Illinois Economic and Fiscal Commission

THE STATE'S PUBLIC UTILITY TAXES

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703 Stratton Building
Springfield, IL 62706

ILLINOIS ECONOMIC and FISCAL COMMISSION

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EXECUTIVE SUMMARY

The public utility tax is the fourth largest general revenue source. In FY 2003, over $1.0 billion in general funds revenue was generated from the State's public utility tax, representing approximately 4.4% of base general funds revenue. The public utility tax consists of three different taxes that generate revenue for the State's general fund: the electricity excise tax, the telecommunications excise tax, and the natural gas revenue tax. In addition, there are several other non-general fund public utility taxes and fees, including the intrastate gross revenue tax and the public utility replacement tax. All of these taxes have various rates and bases.

The following report takes a detailed look at all of the State's public utility taxes. Each section provides a summary of the history of the tax, the receipts generated, how the revenue is distributed, and other pertinent information. Several charts and tables are used throughout this report to accompany the information provided. Included are analyses of recently passed legislation that could impact the public utility industry. Also included in this report is a section discussing the recent decline in telecommunications excise tax receipts and the possible reasons for the downward turn. Highlights of the report are summarized below.

- Over the last decade, general funds revenue from the electricity excise tax has ranged from $293 million in FY 1995 to $351 million in FY 2000. Of the $342 million collected in FY 2003, $332 million was deposited into the General Revenue Fund, while $10 million was deposited into the Public Utility Fund.

- Revenue collected from the electricity excise tax is largely affected by weather. Years with extreme temperatures would require more electricity, and thus, will generate more revenue for the State.

- Illinois electric utility companies collected over $8.6 billion in electric revenues in 2002. Of this amount $3.3 billion, or 38.4% were from residential sales.

- Of the $619 million in telecommunications tax revenues collected in FY 2003, $427 million was deposited into the General Revenue Fund, $102 million went into the Common School Fund, while the remaining $90 million was deposited into the School Infrastructure Fund.

- The telecommunications excise tax hit its high point in FY 2001, generating $675 million. However, receipts declined 3.5% in FY 2002, and fell another 18.8% in FY 2003. Possible reasons for the declines include the emergence of broadband Internet services, competition from mobile wireless service, pre-paid calling cards, and the struggling economy.

- Although P.A. 93-0005 increased the rate that incumbent local exchange carriers, such as SBC, may charge a competitive local exchange carrier, a federal judge ordered a halt to the increase, calling the legislation "anti-competitive". An appeal of the decision still remains in court.

- In FY 2003, $141 million was collected from the State's natural gas revenue tax. All of the revenue collected from this tax is deposited into the General Revenue Fund.

- Over the last decade, revenue from the natural gas revenue tax has been as high as $155 million in FY 1994 to as low as $108 million in FY 1999. Like the electricity excise tax, revenue from the natural gas tax is largely affected by weather.

- During the latest legislative session, P.A. 93-0031 created the natural gas use tax. This tax was created to eliminate a loophole that allows out-of-state purchases to be excluded from natural gas taxes. The Department of Revenue estimates that this tax will annually generate approximately $38 to $43 million for the State.

- Of the $3.2 billion in sales to ultimate customers in 2002 collected by Illinois natural gas companies, $2.5 billion, or 79.06% were from residential sales. Businesses made up the remaining 20.94%.

- Because the telecommunications tax is the largest component of the State's public utility taxes, the success of the public utility tax, in terms of revenues, ultimately depends on the behavior of the telecommunications excise tax.

- The public utility replacement tax consists of the invested capital tax, the electricity distribution tax, and the telecommunications infrastructure maintenance fee. A total of $208 million was collected from these taxes in FY 2003. Revenues from the tax are deposited into the Property Tax Replacement Fund to be distributed to local governments throughout Illinois.

The Electricity Excise Tax

The first public utility tax discussed is the *electricity excise tax*. Under current law, electric suppliers pass this tax to the residential customer by adding it to the consumer's electric bill. Nonresidential customers can register as "self-assessing purchasers" and pay the tax directly to the Department of Revenue. State laws exempt electricity used by municipalities to operate public transportation systems they own. The rate and base of the electricity excise tax is as follows:

Residential customers:

Kwh used Per month		*Tax Per kwh*	*Kwh used per month*		*Tax per kwh*
First	2,000	0.330 cents	Next	2,000,000	0.270 cents
Next	48,000	0.319	Next	2,000,000	0.254
Next	50,000	0.303	Next	5,000,000	0.233
Next	400,000	0.297	Next	10,000,000	0.207
Next	500,000	0.286	Over	20,000,000	0.202

The rate for self-assessing (nonresidential) purchasers is 5.1% of the purchase price.

Customers of municipal electric systems and rural electric cooperatives pay the LESSER of (a) 0.32 cents per kilowatt-hour OR (b) 5% of purchase price.

RATE HISTORY

The first public utility electric tax was enacted in 1937 at a rate of 3% of gross revenue. The rate was changed three times in the 1960s, eventually settling at 5% of gross revenue in 1967. In 1985 the rate was set at the lesser of 5% or 0.32 cents per kwh sold to each customer. That tax was repealed by the 1997 law deregulating the electric industry, and replaced by the new excise tax on August 1, 1998. At the same time, the new excise tax also replaced the intrastate gross (electric) revenue tax of 0.08% used to fund the Illinois Commerce Commission. When the new excise tax was created, it was intended to raise essentially the same amount of revenue as the gross revenue taxes it replaced.

EXEMPTIONS AND CREDITS

There is a tax exemption available to a business enterprise, classified by the Department of Commerce and Economic Opportunity as a "high impact business", that intends either:

a) to make a minimum investment of $12 million and create 500 full-time jobs, or
b) to make a minimum investment of $30 million and retain at least 1,500 full-time jobs at an Illinois location.

A high impact business can be partly or a fully exempt from the electricity excise tax and can be exempt for up to 20 years. The Department of Commerce and Economic Opportunity determines the extent of the exemption. According to the Comptroller's *Tax Expenditure Report*, in FY 2002, this exemption cost the State $22.0 million in general funds receipts.

There is also a tax credit available for the purchase and sale of electric energy from qualified solid waste energy facilities. According to the Comptroller's *Tax Expenditure Report*, in FY 2001, this credit cost the State $23.0 million in general funds receipts. In FY 2002, this amount rose to $31.2 million.

DISTRIBUTION

Revenue generated from the electricity excise tax is distributed in the following manner:

3% to the Public Utility Fund.
97% to the General Revenue Fund.

In FY 2003, $341.7 million was generated from the electricity excise tax. Of this amount, $331.4 million was deposited into the General Revenue Fund, while the remaining $10.3 was deposited into the Public Utility Fund.

GENERAL REVENUE COLLECTIONS HISTORY-ELECTRICITY

Revenue from the State's electricity excise tax has experienced a significant amount of volatility over the last decade. The revenue collected from this tax is largely affected by weather. Due to the taxing structure, most of the volatility is due to consumption fluctuations rather than price fluctuations. Over the last decade, general funds revenue from the electricity excise tax has ranged from $293 million in FY 1995 to $351 million in FY 2000. A table and chart displaying the revenue history of the State's electricity excise tax is shown in Table 1 and Chart 1.

Table 1: Electricity Excise Tax (General Funds) Annual Percentage Changes
($ in millions)

Fiscal Year	Revenue	% Change	Fiscal Year	Revenue	% Change
1994	$302	2.0%	1999	$309	-2.2%
1995	$293	-3.0%	2000	$351	13.6%
1996	$320	9.2%	2001	$324	-7.7%
1997	$312	1.4%	2002	$333	2.8%
1998	$316	1.3%	2003	$331	-0.6%

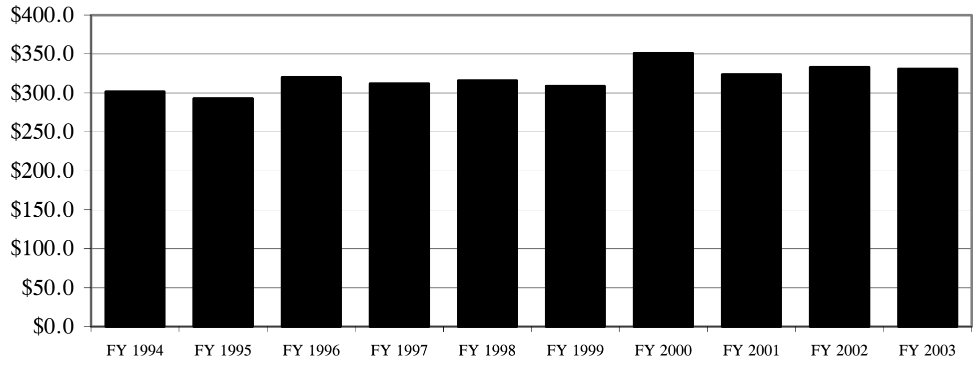


Chart 1: History of Electicity Excise Tax Revenue
(General Funds)
($ in millions)

Other Taxes on Electric Utilities

There is no federal tax on electric utilities. However, municipalities can impose a tax on the privilege of using electricity within its boundaries. According to the 2003 edition of the *Illinois Tax Handbook for Legislators*, local rates decline with more electricity use by a customer, from 0.61 cents per kwh on the first 2,000 kwh per month to 0.30 cents per kwh on monthly usage over 20 million kwh. By request from a municipality, the Illinois Commerce Commission may approve alternative maximum rates. This tax was authorized by the 1997 electric deregulation law, replacing the tax of 5% of electric companies' gross revenue. The new tax could be imposed on nonresidential customers when they became eligible to choose alternative electric suppliers.

In addition, municipalities may charge deliverers of electricity a fee for using public rights of way. This fee is also based on monthly usage by each customer, declining from 0.53 cents per kwh on the first 2,000 kwh to 0.26 cents per kwh on monthly amounts over 20 million kwh.

Other Related Information

Recently, the Illinois Commerce Commission released a report entitled, "Illinois Electric Utilities: Comparison of Electric Sales Statistics for Calendar Years 2002 and 2001". The report provides a comparison of electric statistics for nine Illinois electric utilities, including AmerenCIPS, Commonwealth Edison Company, and Illinois Power Company. The report shows that $8.6 billion in total electric operating revenues were collected by these companies in 2002. Of this amount, $3.3 billion, or 38.43% were from residential sales. Table 2 summarizes the electric statistics provided in the report.

TABLE 2

Illinois Electric Utilities
Summary of 2002 Statistics by Category and by Class of Service

				Percent of Total Company Sales to Ultimate Customers	
Class of Service / Category	2002 Revenues	Revenue in Cents per kWh	Percent of Total Company Operating Revenues	Revenue	mWh
		Total Company			
Residential Sales	$3,313,172,547	8.35	38.43%	41.06%	31.16%
Small (or Commercial) Sales	2,807,506,951	6.80	32.56%	34.79%	32.43%
Large (or Industrial) Sales	1,426,517,166	3.87	16.55%	17.68%	28.98%
Public Street & Highway Lighting	55,098,868	7.04	0.64%	0.68%	0.61%
Other Sales to Public Authorities	438,489,348	5.35	5.09%	5.43%	6.44%
Sales to Railroads	29,021,031	6.07	0.34%	0.36%	0.38%
Sales to Ultimate Customers	$8,069,805,911	3.93	93.60%	100.00%	100.00%
Sales For Resale	212,191,338	3.02	2.46%		
Interdepartmental Sales	3,951,510	6.24	0.05%		
Total Sales of Electricity	$8,285,948,759		96.11%		
Less: Prov. For Rate Refunds	(638,951)		-0.01%		
Total Sales Net of Prov. Rate Ref.	$8,285,309,808		96.10%		
Other Electric Operating Revenues	335,951,092		3.90%		
Total Electric Operating Revenues	$8,621,260,900		100.00%		

Source: Illinois Commerce Commission

The Telecommunications (Messages) Excise Tax

The *telecommunications (messages) excise tax*, the largest revenue producer of the public utility taxes, is imposed on persons who send or receive interstate and/or intrastate telecommunications. This includes telephone, telegraph, channel, private line, teletypewriter, computer exchange, mobile radio, and telephone and paging services. The tax is applied to the transmission of messages or information between or among points by wire, cable, fiber optics, microwave, radio, laser, satellite, and other methods. The tax is collected from the consumer through the telecommunications provider.

The rate and base of the telecommunications excise tax is simple: 7% of gross charges by businesses for transmitting messages in interstate or intrastate commerce.

RATE HISTORY

The original telecommunications tax was enacted in 1945 at a rate of 3% of gross receipts. The following table shows the rate history of the telecommunications tax in Illinois:

Year	Rate
1945	3.00%
1965	4.00%
1966	3.92%
1967	5.00%
*1985	5.00%
1998 (Current)	7.00%

* In 1985, the rate stayed at 5%, however, the tax was expanded to cover new telecommunications services and interstate messages.

EXEMPTIONS AND CREDITS

As with the electricity excise tax, there is an exemption available for enterprise zone and foreign zone high economic impact businesses. The Department of Commerce and Economic Opportunity determines the extent of the exemption. According to the Comptroller's *Tax Expenditure Report*, in FY 2002, this exemption only cost the State approximately $27,000. There is also a coin-operated telecommunications devices exemption available, however, this exemption only cost the State approximately $11,000 in FY 2002.

DISTRIBUTION

As shown previously, the telecommunications excise tax was increased from 5% to 7%

in 1998. As a result of this increase, the distribution for the tax is as follows:
Of the original 5% tax:

a) $12 million per year goes to the Common School Fund;
b) Remainder to the General Revenue Fund.

Of the additional 2%:

a) 50% goes to the Common School Fund;
b) 50% goes to the School Infrastructure Fund.

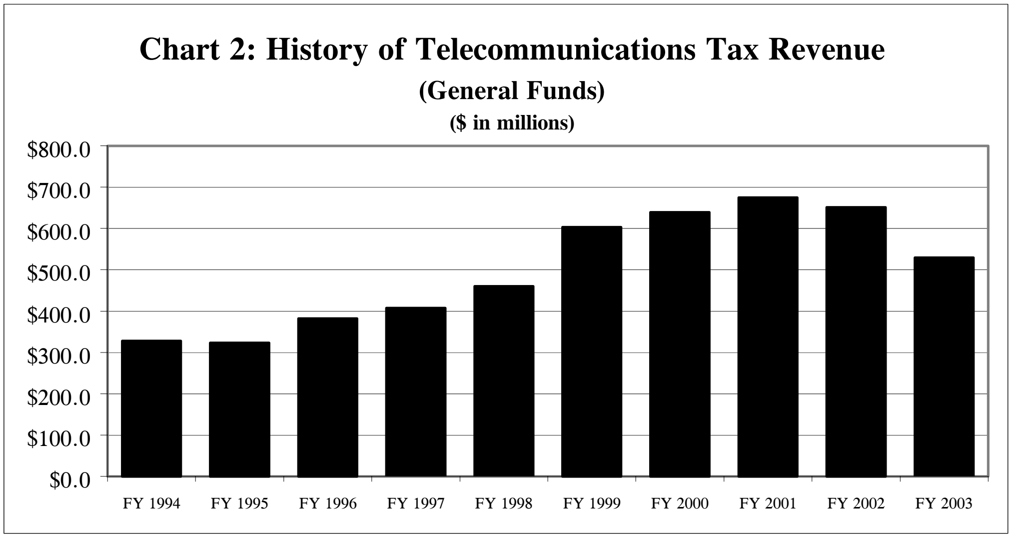
In FY 2003, $618.7 million was generated from the telecommunications excise tax. Of this amount, $427.3 million was deposited into the General Revenue Fund, $101.7 million was deposited into the Common School Fund, while the remaining $89.7 million was deposited into the School Infrastructure Fund. (The General Revenue Fund and the Common School Fund are considered *General Funds*, which meant $529.0 million in General Funds was collected in FY 2003 from this tax).

GENERAL REVENUE COLLECTIONS HISTORY-TELECOMMUNICATIONS

After a period of significant growth, revenue from the State's telecommunications tax is now in the midst of a steady downward trend. The telecommunications tax hit its high point in FY 2001, generating $675 million. However, receipts declined 3.5% in FY 2002, and fell a staggering 18.8% in FY 2003. Recent figures suggest another significant decline in FY 2004. A table and chart displaying the revenue history of the State's electricity excise tax is shown in Table 3 and Chart 2.

Table 3: Telecommunications Excise Tax (General Funds) Annual % Changes
($ in millions)

Fiscal Year	Revenue	% Change	Fiscal Year	Revenue	% Change
1994	$328	13.1%	1999	$603	30.9%
1995	$323	-1.4%	2000	$639	6.1%
1996	$382	18.3%	2001	$675	5.5%
1997	$407	6.6%	2002	$651	-3.5%
1998	$460	13.0%	2003	$529	-18.8%



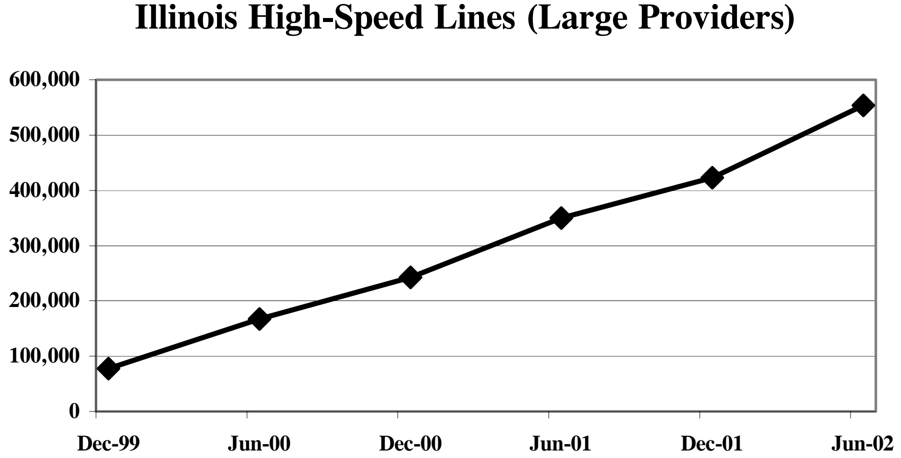
As stated previously, the telecommunications excise tax is equal to 7% of gross charges by businesses for transmitting messages in interstate or intrastate commerce. Because the tax is based upon usage, any decline in taxable telecommunication services results in a lower tax base and thus, lower tax receipts. According to the Illinois Commerce Commission's "Annual Report on Telecommunications Markets in Illinois", the number of plain-old-telephone-service (POTS) lines in Illinois decreased from just over 9 million at year-end 2001 to just over 8.7 million lines at year-end 2002. This was a decrease of over 300,000 lines. The report notes that Illinois is not alone in this respect. The Federal Communications Commission (FCC) has reported that the nationwide number of POTS lines has decreased in recent periods as well.

So, what are the reasons for the sudden decline in POTS lines and, therefore, in telecommunications tax receipts. There are a number of possible reasons that industry experts point to as major contributors to these decreases. To understand these reasons, a basic knowledge of the recent trends affecting the telecommunications industry is necessary.

During the mid-1990s, telecommunications tax receipts remained relatively flat. However, the emergence of the Internet dramatically changed the landscape of the telecommunications industry. As the Internet gained popularity, many sought to establish Internet connections in their home, which required phone lines. In order for phone lines to stay open for telephone usage, residents began obtaining a second phone line for their dial-up access to the Internet. This additional phone line resulted in a higher phone bill, and thus, higher State taxes. Many considered this convenience a small price to pay, especially during the robust economic times of the late 1990s.

While the popularity of the Internet was a major contributing factor for the telecommunications tax revenue increases experienced, it also is part of the reason for the decline in tax receipts in recent years. Searching for more convenient ways to access the Internet, the telecommunications industry began promoting broadband services to obtain high-speed Internet access instead of the slower dial-up access. The most popular of these methods are high-speed service over coaxial cable (cable modem) technology and high-speed service over an asymmetrical-digital-subscriber line (ADSL or DSL, as it is commonly called). Data from the Illinois Commerce Commission shows that Illinois experienced rapid growth in this area over a relatively short time span. As shown in Chart 3, the number of high-speed lines in Illinois increased from 77,672 lines in December of 1999 to 553,442 lines in June of 2002. This is an increase of nearly 613% over only a 2 ½ year period.

CHART 3



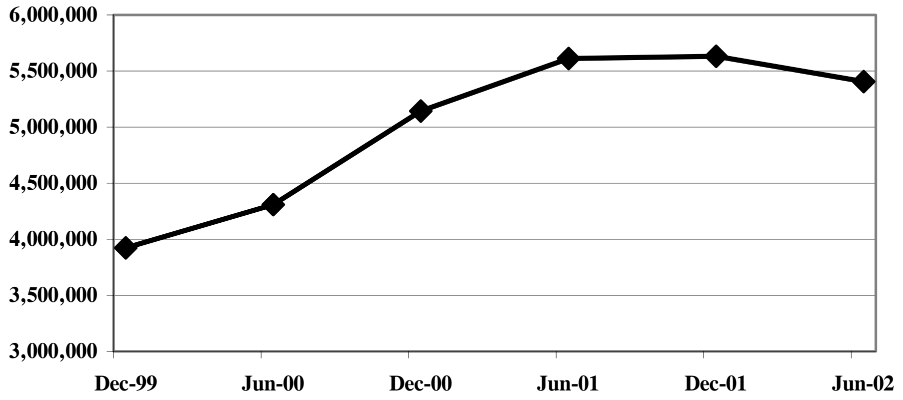
Source: Illinois Commerce Commission's Annual Report on Telecommunications Markets in Illinois

So how did these broadband services affect the State telecommunications tax receipt totals? Cable modems do not require a phone line. As a result, there is no State telecommunications excise tax on this technology. As for DSL, its technology permits the customer to have both conventional voice and high-speed data carried on the same line simultaneously because it segregates the high frequency data traffic from the voice traffic. This allows customers the ability to have a connection for the data traffic and an open path for telephone calls over a single line. Because the line can be used for the Internet and a telephone conversation at the same time, a second phone line is no longer needed. As a result, second phone lines are being dropped, thus, lowering the taxable base for the telecommunications excise tax.

Changes in the Internet industry are not the only factor contributing to the decline in telecommunications tax receipts. Another reason is due to the popularity of mobile wireless services. As shown in Chart 4, the number of Illinois mobile wireless subscribers increased from 3.9 million in December of 1999 to nearly 5.5 million in June of 2002.

CHART 4

Illinois Mobile Wireless Subscribers (Large Providers)



Source: Illinois Commerce Commission's Annual Report on Telecommunications Markets in Illinois

While the State's telecommunications excise tax is also imposed on wireless mobile phone service, the increased popularity of wireless phones may be affecting tax receipts as a result of the competition that has developed in the telecommunications industry. Wireless companies continue to use low rate plans that offer large amounts of minutes to gain the business of the consumer. These attractive plans are causing many consumers to use their mobile phones in place of land-based telephone service for long distance calls. In some instances, consumers are dropping their land-based telephone service all together and using their cellular phones exclusively.

To compete with these cheaper plans, land-based phone companies are lowering their phone rates to levels that enable them to contend with the wireless phone services. While this competition has benefited the consumer, it has impacted State receipts as the reduction in gross charges has resulted in a lower taxable base, and thus, lower telecommunications excise taxes collected. Although, the upward trend in mobile wireless services experienced in recent years is now beginning to level off, the competition that has developed in the telecommunications industry will likely continue into the foreseeable future.

Another factor contributing to the decline in telecommunications tax receipts is due to the increase in pre-paid calling cards. A State sales tax is imposed on these cards, but no telecommunications taxes are collected. As a consequence, like with wireless mobile service, anytime pre-paid calling cards are used in place of land-based phones, this has a negative impact on telecommunications excise tax receipts.

Another possible reason for the decline is due to the implementation of the Mobile Telecommunications Sourcing Act. The law, which took effect in Illinois in August 2002, was created to clarify how state and local transactional taxes are imposed on wireless telecommunications services. Under previous law, the law stated that for states to have jurisdiction to impose taxes on interstate telecommunications, the call must either originate or terminate in a given state and the service address to which the call is charged must also be in that state. This created a problem when, for example, if a caller who resides in Tennessee happens to be driving through Kentucky and places a call to someone in Missouri, and during the call passes into Illinois, what state or states have jurisdiction to impose a tax on such a call?

The Mobile Telecommunications Sourcing Act solved this confusion by stating that all wireless calls are sourced to the subscribers' residential or business address, whichever is the place of primary use. The hope was that this Act would resolve many of the administrative complexities of the current system, would maintain state and local government's ability to tax such services, and would be largely revenue neutral. However, some Illinois tax administrators are concerned that this Act may be negatively impacting Illinois tax receipts, especially in border locations. For example, if an Illinois resident who works in St. Louis subscribed to a wireless phone service in St. Louis and used his business address as his place of primary use, the consumer would be paying Missouri taxes and not Illinois taxes, regardless of the extent he uses the phone in Illinois. The Illinois Department of Revenue is currently looking into the extent of this occurrence to see the degree to which this tax is affecting Illinois tax receipts.

The Department of Revenue also stated that one reason for the sharp decline in receipts in FY 2003 was due to the overpayment of taxes in FY 2002. Because of this overpayment, many taxpayers were given tax credits, which were in turn used in FY 2003. The credits in FY 2003 created even lower receipts than what would have occurred. However, these credits only represent a portion of the nearly 19% drop in tax receipts in FY 2003.

A final reason for the decline in receipts is simply due to the economy. Over the past several years, the nation's economy has been slow to recover from the recession in 2001. As a result, both residents and businesses have looked to save money. To some, that meant dropping their land-based phone line. As the economy recovers, POTS subscriber figures should see improvement, however, the continuing popularity of wireless service and high-speed Internet may prevent the number of subscribers to approach the high figures seen in years past.

Other Taxes on Telecommunications

Aside from the State's excise tax, there are several other taxes and surcharges imposed on telecommunications in Illinois. The following is a summary of those charges as provided in the Illinois Commerce Commission's "Annual Report on Telecommunications Markets in Illinois":

Other State Taxes

Public Utilities Tax: This is a tax of 1/10 of 1% of gross receipts on utility bills, which supports the work of the Illinois Commerce Commission.

Wireless 9-1-1 Surcharge: As of September 2000 (and starting earlier for some providers), wireless services providers collect a 75-cent statewide surcharge on wireless phone numbers to support the implementation and operation of emergency services for wireless phone customers.

Illinois Universal Service Fund: This represents a mandatory surcharge on the local and instate long-distance portion of a customer's bill. Funds raised by this levy are used to keep basic local phone service affordable for subscribers of telecommunications carriers located in rural and high cost areas within the state. This charge was approved in September of 2001 and is currently set at approximately 0.3%.

Illinois Telecommunications Access Corporation (ITAC) Supplemental Charge: Telephone companies currently impose an ITAC supplemental charge of eight cents ($.08) per month per line for all subscriber lines other than Centrex-type lines, and a charge of eight tenths of one cent ($.008) for each Centrex-type line. (Rate amounts may change from year to year). ITAC is a loan program that enables persons who are certified as deaf, hard-of-hearing, or speech-impaired to obtain a teletypewriter, known as a TTY, at no charge so they may communicate by telephone more easily. This surcharge, which is currently included in a customer's line charge, is used to fund ITAC's annual budget of approximately $6 million per year.

Federal Charges

Federal Excise Tax: This is a basic tax on telecommunications services. The Federal Excise Tax is currently 3%.

Federal Subscribers Line Charges: The lines connected to your home or business have extra expenses not already recovered by the local company's regular line charge. The FCC allows the local company to apply this charge for each phone line a customer has. The charge may be higher for each additional phone line.

Universal Services Charge: This represents a mandatory contribution by toll carriers. The carriers contribute to a fund that supplies financial support for telecommunications in rural and other high cost areas, schools, libraries and health care facilities. In addition, this fund supports the Lifeline and Link-Up programs to assist low-income phone customers.

Number Portability Charge: The FCC allows local phone companies to recover the costs associated with making it possible for customers to take their current phone numbers with them when they switch to new local carriers.

Municipal/County Charges

Infrastructure Maintenance Fee (IMF): All telecommunications carriers on a customer's bill must collect this fee. The funds for the State IMF help to support the costs of providing and maintaining utility rights of way. Revenue from the IMF is dedicated for Personal Property Replacement Tax (PPRT) purposes and is disbursed to all taxing districts. The State IMF is 0.5% of gross receipts.

9-1-1 Surcharges: If the charges to support 9-1-1 services appear on a consumer's phone bill, then a local referendum approved such a process. The phone company collects a specific amount on each bill, and these amounts may vary from community to community across the state. In some cases, the surcharge may be assessed even before the 9-1-1 system is active. This is to enable the local government to build up the funds necessary to create the system.

Simplified Municipal Telecommunications Tax: Effective January 1, 2003, local governments have been empowered to replace the Optional IMF, Municipal IMF, Municipal Messages Tax and the Municipal Telecommunications Tax with a Simplified Municipal Telecommunications Tax. For municipalities with populations of 500,000 or more, the Simplified Municipal Telecommunications Tax may not exceed 7% of the gross charge for telecommunications on a customer's bill. For municipalities with populations less than 500,000, the Simplified Municipal Telecommunications Tax may not exceed 6% of the gross charge for telecommunications on a customer's bill. Mobile telephone bills are also assessed this tax.

Other Related Information

Telecommunications Statistics

Telephone service is provided to residents and businesses by way of local exchange carriers (LECs). There are two general classes of LECs that provide land-line telephone service in Illinois: incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs). The Illinois Commerce Commission defines an ILEC as "a telecommunications carrier (including its successors, assigns, and affiliates) that historically has served as the exclusive provider of wireline local telephone service in a specific service territory." A CLEC is defined as "competitive carriers that have been authorized and certificated by the Commission to provide local telephone service in competitions with ILECs." Telecommunications carriers can operate both ILEC and CLEC services.

According to the Illinois Commerce Commission's latest annual report, a total of 49 ILECs reported providing POTS lines in Illinois. They report that the four largest ILECs (Ameritech Illinois (now SBC), Verizon Communications, Citizens Communications Company, and Illinois Consolidated Telephone Company) provided approximately 97% of all ILEC retail POTS lines. As for the CLECs, of the 45 that reported providing retail POTS service in Illinois, the four largest CLECs (AT&T, Comcast Corporation, WorldCom, Inc., and McLeodUSA, Inc.) accounted for approximately 70% of all CLEC retail POTS lines.

The Telecommunications Act of 1996

When the Telecommunications Act of 1996 was enacted, it sought to increase competition in the telecommunications industry by promoting new rivalry in the local telephone markets and the long-distance telephone markets. In order to introduce competition into local telephone markets, the 1996 Act removed statutory, regulatory, and operational barriers to potential competitors by making three changes:

- CLECs were allowed to resell the services of ILECs.
- CLECs were permitted to make use of ILEC facilities.
- CLECs were given the authority to build the facilities necessary to compete with the incumbent service providers.

Although ILECs are allowed to charge CLECs for using their facilities, ILECs must set their prices at reasonable rates. In fact, the Act states that ILECs have "the duty to provide, to any requesting telecommunications carrier for the provision of telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory..." The Act further states that "No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." This provision was included to eliminate the local service monopoly franchises that existed in most states.

P.A. 93-0005

The cost of the leased line for Illinois CLECs has currently averaged around $12 per month per line. During the latest legislative session, one of the major ILECs, SBC, argued that the current rate was so low the company was effectively subsidizing its competition. SBC approached the legislature on increasing this rate to an average of over $19 per month per line, and, as a result, SB 0885 was formalized. After a period of debate, SB 0885 was passed creating P.A. 93-0005. This legislation was to go into effect in June of 2003, however, a federal judge ordered a halt to the increase, calling the legislation "anti-competitive". Many felt that if this legislation was allowed to go into effect, CLECs, such as AT&T and MCI, would have passed this fee increase onto the consumers, resulting in higher telephone bills. The federal judge's decision to stop the rate increase has been appealed and its ruling remains up in the air. While the route of going through the State legislature for the rate hike has been stalled, it should be noted that ILECs can still obtain a higher lease rate by going through the Illinois Commerce Commission.

Long-Distance Service and SBC

Another effect the Telecommunications Act of 1996 had on the telecommunications industry was the allowance of RBOCs (Regional Bell Operating Companies) into long-distance telephone markets. However, the RBOCs, such as SBC, were only allowed to compete in the long distance market if they met certain conditions. For entry, an RBOC must meet certain requirements, satisfy a 14-point competitive checklist, and prove that its entry serves the public interest.

For the past several years, SBC has sought to enter the long-distance market. In May of 2003, the ICC agreed that SBC Illinois had complied with federal requirements to open it's network to telecommunications companies seeking to provide customers with alternative telecommunications service. In October 2003, SBC received final approval from the FCC, allowing them to offer long distance phone service in Illinois, Indiana, Wisconsin, and Ohio effective October 24, 2003. This approval meant that the FCC is convinced that SBC's operational systems are working, competitors are able to purchase the parts of the incumbent's network needed to provide customer service, and that competition is, in fact, developing.

For more info on the telecommunication's industry, please see the IEFC's April 2001 report, "Telecommunications Deregulation: Issues and Impacts", which can be found at the IEFC's website: http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html.

The Natural Gas Revenue Tax

The third portion of the public utility tax is the *natural gas revenue tax*. This tax is imposed on companies distributing natural gas in Illinois, which can pass it on to customers. All of the natural gas revenue tax is deposited into the General Revenue Fund. The rate and base of the natural gas revenue tax is the LESSER of the following:

a) 2.4 cents per therm of gas sold to each customer, OR
b) 5% of gross revenue from each customer.

RATE HISTORY

The natural gas revenue tax was first imposed in 1945 at a rate of 3%. The following table displays the rate history of the tax since its inception.

Year	**Rate**
1945	3.00%
1965	4.00%
1966	3.92%
1967	5.00%
1985 (Current)	5.00% or 2.4 cents per therm

EXEMPTIONS AND CREDITS

As with the other State public utility taxes, there is a natural gas tax exemption available for enterprise zone and foreign zone high economic impact businesses. The Department of Commerce and Economic Opportunity determines the extent of this exemption as well. According to the Comptroller's *Tax Expenditure Report*, in FY 2002, this exemption cost the State nearly $1.6 million in general funds receipts.

There is also available a purchase from out-of-state supplier exemption. This natural gas tax exemption cost the State nearly $3.0 million in FY 2002; down from the $5.0 million it cost the State in FY 2001.

DISTRIBUTION

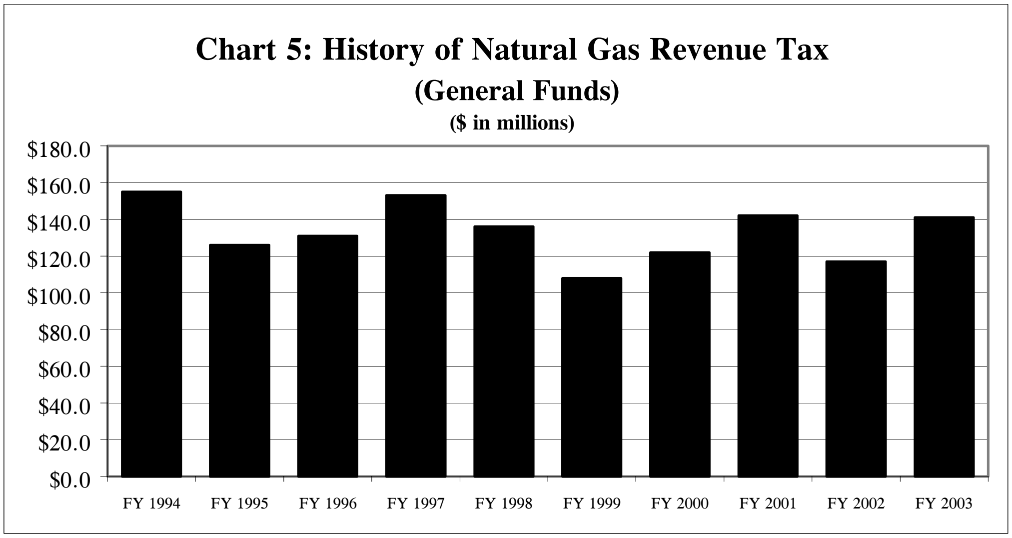
As stated previously, 100% of the revenue collected from the State natural gas revenue tax is deposited into the General Revenue Fund.

GENERAL REVENUE COLLECTIONS HISTORY-NATURAL GAS

The following table and chart shows a history of the natural gas revenue tax over the last ten years. As displayed, this revenue source has experienced much volatility over the last decade. This is because, like the electricity tax, the natural gas tax is largely affected by weather, especially the colder months. Because many Illinois homes utilize natural gas to keep their residences warm during cold periods, the amount of natural gas tax receipts collected in a year has a lot to do with how cold it gets in a given year. Regardless of which qualifying rate is used, this tax is dependent on the extent of the usage of the gas, which means, the higher the usage, the more natural gas tax revenue realized for the State.

Table 4: Natural Gas Revenue Tax (General Funds) Annual Percentage Changes
($ in millions)

Fiscal Year	Revenue	% Change	Fiscal Year	Revenue	% Change
1994	$155	3.3%	1999	$108	-20.6%
1995	$126	-18.7%	2000	$122	13.0%
1996	$131	4.0%	2001	$142	16.4%
1997	$153	16.8%	2002	$117	-17.6%
1998	$136	-11.1%	2003	$141	20.5%



OTHER TAXES ON NATURAL GAS UTILITIES

There is no federal tax on natural gas utilities. However, a municipality can impose an occupation tax based on the gross receipts of businesses that provide natural gas for consumption within its limits, at a rate up to 8% in Chicago, or 5% elsewhere.

P.A. 93-0031

During the latest legislative session, in an effort to create additional revenue for a struggling State budget, lawmakers, along with the Governor signed into law P.A. 93-0031 (SB 1733), which created a natural gas use tax. The natural gas use tax was created to eliminate a loophole that allows out-of-state purchases to be excluded from natural gas taxes. The public act provides that beginning October 1, 2003, a tax is imposed upon the privilege of using in this State gas obtained in a purchase of out-of-state gas at the rate of 2.4 cents per therm or 5% of the purchase price for the billing period, whichever is the lower rate (the same rate as the regular natural gas tax).

P.A. 93-0031 exempts certain groups from this natural gas use tax. The public act states that this new tax shall not apply to:

1) Gas used by enterprise zone businesses;
2) Gas used by local governments, charitable and religious organizations;
3) Gas used in the production of electric energy;
4) Gas used in a petroleum refinery operation;
5) Gas purchased by persons for use in liquefaction and fractionation processes that produce value added natural gas byproducts for resale;
6) Gas used in the production of anhydrous ammonia and downstream nitrogen fertilizer products for resale;

The public act clarifies that beginning with bills issued to customers on and after October 1, 2003, the current natural gas tax shall not be imposed on transactions with customers who incur a tax liability under the newly created Gas Use Tax Law. P.A. 93-0031 became effective on October 1, 2003.

The Department of Revenue estimates that, before this tax went into effect, the natural gas tax loophole was costing the State approximately $70 million in natural gas tax receipts. P.A. 93-0031 retains a portion of this “lost” revenue by creating a natural gas use tax for those out-of-state purchases not currently taxed by the State’s natural gas tax. However, not all of the lost revenue will be collected because, as shown above, the public act provides that certain businesses and organizations will be exempt from paying the newly created natural gas use tax. The Department of Revenue estimates that the creation of this natural gas use tax in Illinois will generate approximately $38 to $43 million for the State. All of the funds generated will be deposited into the General Revenue Fund.

Natural Gas Statistics

Recently, the Illinois Commerce Commission released a report entitled, "Illinois Gas Utilities: Comparison of Gas Sales Statistics for Calendar Years 2002 and 2001". The report provides a comparison of natural gas statistics for fourteen Illinois gas utilities, including the five largest companies, Nicor Gas, Peoples Gas, Illinois Power, AmerenCILCO, and AmerenCIPS. The report shows that $3.2 billion in gas sales to ultimate customers were collected by these companies in 2002. Of this amount, $2.5 billion, or 79.06% were from residential sales. The following tables summarize the natural gas statistics provided in the report.

TABLE 5

Illinois Gas Utilities
Summary of 2002 Statistics by Category and by Class of Service

Class of Service / Category	2002 Revenues	Revenue in Cents per therm	Percent of Company Operating Revenues	Percent of Total Sales to Ultimate Customers	
				Revenue	Therms
		Total Company			
Residential Sales	$2,515,174,478	61.75	68.26%	79.06%	78.02%
Small (or Commercial) Sales	543,804,599	59.52	14.76%	17.09%	17.50%
Large (or Industrial) Sales	122,101,399	52.23	3.31%	3.84%	4.48%
Other Sales to Public Authorities	144,240	59.87	0.00%	0.00%	0.00%
Total Sales to Ultimate Customers	$3,181,224,716	60.93	86.33%	100.00%	100.00%
Interdepartmental Sales	$13,125,155	35.82	0.36%		
Sales For Resale	14,240,176	31.71	0.39%		
Total Gas Service Revenues	$3,208,590,047	60.51	87.08%		
Total Other Gas Operating Revenues	476,211,184		12.92%		
Total Gas Operating Revenues	$3,684,801,231		100.00%		
Less: Prov. For Rate Refunds	0		0.00%		
Total Gas Op. Rev. Net of Prov. For Ref.	$3,684,801,231		100.00%		

Source: Illinois Commerce Commission

TABLE 6

Illinois Gas Utilities

2002 Total Gas Service Revenues (and Sales)

	Revenues	Therms	Customers
AmerenCILCO	$215,599,603	319,753,070	208,054
AmerenCIPS	$156,895,244	184,560,090	165,155
AmerenUE	$16,244,147	18,150,645	17,433
Atmos Energy	$18,994,354	25,208,560	23,420
Consumers Gas	$5,071,824	6,909,950	5,911
Illinois Gas	$9,571,255	12,354,591	10,308
Illinois Power	$359,807,482	520,586,854	399,175
Interstate Power	$4,137,616	6,913,165	5,487
MidAmerican	$63,710,154	140,786,319	65,203
Mt. Carmel	$3,272,057	4,440,167	3,684
Nicor Gas	$1,299,341,998	2,446,103,095	1,851,441
North Shore Gas	$167,646,313	229,419,400	149,108
Peoples Gas	$882,398,340	1,106,153,560	817,296
South Beloit	$5,899,660	7,805,702	6,849
	$3,208,590,047	**5,029,145,168**	**3,728,524**

Source: Illinois Commerce Commission

Overview

Below is a graph of the three general funds public utility taxes over the last ten years. As shown, the telecommunications tax continues be the largest component of the total, in spite of its recent downward turn. Because of this, as well as the relative stability of the electricity excise tax and the natural gas tax, the success of the State's public utility tax, in terms of revenues collected, is ultimately dependent on the behavior of the telecommunications tax. As long as receipts from the telecommunications tax continue to struggle, so will the total amount of public utility tax revenues collected.

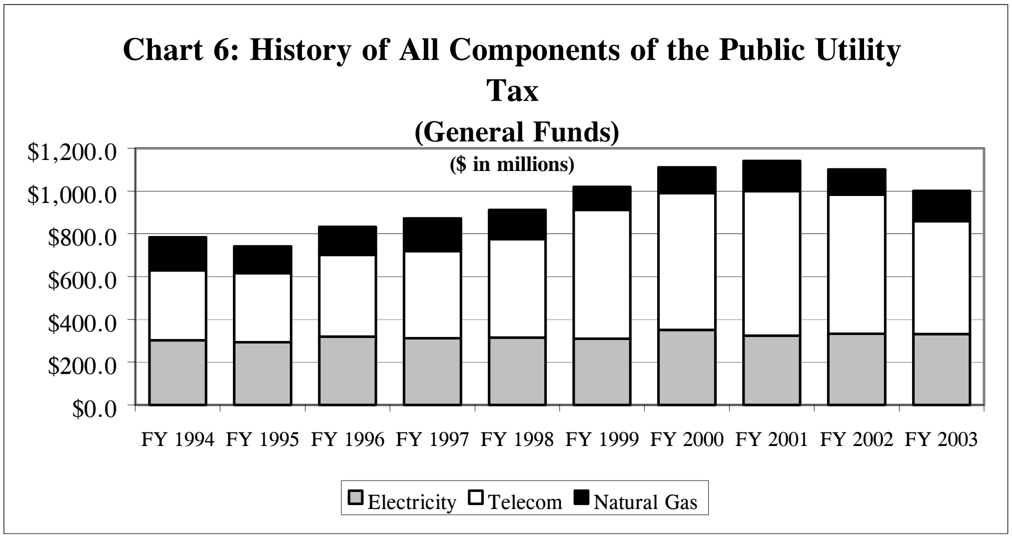


Chart 6: History of All Components of the Public Utility Tax

(General Funds)

($ in millions)

Other Public Utility Taxes

The following is a summary of other public utility related taxes not previously discussed.

Intrastate Gross Revenue Tax: This tax is imposed on public utility companies (except electric companies) that are regulated by the Illinois Commerce Commission, for the privilege of doing business in the State. The law excludes municipally operated utilities and mutual telephone companies. The tax has a rate up to 0.1% of a company's gross revenue from intrastate business for the calendar year. All of the revenue from the tax is deposited into the Public Utility Fund and is used to pay the expenses of the Illinois Commerce Commission.

Personal Property Tax Replacement Tax: In 1979 the General Assembly replaced the personal property tax on businesses with an income tax on corporations and an invested capital tax on public utilities. A 1997 law repealed the invested capital tax on electricity distributors (except electric cooperatives) and telecommunications distributors. Instead, electricity distributors pay a personal property tax replacement tax based on amounts of electricity delivered in Illinois, while telecommunications distributors pay a telecommunications infrastructure maintenance fee. Electric cooperatives continue to pay the invested capital tax.

All of the amounts collected from the public utility replacement taxes are deposited into the personal property tax replacement fund. From this fund, 51.65% is sent to local governments in Cook County, while 48.35% is sent to local governments in the other 101 counties. A table and graph displaying the revenue collected from the public utility replacement taxes over the past ten years are shown on the following page. A summary of each of these taxes, as provided in the 19th edition of the "Illinois Tax Handbook for Legislators" is provided below.

> ***Invested Capital Tax:*** Imposed on the invested capital of rural electric cooperatives and businesses that sell gas or water services. Municipally owned electric and water companies, and telephone cooperatives are exempt from this law. The rate of this tax is 0.8% of capital invested in gas plants in service during the taxable period.
>
> ***Electricity Distribution Tax:*** Imposed on electricity distributors, other than electric cooperatives. The annual revenue from the tax is limited to $145.3 million, plus the lesser of a) 5% or b) the percentage increase in the Consumer Price Index for All Urban Consumers, All Items (CPI-U) for the preceding year – in either case multiplied by revenue in the preceding year. The rate of the tax is based on the following scale:

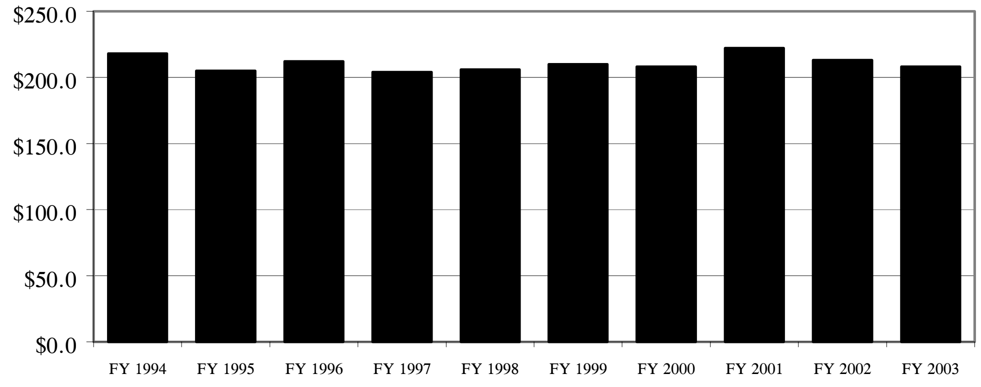
Kwh distributed Per month	**Cents Per kwh**
First 500 million	0.031 cents
Next 1 billion	0.050
Next 2.5 billion	0.070
Next 4 billion	0.140
Next 7 billion	0.180
Next 3 billion	0.142
Over 18 billion	0.131

Telecommunications Infrastructure Maintenance Fee: Imposed on telecommunications services, including provision of messages or information through local, toll, and wide-area telephone services; channel, telegraph, teletypewriter, computer exchange, private line, and specialized mobile radio services; and any other transmission of messages or information by electronic or similar means, between or among pints by wire, cable, fiber optics, laser, microwave, radio, satellite, or similar facilities. The rate of the fee is 0.5% of the retailer's gross charges for telecommunications services. Revenue from this fee is distributed the same as the invested capital tax.

Table 7: Public Utility Replacement Tax Annual Percentage Changes
($ in millions)

Fiscal Year	Revenue	% Change	Fiscal Year	Revenue	% Change
1994	$218	-2.2%	1999	$210	1.9%
1995	$205	-6.0%	2000	$208	-1.0%
1996	$212	3.4%	2001	$222	6.7%
1997	$204	-3.8%	2002	$213	-4.1%
1998	$206	1.0%	2003	$208	-2.3%

Chart 7: History of the Public Utility Replacement Tax
($ in millions)



BACKGROUND

The Illinois Economic and Fiscal Commission, a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

1) Preparation of annual revenue estimates with periodic updates;
2) Analysis of the fiscal impact of revenue bills;
3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;
4) Periodic assessment of capital facility plans; and
5) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes two primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

Reports can also be accessed from our Webpage:

http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html