportionment with a direction to the tax collector to make the appropriate entries on the roll;

Step #3: Advise the tax collecting officer of his or her responsibility to prepare a new tax bill for New York Telephone based upon the apportionment, mark it "corrected tax bill", and send it to New York Telephone.

Step #4: Prepare a notice of assessment informing ATTIS that such assessment is in accordance with chapter 895 of the Laws of 1984 which classifies station equipment as taxable real property subject to the assessment ceiling provisions of RPTL, section 470. The notice should also advise ATTIS that while no administrative review is authorized by chapter 895, judicial review under RPTL, Article 7 is available.

For town and county purposes, steps #2 and 4 may be followed prior to the preparation of tax bills and warrants. This will prevent having to follow the remaining steps later this year or early 1985.

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* Exclusive of New York City, Nassau County and Suffolk County.

** For simplicity's sake, this example refers to New York Telephone and ATTIS and a station equipment assessment currently in the name of New York Telephone only. However, the procedure is equally applicable to an apportionment with respect to ATTCOM and may be used, as well, to restore assessments which were entirely removed from the roll.

Assessment Review

Chapter 895 authorizes judicial review, pursuant to Article 7 of the RPTL, of any changes made in accordnace with the new law. No provision is made for administrative review. Accordingly, we assume that an owner will have 30 days from the date as of which the change is entered on the roll to commence such a proceeding.

School and Special District Levies

If you elect to apportion any "470 equipment" assessments, you should comparably pro rate school and special district shares, maintaining the district to district percentage of the original assessment.

For example, assume a "470 equipment" of $100,000 in a Town, broken down among four school districts as follows 40,000; 30,000; 20,000 and $10,000. After determining that the original New York Telephone assessment should be divided 60% to New York Telephone and 40% to ATTIS, the school district assessment should be:

1983	New York Telephone	ATTIS
#1	24,000	16,000
#2	18,000	12,000
#3	12,000	8,000
#4	6,000	4,000

What to Do

Chapter 895 resolved but one (and that only temporarily) of the many questions resulting from the dramatic changes in the telephone industry in the past few years. That question, of course, is the classification for 1984 of transferred station equipment and central office equipment.

As indicated, with or without chapter 895, assessors have had the authority to apportion any assessed value provided they were satisfied that there has been a partial transfer or acquisition of title to what had been assessed as one parcel and that they were provided with sufficiently specific information to make an appropriate determination.

Whether or not you act in accordance with New York Telephone's request for an apportionment, your assessment may become the subject of litigation. As you are all aware, New York Telephone has followed up its complaints to the boards of assessment review with petitions for judicial review under Article 7. If an apportionment is made, it seems highly likely that the new assessee (be it ATTIS or ATTCOM) will challenge that assessment (with or without payment of the corresponding tax liabilities).

If you have any questions concerning this memorandum, please contact our Bureau of Legal Services at (518)474-8821.

Memorandum

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
DIVISION OF EQUALIZATION AND ASSESSMENT

September 21, 1984

TO: Assessors and County Directors

FROM: Robert L. Beebe

SUBJECT: Addendum to Memorandum of 9/18/84 re: Assessment of Telephone Equipment

On page three of our memorandum of September 18, 1984, we outlined the administrative procedures to be followed if the assessor elects to apportion an assessment of telephone equipment subject to the provisions of section 470 of the RPTL. That outline should have included the following step:

> Step #5: For Town and County tax rolls and bills, users of a computer system (ARLM) may submit the changes now to apportion the assessment. This will insure the appropriate billing later. For example, a typical situation may require a reduction on the assessment of the NY Telephone parcel and the creation of a new parcel or parcels for ATTIS and/or ATTCOM. Care should be given to balancing out the total assessment among the parcels, and attention paid to school and special district apportionment also.

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