

To: New Jersey Law Revision Commission
From: Melissa E. Sungela
Re: Calculation of Telephone Company Taxation (*Verizon N.J., Inc. v. Borough of Hopewell* – N.J.S. 54:4-1)
Date: July 20, 2020

MEMORANDUM

Executive Summary

N.J.S. 54:4-1 requires a significant annual tax to be paid by certain telecommunications carriers to local municipalities.¹ The formula calculated annually to determine whether the tax is applicable includes three terms that can be interpreted differently, leading to questions about whether the tax is required. These terms are: “local telephone exchange”, “dial tone and access [lines]”, and “market share”.² Determining the applicability of this tax has been the subject of hundreds of cases.³ In addition, at least one of the affected telecommunications carriers has also asserted that if the tax is not applicable in any *single* year, then the telephone carrier is forever discharged from future obligation for this tax.⁴

In *Verizon N.J., Inc. v. Borough of Hopewell*, the Tax Court of New Jersey defined the manner in which “local telephone exchange” should be interpreted in applying N.J.S.A. 54:4-1.⁵ Due to the facts of this specific case, it was not necessary for the Court to decide how dial tone and access lines or market share were to be derived.⁶ Further, the case did not provide the basis for the Court to determine whether the affected telecommunications carriers could forever discharge their liability for this tax if the tax was not applicable in any single year.⁷

Statute Considered

N.J.S.A. 54:4-1 provides, in pertinent part:

Personal property taxable under this chapter shall include . . . the tangible goods and chattels, exclusive of inventories, used in business of local exchange telephone, telegraph and messenger systems, companies, corporations or associations that were subject to tax as of April 1, 1997 under P.L.1940, c.4 (C.54:30A-16 et seq.) as amended . . . As used in this section, "local exchange telephone company" means a telecommunications carrier providing dial tone and access [lines] to 51% of a local telephone exchange.⁸

¹ *Verizon N.J., Inc. v. Borough of Hopewell*, 31 N.J. Tax 49, 61 (N.J. T.C. 2019).

² *Id.* at 51, 63-67.

³ *Id.* at 61 n. 9.

⁴ *Id.* at 52 n. 4.

⁵ *Id.* at 75.

⁶ *Id.*

⁷ *Id.* at 52 n.4.

⁸ *Id.* at 70.

Background

N.J.S.A. 54:4-1 is only applicable to defined organizations that were “subject to tax as of April 1, 1997.”⁹ Only three companies are a defined organization under this regulation: Verizon N.J., Inc. (Verizon); United Telephone Company of New Jersey; and Warwick Telephone Company.¹⁰ Together, they are known as “incumbent local exchange carriers” (ILECs).¹¹ “Verizon owns land and a building in the Borough of Hopewell that is used as a switching station for telecommunications.”¹² The building houses fiber optic cables and electronic equipment subject to personal property tax under N.J.S.A. 54:4-1. “In addition to Verizon’s cable and equipment, the switching station also holds equipment that is the personal property of one of Verizon’s competitors.”¹³ Verizon’s competitors’ personal property is *not* subject to the tax because it is not one of the three ILECs.¹⁴

Rate Center v. Telephone Exchange

The tax required under N.J.S.A. 54:4-1 is owed when one of the three telecommunications carriers named above provides dial tone and access lines to 51% of a local telephone exchange.¹⁵ “Local telephone exchange” is not defined in the applicable regulations.¹⁶

The telecommunications industry has legacy infrastructure that includes “rate centers” and “telephone exchanges”.¹⁷ A “rate center” is a specific geographic point within a geographic exchange area that is generally defined by vertical and horizontal coordinates and is used to determine applicable long distance charges for calls between telephone exchanges.¹⁸ “There are no physical properties associated with a rate center.”¹⁹ A “telephone exchange” is a geographically defined area serviced by a physical construct that serves as a building block for service delivery, call routing, and regulatory infrastructure.²⁰

Prior to deregulation, AT&T controlled all aspects of managing the system that assigned telephone listings (i.e., numbers) to rate centers²¹ and rate center assignments were aligned with the geographic boundaries of telephone exchanges.²² After deregulation, this responsibility was assigned to a third party, which assigned telephone listings without knowledge of, or consideration for, the physical location of the customer.²³ Thus, it has become common for customers located far *outside* the geographic boundaries of a telephone exchange to be assigned

⁹ *Id.* at 70.

¹⁰ *Id.* at 52 n.3.

¹¹ *Id.* at 71.

¹² *Id.* at 52.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.* at 51.

¹⁶ *Id.*

¹⁷ *Id.* at 56.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.* at 74.

²¹ *Id.* at 59, 72-73.

²² *Id.* at 72

²³ *Id.* at 73.

to a rate center that was formerly wholly dedicated to that geographic telephone exchange.²⁴ In this case, customers of both the Hopewell Telephone Exchange and the Pennington Telephone Exchange were assigned to the Hopewell Rate Center.²⁵ Conversely, some customers within the Hopewell Telephone Exchange geographic area were assigned to the Belle Meade Rate Center.²⁶

Verizon claimed that the percentage of its customers assigned dial tone and access lines through the Hopewell Rate Center should be used to calculate the percentage market share which triggers the tax under N.J.S.A. 54:4-1, rather than the geographically based Hopewell Telephone Exchange.²⁷ Using the Hopewell Rate Center to determine market share would not trigger a tax payable by Verizon; whereas using the Hopewell Telephone Exchange would.²⁸

Dial Tone, Access Lines, and Market Share

The assignment of a telephone *listing* to a customer does not automatically equate to a telephone *line* with dial tone and access.²⁹ For example, larger businesses may wish to have a telephone *listing* for each employee; however, realistically not all the listings need to be used at the same time and thus the business is assigned fewer *lines*.³⁰ Thus, there is an inability to associate a one-to-one ratio of listings with dial tone and access lines.

Because AT&T controlled all aspects of managing the telephone system prior to the completion of deregulation activities,³¹ it appears that AT&T was able to calculate the total number of dial tone and access lines *by telecommunications carrier and by geographic telephone exchange area*. After deregulation, no central source reliably tracks all of the dial tone and access lines by each local geographic telephone exchange area, although there is a source of data to track this information for the entire state of New Jersey.³²

Because there is not a central source of information about *all* telecommunications carriers (by rate center or by telephone exchange), an estimate must be used to adjust the number of *listings* into the estimated number of *lines*, in order to calculate the ILEC's market share.³³ Verizon used its own information to calculate a ratio of dial tone and access lines to telephone listings and applied that ratio to its competitors' listings to calculate an assumed total market share for the Hopewell Rate Center.³⁴ The Borough of Hopewell (Hopewell) used *its* own estimates to calculate Verizon's percentage of dial tone and access lines for the Hopewell Telephone Exchange, which differed from Verizon's calculation, even after adjusting for the difference in approach for rate center versus telephone exchange.³⁵ Neither Verizon nor

²⁴ *Id.* at 68.

²⁵ *Id.* at 59.

²⁶ *Id.* at 69.

²⁷ *Id.* at 73.

²⁸ *Id.* at 65, 75.

²⁹ *Id.* at 56.

³⁰ *Id.*

³¹ *Id.* at 59.

³² *Id.* at 58, 66 n. 13.

³³ *Id.* at 60.

³⁴ *Id.* at 65.

³⁵ *Id.* at 66-70.

Hopewell attempted to obtain dial tone and access line information from Verizon’s competitors, which could have been used to calculate an actual total (for both the rate center or the telephone exchange).³⁶

Court Conclusion

The Court found the “local telephone exchange” referred to in N.J.S.A. 54:4-1 is a geographically defined area serviced by a physical construct.³⁷ As a result, the Pennington Telephone Exchange dial tone and access lines were excluded from the calculation of market share and the Belle Meade Rate Center dial tone and access lines associated with the geographic Hopewell Telephone Exchange area were included.³⁸ While Verizon and Hopewell did not agree on *how* to calculate Verizon’s total percentage of dial tone and access lines, both parties agreed that Verizon furnished more than 51% of dial tone and access lines in the Hopewell Telephone Exchange, regardless of the method used.³⁹ Thus, it was not necessary for the Court to decide how to derive dial tone and access lines or to decide how to calculate market share for this case.⁴⁰

Analysis

There are 209 New Jersey telephone exchanges.⁴¹ Verizon first brought litigation against the N.J.S.A. 54:4-1 tax in 2008.⁴² In the years following, hundreds of cases have been filed by Verizon, the other two ILECs, and municipalities, involving this same tax and those cases have been marked inactive awaiting final resolution of this case.⁴³

Dial Tone and Access Lines and Market Share

The Court’s opinion devoted significant explanation to the lack of definitive data available to measure dial tone and access lines due to procedural changes since deregulation.⁴⁴ Because both parties agreed the designation of a geographic telephone exchange meant Verizon had well over 51% of the market share (regardless how the market share was calculated), the Court was not required to find which method of calculating dial tone and access line, or market share, should be applied in future cases where the differing methods used by the ILEC and the municipalities might yield different results.⁴⁵ While the Court noted utilization of a geographic definition of a local telephone exchange permits the usage of public and transparent data sources when calculating market share, such as data sources from the FCC, United States Census Bureau, Nielsen, PEW, and InfoU;⁴⁶ the Court did not mandate which source to use or how to use it.

³⁶ *Id.* at 58.

³⁷ *Id.* at 74.

³⁸ *Id.* at 75.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* at 53-54.

⁴² *Id.* at 61 n.9.

⁴³ *Id.*

⁴⁴ *Id.* at 59, 72-73.

⁴⁵ *Id.* at 75.

⁴⁶ *Id.*

Absent Legislative direction, ILECs and municipalities are left to establish their own methods for calculating market share.⁴⁷

The opinion also noted that it is presumed the Legislature intended *not* to provide an explicit method of calculating market share when it drafted N.J.S.A. 54:4-1.⁴⁸ The Court presumed that the Legislature appreciated the publicly available information at the time, given that the telecommunications industry is highly regulated both federally and by the State.⁴⁹ N.J.S.A. 54:4-1 was enacted on July 14, 1997⁵⁰ when AT&T still controlled all aspects of managing the local exchange telephone system⁵¹ (and, thus, the number of dial tone and access lines by telecommunication carrier and by telephone exchange was available to calculate market share). However, the transition of administration of the system to a third-party did not occur until January 19, 1998⁵² which was *after* the Legislature enacted N.J.S.A. 54:4-1.

The Court acknowledged there has been an erosion of information available to calculate market share;⁵³ however, it is not clear that the Court considered that the timing of the erosion of information occurred *after* the enactment of the legislation. Instead, the Court may have presumed that the Legislature had an understanding of the advances being made in technology and the changes in the industry.⁵⁴

Tax Liability Forever Discharged?

While an earlier decision interpreted N.J.S.A. 54:4-1 to be an annual test, Verizon asserted to the court that once it falls below the 51% threshold, it will no longer be required to pay this tax.⁵⁵ This matter was not decided by this Court.⁵⁶

Pending Legislation

A bill was introduced on February 1, 2018 to reverse a previous tax court decision requiring the percentage 51% test be performed annually as of the assessment date, rather than a one-time test performed at July 1, 1997.⁵⁷ *See* Assemb. B. 2664, 218th Leg., Reg. Sess. (N.J. 2018) (Referred to Assembly Appropriations Committee.)⁵⁸ Staff has not identified any legislation introduced in the current legislative session pertaining to this issue.

⁴⁷ *Id.* at 74.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ https://www.njleg.state.nj.us/9697/Bills/PL97/162_.HTM.

⁵¹ *Verizon N.J.* at 59, 72-73.

⁵² Letter from J.N. Deak – NANP Administration North American Numbering Plan Planning Letter (Dec. 23, 1997), https://www.nationalnanpa.com/pdf_previous/pl-nanp-106.pdf.

⁵³ *Verizon N.J.* at 59.

⁵⁴ *Id.* at 74.

⁵⁵ *Id.* at 53 n. 4.

⁵⁶ *Id.*

⁵⁷ *Id.* at 63 n. 11.

⁵⁸ *Id.*

Conclusion

Rate Center v. Telephone Exchange

It may not be necessary to explicitly define “local telephone exchange” within N.J.S. 54:4-1 since all cases affected by the definition will be disposed of by this tax court.⁵⁹

Dial Tone and Access and Market Share

Legislative clarity regarding how to estimate dial tone and access lines, and thus calculate market share, however, might reduce the number of future cases. Because there are multiple ways to estimate dial tone and access lines and to derive market share using public sources, ILECs and municipalities will be inclined to choose approaches that will promote their position to avoid taxation or to establish taxability, respectively. The multiple approaches may mean that the issue will not be resolved by a single case.

Tax Liability Forever Discharged?

It may also be useful to clarify whether the legislature intended for the ILECs to continue calculating market share for the local telephone exchanges after a year in which their market share falls below the 51% trigger, or whether the ILECs are thereafter discharged from future taxation.

Staff seeks authorization to engage in additional research and outreach to determine whether modifications to the statute would be of assistance in this area.

⁵⁹ *Id.* at 74.