ENERGIZING TAX RELIEF

The History of Energy Utility Taxation in New Jersey

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Revised April 2018

Every year, during the State's budget debate, reference is made to "state aid to municipalities." Throughout the years, the public is told that "state aid to municipalities" is State money that the State Government budgets for municipalities. In fact, most of the funds are actually replacement revenues that are intended to replace property tax relief funding which was formerly generated through locally assessed and locally collected taxes, specifically to fund municipal programs and services. One such program is the Energy Tax Receipts Property Tax Relief program.

At the 2010 New Jersey League of Municipalities' annual conference, the delegates voted in favor of a Resolution "To End State Diversion of Municipal Revenues and Demand Compliance with State Laws" as a major priority for the League's Legislative Action Program. The resolution notes that New Jersey's two main formula-driven general municipal property tax relief programs, though often referred to as "State Aid" programs, are actually revenue replacement programs, intended to replace property tax relief funding that was formerly generated through taxes assessed and collected locally. Organized pursuant to the Resolution, the Statutory Funding Compliance Committee, chaired by East Windsor Mayor and League Past President Janice Mironov, has centered its efforts around some core principles.

Energy Tax funding is and has been the #1 issue for municipalities and for property taxpayers.

The taxes were put in place and had always been collected in order to relieve the burdens heaped upon our municipal property taxpayers. The diversion of these property tax relief revenues to other State needs has been practiced for over 25 years; but never to the dramatic levels of 2010.

Understanding the fiscal problems that the Governor inherited, we tempered our objections to the State's use of municipal revenues to balance the FY 2011 budget. Now, we must draw a line in the sand. Faced with unprecedented fiscal challenges and new stringent budget caps, we cannot carry the State any longer.

While we appreciate the Governor's and the Legislature's efforts to deliver meaningful toolkit management reforms, those initiatives will not help Mayors balance their budgets, nor will they help our citizens with their property taxes.

This year, we wanted to ask that funding be restored to 2009 levels. We insisted that funding not fall below 2010 levels. Further, we wish to see a State commitment and will work with the Administration and the Legislature on a plan to phase in State compliance with State statutes regarding Energy Tax (and CMPTRA) distributions, or to allow municipalities to again directly collect utility revenues, locally.

Today's "Energy Tax" is the direct lineal descendant of the Public Utility Gross Receipts and Franchise Taxes (PUGRAFT).

In 1992, the Legislature's Commission on County and Municipal Government published its analysis of "Intergovernmental Funding within New Jersey." For over a decade up to that point, and despite dramatic increases in PUGRAFT collections, the State had arbitrarily limited the annual distributions to municipalities at a $685 million level. In its 1992 report, the Commission recommended "that the $685 million of Gross Receipts funding to municipal government … should be displayed (in the State Budget) in a unique category described as *Municipal Revenue Collected by the State for Municipal Purposes."* The report continued, "This approach will clearly reflect the inherently municipal nature of these funds and the large amount of monies transmitted through this *intergovernmental account.* After the property tax, *Gross Receipts* is the single largest source of municipal revenue.

The term "Gross Receipts," as used by that Commission, was a reference to the Public Utility Gross Receipts and Franchise Taxes, the history of which was discussed within the body of the report. That history, up to 1996, is confirmed by a succession of the Annual Reports of the Division of Taxation in the Department of the Treasury, which carefully distinguished the "Franchise" from the "Gross Receipts" components.

Public Utility Gross Receipts and Franchise Tax

Franchise Tax

The first general tax act specifically taxing public utilities was enacted in 1884. It provided for a two percent Franchise Tax on gross receipts of telegraph, telephone, cable and express companies. In 1900, the Voorhees Tax Act included all utilities other than those taxable under the Railroad and Canal Property Tax Act. It also provided that the receipts collected by the State were to be transferred back to municipalities. In 1917, franchise tax rates were increased to 3%, 4% in 1918, and 5% percent in 1919 and thereafter.

In 1940, significant revisions and amendments were adopted. Unit values were applied to each class or type of public utility, tangible, personal property for the purpose of securing a fair and equitable apportionment of taxes. An accelerated payment schedule was imposed on all public utility companies paying the Franchise or Gross Receipts Taxes. Chapters 10 and 11, P.L. 1980 amended Chapters Four and Five, with P.L. 1980 establishing a Municipal Purposes Tax Assistance Fund and providing for a distribution to designated municipalities of not less than $27 million.

By 1992, the Franchise Tax (N.J.S.A. 54:30A-16 et seq. and 54:30A-49 et seq.) applied to persons, co-partnerships, associations and corporations, other than those specifically exempted, having lines or mains located on or over any street, highway or other public place. Utilities subject to taxation–which encompass telegraph, telephone and district messenger systems companies–included both communication and non-communication utilities. The rate was either 2% or 5%t of a proportion of the gross receipts of the taxpayer for preceding calendar year. The rate was 2% for gross receipts of $50,000 or less and 5% for gross receipts exceeding $50,000.

The proportion of gross receipts subject to tax was the ratio of the taxpayer's total length of lines or mains which were located on or over any street, highway or other public place to the whole length of lines or mains. Measurement of lengths of lines or mains excluded service connections.

The Franchise Tax was collected by the State for distribution to municipalities together with the gross receipts tax distribution. The tax was payable by the State to the municipal tax collectors in three installments: 25% within 30 days after certification of the apportionment; 40% on September 1st; and 35% on December 1st. Revenues, after deductions for the cost of administering the tax by the State, were for local use. The tax was distributed to the municipalities, subject to the limitations imposed by the State's budget.

Gross Receipts Tax

The Public Utility Gross Receipts Tax was levied in 1919 as an addition to the Franchise Tax. The tax was in lieu of State, county, school, and local taxes on personal property and materials other than land and buildings. The rate of tax was the average rate of the aggregate general property tax. In 1952 sewerage corporations were included among taxable public utility companies. In 1955 a maximum rate of 7.5% was adopted and in 1956 a minimum of 5% was established. The "average rate of taxation" concept was eliminated in 1960 and a tax rate of 7.5% of gross receipts was established. Water companies became subject to the Gross Receipts in 1961. An accelerated payment schedule was imposed in 1979 on all public utility companies paying the Franchise or Gross Receipts Taxes. Chapters 10 and 11, Public Law 1980 amended Chapters Four and Five, Public Law 1940 to provide for State collection and distribution to municipalities.

The Public Utility Gross Receipts Tax was in addition to the Franchise Tax and was in lieu of local taxes on selected properties for the following types of public utilities performing non-communication functions: sewerage, water, gas and electricity for corporations using or occupying public streets, highways, roads or other public places in New Jersey. The Public Utility Gross Receipts Tax was collected by the State for distribution to municipalities together with the Franchise Tax. By 1992, the rate of tax was 7.5% applied to taxable gross receipts for the preceding calendar year (N.J.S.A. 54:30A-54(b)). The Gross Receipts Tax was distributed to the municipalities, subject to the limitation imposed by the State's budget. The tax was payable by the State to the tax collectors in three installments; 25% within 30 days after municipal certification of the apportionment; 40% on September 1st; and 35% on December 1st.

For FY 1990, a total of $847 million was collected in revenue from the Gross Receipts and Franchise Tax. A total of $685 million was received by New Jersey municipalities and $162 million was taken by State Government for its own use.

That $162 million skim brought to a tragic climax the first decade of State collection of this vital municipal revenue. By assuming the power to collect these municipal taxes, the State of New Jersey had gained access to the most important source of property tax relief dollars and had applied them to other purposes.

Any serious discussion of property tax relief and property tax reform needs to consider this history. And a serious effort to relieve the property tax burden born by New Jersey citizens and businesses can easily begin with a commitment to use utility taxes for their intended purpose.

That consideration was voiced as far back as 1949, when League of Municipalities executive Secretary James Smith testified before the New Jersey Commission on State Tax Policy. That Commission was created in the wake of the new State Constitution, which had modernized the structure of State government. Its intent was to propose a modernized structure for State and local public finance. Fearing a State usurpation of local revenues, Mr. Smith counseled the Commission as follows.

"Tax legislation which in effect takes the tax dollar from the municipality to the State should have as one of its provisions a definite and specific allocation of the municipality's share in the tax, not as a handout or grant from the State, but as a right that is fixed and on which the municipality may rely to support the municipal budget and reduce the tax rate of the general property taxpayer.

Gentlemen, in this way you will encourage responsive and responsible government in our municipalities. There is no better way to maintain the dignity and promote the efficiency of municipal government in our State."

Mr. Smith's testimony reminds us that there once was a time when municipalities had direct access to a number of revenue sources, aside from the general property tax. In 1966, the State became the collection agent for property taxes on Class II Railroad properties and agreed to hold municipalities harmless, by annual appropriation. Until 1968, when the State became the collection agency, municipalities also collected the Business Personal Property Tax. When it assumed collection, the State pledged to return the revenues to local government. In 1970, the Financial Business Tax, which had formerly been equally divided between the host municipality and the host county, was doubled, and the new revenue distribution was 50% for the State, 25% for the host county and 25% for the host municipality.

Then, in 1980, major changes in Public Utility Gross Receipts and Franchise Taxes were enacted, but the State promised, once again, to return the revenues to the host municipalities.

That promise was soon forgotten. In 1982, the Governor then in office used the line item veto of the State's Annual Appropriations Act (for FY 1983) to skim $32 million of Public Utility Gross Receipts and Franchise Tax funding from the appropriation intended for municipalities, and to use that money for other State priorities–priorities other than property tax relief. The then-Assembly Speaker and the then-Senate President went to bat for our property taxpayers. This skim was challenged in Court. But, in the case of *Karcher v. Kean*, 97 N.J. 483, 507, 479 A.2d 403 (1984), the State Supreme Court sanctioned this practice. Throughout the '80's and into the '90's, every State Budget featured an annual diversion of some of the funding dedicated by permanent statutes to municipal property tax relief, and the use of that funding for different State purposes.

So the lion's share of the money that municipalities receive from the State is a partial replacement for funds that were originally direct sources of municipal revenue. From Public Utility Gross Receipts and Franchise Taxes, now distributed as Energy Tax Receipts Property Tax Relief, to Business Personal Property Taxes, Financial Business Taxes and Class II Railroad Property Taxes, all of which have been folded into Consolidated Municipal Property Tax Relief Aid, these revenues were intended for municipal use from their beginnings. When the State, at the request and for the convenience of the taxpaying businesses, became the collection agent for these taxes, it pledged to redistribute the funds back to local governments. So, from our perspective, these do not constitute new "aid" from the Treasurer of New Jersey. Instead, we see them as local revenues, temporarily displaced.

In the mid-1990s, as energy deregulation took hold in New Jersey, the future of the gross receipts and franchise tax was very much in doubt. The rise of major energy users switching to non-utility power sources to save money, in part by avoiding the tax, meant this important municipal revenue was at risk. So, 1997 legislation replaced the old Gross Receipts and Franchise Tax with the "Energy Tax Receipts Property Tax Relief Fund." Up to five revenue streams, including the sales and use tax to energy and utility services, replaced the Gross Receipt and Franchise Tax.

While the tax streams are different, the intent was crystal clear: Rather than see municipalities lose this critical revenue, the reform was designed to provide reliable property tax relief. An October 1997 Local Finance Notice states, "The Energy Tax Receipts Program is allocated to ensure that municipalities will receive at least the same amount of money they received from the Gross Receipts and Franchise Tax."

In other words, energy tax receipts were not to be treated like discretionary forms of "state aid," which were subject to political winds and economic misfortune. In an attempt to prevent future State raids on this vital property tax relief funding, the new energy tax regimen would be jeopardized, if the State failed to deliver on this promise. The new law included a "Poison Pill," a provision that would revoke the State's authority to collect these taxes, if it failed to distribute the proper funding to municipalities.

The original law (Chap. 167, PL 1997) stated that each individual municipality must receive at least the amount of ETR that they received in State Fiscal 2002, OR THE POISON PILL IS ACTIVATED.

A few years later, Legislators in both parties and in both Houses recognized the fact that increases in population, prices, wages and employee benefits–increases over which mayors and governing bodies have little, if any, control–erode the ability of local officials to keep a lid on property taxes with "level funding." Appreciating that fact, they put laws on the books that were supposed to preserve the property tax relief benefits of the most significant of these programs, into the future.

The law that established the annual inflationary increments (Chap 168, PL 1999) provided that the AGGREGATE amount that the State distributes to all municipalities has to increase by the Implicit Price Deflator (IPD) OR THE POISON PILL IS ACTIVATED. That law also promised annual inflationary adjustment in the other main State revenue replacement funding program, the

Consolidated Municipal Property Tax Relief Act (CMPTRA). But the CMPTRA distributions were never protected by the "poison pill" provision. Therefore, there are no consequences for the State if it fails to increase CMPTRA by the IPD.

For the next seven years, by putting language into each annual appropriations act, the State has shifted CMPTRA funds to the ERT, on paper, to avoid the "Poison Pill." A municipality's CMPTRA amount went down by the same amount that their ETR amount went up. And in the last three years, while the State changed the distribution formula, it made certain that municipalities did not get less than their 2002 distribution.

Thus, for years, State policy makers skirted the law by annually reducing the CPMTRA distribution by the same amount that it increased the Energy Tax distribution. The State, then, strayed even farther from original legislative intent, when, in 2008, CMPTRA was reduced by about $26 million more than the Energy Tax was increased, and in 2009, the net loss equaled about $32 million. Then, in 2010, the State used over $271 million of these, supposedly 'dedicated,' local property tax relief dollars for other purposes.

And based on actual tax receipts, not the "mandatory" minimum distributions supposedly protected by the "poison pill," the State's Energy Tax skim, which had totaled $403 million in 1998, more than doubled to $829 million by 2008.

Giving municipal property taxpayers all the relief they deserve needs to be a part of "the new normal." For 10 years now, however, it has been standard operating procedure to give our State's struggling citizens less.

Over the past 10 years, in fact, the State has denied local property taxpayers, statewide, over $3.4 billion of relief.

To recapitulate, New Jersey's two main formula-driven general municipal property tax relief programs are the Energy Tax Receipts Property Tax Relief program (Energy Tax) and the Consolidated Municipal Property Tax Relief Act program (CMPTRA). Though often referred to as "State Aid" programs, both are actually revenue replacement programs, intended to replace property tax relief funding that was, formerly, generated through taxes assessed and collected, specifically, to fund municipal programs and services.

Chapter 168, P.L. 1999, provided that in each year subsequent to State FY 2002, Energy Tax and CMPTRA distributions would annually increase at the rate of the Implicit Price Deflator–used to measure the impact of inflation on governmental spending. According to a decision rendered by our State Supreme Court in the 1980s, however, the State can supersede permanent statutes simply by including a provision, to that effect, in the Annual Appropriations Act (the State Budget). For the past 10 years, that is exactly what has happened.

If, however, the State had complied with those statutory funding requirements, the $1,580,292,000 which municipalities shared in 2001 would have grown to $2,182,502,000 this year. Instead, the Governor has recommended that $1,293,794,000 be distributed. In this year alone, therefore, the State budget has been balanced by $888,708,000 that should be returned to municipalities for property tax relief. The 2011 total distribution should be roughly 38% more than the distribution in 2001. The amount of combined CMPTRA and Energy Tax that was distributed to your municipality in calendar year 2001 (or Fiscal year 2001-2002) plus 38% will give you that approximate total.

As League President Mayor Chuck Chiarello of Buena Vista Township has said, "Giving municipal property taxpayers all the relief they have coming to them needs to be a part of the 'new normal.'" For years, however, State-level budget decisions have denied municipal property taxpayers more and more of that relief.

The history of Public Utility/Energy Taxes is clear. These taxes were imposed to compensate municipalities for the benefits that the utilities derived from their use of the public's rights of way. In lieu of other taxes, the proceeds are supposed to flow into municipal budgets to reduce the amounts that would need to be raised through property taxation. This is not "aid" provided by the "State." It is–or, at least, it is meant to be–just compensation provided by certain utilities to municipal property taxpayers for the economic benefits that those utilities derive from the use of public rights of way.

Let the record be clear. Whenever it fails to comply with the laws on the books and, instead, diverts the proceeds from the Energy Tax to any other purpose, the State is balancing its budget with municipal revenues. In order to avoid increasing State administered taxes, or cutting other State spending, the State has consistently decided to use this municipal property tax relief funding to bridge the gap. In fact, most of the Consolidated Municipal Property Tax Relief Act (CMPTRA) and all of the Energy Tax Property Tax Relief (Energy Tax) funding is revenue replacement funding. It is supposed to replace revenues that were originally collected by municipalities for local use. Those alternative revenues delivered municipal property tax relief for a long time, before various 'reforms' took them away from our cities, towns, townships, boroughs and villages–always accompanied by the solemn, statutory vow that we would be 'held harmless.' Further, pursuant to a 10-year old State law, which has long been honored more in the breach than in the observance, CMPTRA and the Energy Tax are supposed to be annually adjusted to account for the effects of inflation.

Past League President and Mayor of East Windsor Janice S. Mironov, Chair of the League's Statutory Funding Compliance Committee, gives a strong and straight-forward summary of the problem. She states, *"A promise made should be a promise kept, and municipal officials have not forgotten and will not sit quietly by while municipal funds continue to be diverted for state use. State officials are quick to announce a 2% spending cap for municipalities, passage of so-called "toolkit" legislation, and a claim of no new state taxes. Yet at the same time they are diverting huge amounts of municipal monies from energy tax receipts. In effect, state officials are transferring their problems down to local officials and increasing local property taxes. The state must be held accountable to towns and local property taxpayers. We call for an immediate and full restoration of this vital property tax relief funding."*