

City of Chula Vista Proposed Modernization of the City's 1978 Telecommunications Users' Tax Brief Summary

- The City of Chula Vista is proposing a modernization (broadening) of its 5% Telecommunications Tax (part of the City's Utility Users' Tax or UUT). The measure will be placed on the November 2010 ballot. The purpose of the measure is to allow the City to collect UUT revenue on a broad range of telecommunication services currently not covered by the ordinance.
- In 1970, the City of Chula Vista adopted a Utility Users' Tax (UUT) to help fund public services and capital improvement projects through the City's General Fund. The City receives UUT based on the usage of natural gas, electricity, and telecommunications.
- Telecommunication services are levied a 5% charge based on the total amount paid for such services. Many older UUT ordinances (like Chula Vista's) do not provide the opportunity to assess new technology—such as internet and cellular phones. In addition, many local UUT ordinances in existence prior to this date contained language referring to the Federal Excise Tax (FET) and its exemptions. For this reason, cities with older UUT ordinances (only able to levy taxes on traditional telephone service) typically collect less revenue than those with modernized ordinances (explicitly able to levy taxes on mobile phones).
- The City has concerns that if its UUT is not modernized, a large portion of its UUT is subject to extinction. Modernizing the UUT would result in \$265,000 of additional revenue annually. In FY 2009, the City collected \$5.3 million in revenues related to the Telecommunications Users' Tax, \$4.0 million of which was collected on wireless telecommunications services pursuant to agreements made between the City and telecommunications providers.
- The ordinance proposes two major modifications to the Telephone Users' Tax: (1) eliminating reference to the FET and (2) broadening the scope of taxable telecommunications service. Eliminating reference to the FET would prevent the City from being subject to future court rulings or IRS actions regarding collection of the FET. The scope of taxable telecommunications services would be broadened by taxing interstate and international telecommunications services, as opposed to only intrastate telecommunications, and expanding the definition of telecommunications services to include wireless communications, private communication services (T-1 lines), paging, and VOIP and toll free numbers.
- The City still faces significant financial hurdles in regards to increasing debt and pension obligations. City employees are still not contributing anything to their pensions and they have the most generous formulas available.
- SDCTA **OPPOSES** the proposed modernization of the Telecommunications Users' Tax because the City continues to fail to demonstrate sufficient fiscal responsibility to request additional revenue from taxpayers. In addition, SDCTA has concerns that the proposed ballot language does not properly convey to taxpayers the true implications of the measure, which is approval of a tax increase.



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June 2010

Board Recommendation:

OPPOSE

Rationale:

SDCTA opposes the proposed modernization of the Telecommunications Users' Tax because the City continues to fail to demonstrate sufficient fiscal responsibility to request additional revenue from taxpayers. In addition, SDCTA has concerns that the proposed ballot language does not properly convey to taxpayers the true implications of the measure, which is approval of a tax increase.

The City of Chula Vista held a Special Election on May 5, 2009 to ask voters for a 10-year, 1% sales tax increase, which would set the rate from 8.75% to 9.75% (Proposition A)—the highest in the County. The City Council spent between \$255,000 and \$285,000 of taxpayer money holding a special mail ballot election. The cost to place the measure on the ballot during a regular election would have likely cost half of that. SDCTA opposed the measure for the following reason:

"The City of Chula Vista is facing a serious, self-created financial crisis due to increases in spending, increases in the General Fund Debt, and unsustainable compensation increases. These actions have forced the city to resort to deficit spending and a reduction of emergency reserves in order to balance the budget. In order to balance some of these shortfalls, Chula Vista proposed a special election to ask voters to increase the sales tax by 1%. SDCTA opposed this sales tax increase, recommending instead that the City make every effort to reduce labor costs, streamline operations and demonstrate fiscal discipline prior to seeking additional revenues from taxpayers."

Background:

Federal Telecommunications Excise Tax

Established in 1898, the Federal Telecommunications Excise Tax (FET) imposes a 3% charge on the use of telecommunications services. Definitions of taxable telecommunications services and computation methods have been amended several times since the inception of the FET. Currently, the FET is governed by § 4251-4254 of the Internal Revenue Code. § 4251 states that taxable telecommunications services include local telephone service, toll telephone service, and teletypewriter service. Under this section wireless or mobile communications and voice over internet protocol (VoIP) services are not subject to the FET. § 4252 provides definitions of the terms local telephone service and toll telephone service, which are provided below.

Local telephone service: "(1) the access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system, and (2) any facility or service provided in connection with a service described in paragraph (1)."

Toll telephone service: "(1) a telephonic quality communication for which (A) there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication and (B) the charge is paid within the United States, and (2) a service which entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radio telephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located."

Toll telephone service is also commonly known as long-distance telephone service. At the time of adoption of these regulations, long-distance service was commonly billed based on the time of the call and the distance of the transmission. However, over time the billing practices of telecommunications companies have evolved to include several types of billing, including bundling and time-only services, that do not charge users based upon both the time of the call and the distance of transmission. Bundled service is a package of local and long-distance services provided under a single plan in which the charge for each component is not stated separately. Time-only services are long-distance services in which the charge to the user is based solely upon the time of the call, without regard for the distance of transmission.

Several federal court rulings, including *Am. Bankers Ins. Group v. United States*, *OfficeMax, Inc. v. United States*, *Nat'l R.R. Passenger Corp. v. United States*, *Fortis v. United States*, and *Reese Bros. v. United States*, have held that bundled and time-only services are not subject to the FET given that the charge for such services does not vary based on the distance of transmission. In response to these rulings, in 2006 the IRS issued Notice 2006-50 which stated that they would no longer collect excise tax on the usage of long-distance or bundled services, essentially leaving local telephone services as the only federally taxable form of telecommunications service.

Utility Users' Taxes

As of the June 2010 primary election, Utility Users' Taxes (UUT) were revenue sources for 154 cities and four (4) counties in California.¹ UUTs are consumption-based taxes on utility services. The utilities most commonly charged a UUT are electricity, gas, water, sewage, garbage, and telephone services. Revenues from these taxes are collected by the utility and then remitted to the municipality. Most commonly, UUTs are considered a general purpose tax; however, some municipalities levy them with special purposes, such as funding for police, fire, parks, etc.

According to CaliforniaCityFinance.com, most cities and counties that have a UUT adopted the tax prior to 1986.2 As such, many older UUT ordinances do not provide the opportunity to assess new technology—such as internet and cellular phones. In addition, many local UUT ordinances in existence prior to this date contained language referring to the FET and its exemptions. Cities with older UUT ordinances (only able to levy taxes on traditional telephone service) typically collect less revenue than those with modernized ordinances (explicitly able to levy taxes on mobile phones).

Most UUT modernization measures have combined a reduction in the rate with a proposed expansion in service taxation; each measure between 2002 and 2010 that contained both a reduction and expansion received voter approval.

Chula Vista Telephone Users' Tax

In 1970, the City of Chula Vista adopted a Utility Users' Tax (UUT) as a means to help fund public services and capital improvement projects through the City's General Fund. The City receives UUT based on the usage of natural gas, electricity, and telecommunications. Chula Vista municipal code § 3.44.030 governs the administration of a telephone users' tax which imposes a charge "upon every person in the city using intrastate telephone communication services in the city" equal to 5% of the total amount paid for such services. The section also states that the telephone users' tax shall not apply to any intrastate telecommunications services on which a tax is not imposed by the FET, limiting taxable telecommunications services to local telephone services as defined by § 4252 of the Internal Revenue Code.

¹ Source: CaliforniaCityFinance.com, "Utility User Tax Facts." Last revised September 2008. Data extrapolated from election results from November 2008 – June 2010 showed eight cities created a new utility users' tax.

² Ibid.

The City's taxable base of telecommunications services under § 3.44.030 has reduced considerably since its introduction for two main reasons: (1) reference to FET and (2) technological changes. Previously mentioned federal court rulings and IRS actions have reduced the base of taxable telecommunications services under the FET causing a similar reduction in the base of taxable services in the City as a result of direct reference to the FET in the municipal code. In addition, changes in technology have decreased usage of traditional taxable forms of telecommunications (local and toll phone services) in favor of non-taxable mobile phone or VoIP communications.

As a response to declining revenues the City has entered into formal agreements with several telecommunications providers which allow the City to collect UUT revenue on forms of communication for which taxing authority is not provided by the municipal code, such as mobile communications. Such agreements have allowed the City to avoid lost UUT revenue that would have resulted from changes in technology. However collection of this additional revenue is subject to periodic renewal of agreements with telecommunications providers.

Mobile Telecommunications Sourcing Act

In 2000, the U.S. Congress passed the Mobile Telecommunications Sourcing Act (MTSA) to create uniform standards for how transaction based taxes (sales and excise taxes) are imposed on the use of mobile telecommunications, such as cellular phones. Among other provisions, the MTSA requires that taxing authority be given only to the jurisdiction which is deemed to be a user's "place of primary use". Place of primary use is to be determined by the user's service provider and is typically based primarily on the user's residential or business address.

Proposal

The ballot language will appear as follows:

Shall the ordinance to modernize the City's 1978 Telephone Users' Tax (renamed the Telecommunications Users' Tax), with no rate increase; maintain exemptions for low income senior citizens; ensure Tax proceeds continue to be available for general municipal purposes, including police, fire, streets, libraries, and parks; revise the method for calculating and collecting the Tax to reflect technological and legal changes; and amend the tax base to equitably include all applicable telecommunications services be adopted?

The ordinance proposes two major modifications to the Telephone Users' Tax: (1) eliminating reference to the FET and (2) broadening the scope of taxable telecommunications service. Eliminating reference to the FET would prevent the City from being subject to future court rulings or IRS actions regarding collection of the FET. The scope of taxable telecommunications services would be broadened by taxing interstate and international telecommunications services, as opposed to only intrastate telecommunications, and expanding the definition of telecommunications services to include wireless communications, private communication services (T-1 lines), paging, and VOIP and toll free numbers.

Several forms of telecommunications proposed to be included in the broadened tax base (such as wireless, VoIP, and prepaid telecommunications) do not necessarily have a clear nexus to the City of Chula Vista giving them taxing authority. The ordinance specifies that wireless communications shall be taxed according to the provisions of the Mobile Telecommunications Sourcing Act. Under this act, the City would only tax residents whose "place of primary use" is the City of Chula Vista. For other forms of telecommunication, including post-paid telecommunications, prepaid telecommunications, VoIP, and private telecommunications, the ordinance specifies the City shall establish and disseminate to telecommunications service providers sourcing procedures upon the passage of the ordinance.

The ordinance also specifies that if non-taxable services are bundled with taxable services such that charges are not separately stated on a customer's bill, the Telecommunications Users' Tax shall be applied to the total charge (taxable and non-taxable) for the services, unless the telecommunications service provider can provide a reasonable breakdown of the charges for each service.

Analysis

Fiscal Impact

In a report to the Chula Vista City Council on June 8, 2010, City staff estimated that modernizing the UUT would result in generation of \$265,000 in additional revenue annually. In FY 2009, the City collected \$5.3 million in revenues related to the Telecommunications Users' Tax, \$4.0 million of which was collected on wireless telecommunications services pursuant to agreements made between the City and telecommunications providers. The City's municipal code does not currently provide it with the authority to tax wireless communications services, and therefore the ongoing collection of \$4.0 million in annual tax revenue is subject to continued agreements with telecommunications providers. This modernization ordinance would codify the City's authority to collect taxes on wireless communication, ensuring continued collection of these revenues.

The UUT modernization will be proposed to voters in the election held November 2, 2010. The cost of placing the measure on the ballot is estimated to be \$70,000 to \$75,000.

Misleading Ballot Language

Despite the City staffs' recognition that modernization of the UUT would lead to greater tax revenues for the City, the ballot language does not clearly state this. The proposed ballot language asks voters if the City shall "amend" the current tax base "with no rate increase". This phrasing fails to convey to voters that modernization of the UUT will result in an increase in taxes.

Arguments in Support

- The telecommunications UUT should be updated "due to a recent IRS decision, pending legal challenges, a perceived loophole in the current ordinance and changes in technology, which have put this funding at risk."³
- Proposed legislation (HR 1521) would prevent the City from achieving revenue on the existing UUT as it relates to wireless communications.
- The City's UUT should be technology neutral, allowing the City to treat all consumers equally.
- Measure strives to achieve uniformity with other cities levying this type of tax.
- It is critical for the City to maintain its current revenue stream.

Arguments in Opposition

- The City should reform its generous pension system before asking for a tax increase.
- After the City's May 2009 tax proposal failed, despite threats regarding decimation of services (like public safety), the City has not made significant cuts.
- Cox Communications indicates that their concerns were not addressed despite a promised opportunity to collaborate on the modernization effort. In addition, Cox feels that it is disingenuous to voters to claim that the proposed measure is not a rate increase.
- AT&T also felt that their concerns were not taken into consideration.

³ City of Chula Vista. Staff report regarding the City's UUT. June 8, 2010. Item 13.



- Chula Vista Taxpayers Association is supportive of modernization, but would like it to be revenue neutral. Also they feel that the ballot language needs more work.
- In May 2009 voters indicated that they wanted to pursue other policy alternatives to tax increases.
- The Chula Vista Civic Association feels that the measure needs to be up for more public review.