Council Meeting
January 15, 2008

Honorable Mayor and Members
Of the City Council
City Hall
Torrance, California

Members of the Council:

Subject: Finance – Modification of Utility Users' Tax Ordinance

RECOMMENDATION

Recommendation of the Finance Director that City Council direct staff to return with an ordinance modernizing the telecommunications portions of the existing Utility Users' Tax ordinance without changing or increasing the long established tax rate to be placed on the June 2008 Torrance General Municipal Election.

FUNDING

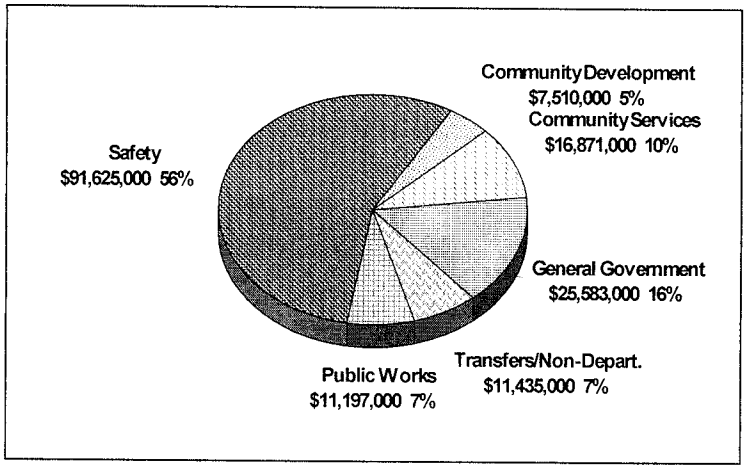
No funding at this time.

BACKGROUND

The City's Utility Users' Tax Ordinance was originally enacted in 1969. The current tax rate of 6.5% is applied to Electricity, Gas, Telecommunications, and Cable and 6% for Water. Approximately 23% or $8 million of all revenues from utility users' tax are derived from telecommunications.

The Utility Users' Tax for the City is a General tax similar to the City's Sales, Property and Business License taxes and their revenues are part of the City's General Fund and used for any governmental use. The top three revenue sources generate over 70% of General fund revenues, Sales tax $45 million (27%) and UUT and Property tax at $36 million (22%) each.

Currently, the General Fund Operating Budget for 2007-08 allocates 56% ($91 million) of all GF resources to Police and Fire (Safety).



The ordinance dealing with telecommunications is outdated in light of the tremendous evolutions and advancements in the industry. The ordinance was based upon 1960's communications technology and antiquated service models (time and distance) and even the

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section of the UUT ordinance that pertains to telecommunication is titled "Telephone and Teletypewriter Exchange Users' Tax". This passage of time has complicated the collection of the UUT in particular Telecommunications and Cable.

To further complicate the collection of UUT on telecommunications was the ruling the Treasury Secretary issued in May 2006. This expansive ruling held that the IRS ruling on Federal Excise Tax (FET) would no longer apply to bundle services which are defined:

> As local and long distance service that is provided under a plan that does not separately state the charge for the local telephone service. This would include Voice Over Internet Protocol service (VOIP), prepaid telephone cards, plans that provide both local and long distance for either a flat monthly fee or a charge that varies with the elapsed transmission time for which the service is used.

The complication occurs because the City's UUT ordinance has reference to Section 4251 (Imposition of Tax) of Title 26 of the United States Code which includes the Federal Excise Tax and would the May ruling affect the City's ability to collect UUT on telecommunications.

There are two schools of thought on providing clean-up language or amending the UUT ordinance with respect to telecommunications. Some cities have made changes to their UUT ordinance (mainly definitional) through Council action, concluding that the changes or amendments has not affected nor increased the UUT tax and provisions of Proposition 218 do not apply. The other school of thought believes that these changes would be a form of a tax or an expansion of the tax and would require approval from the voters (Proposition 218). The cities who have made changes through Council action could be challenged legally and are open to future litigation.

Pending litigation in other jurisdictions underscores the need to address this issue prior to exposing the City to the risk of both the costs and risks of similar lawsuits and the chance of an adverse judgment against the City. Staff is aware of five (5) lawsuits: Los Angeles (2), Long Beach and Sacramento that are being challenged because they amended their ordinance through Council action only and the County of Los Angeles is being challenged because they did not change their ordinance.

Whether clean-up of the definitions in the ordinance is or not subject to provisions of Proposition 218 will ultimately be decided by the Courts and un-modified ordinances will more likely than not be subject to future litigation.

In addition Proposition 218 restricts when you can place this type of issue on the ballot. Proposition 218 guidelines states that elections for general taxes must be consolidated with a regularly scheduled election for members of the local governing body. This would only allow a UUT measure be placed on the June 2008 ballot or every two years after that 2010, 2012, etc. It would take an action by the majority of the Council to place it on the ballot; however, there is a provision in Proposition 218 for emergencies that this provision may be waived by a unanimous vote of the governing body.

The most fiscally conservative approach would be to take the clean-up language to the voters. This would leave no doubt and, if the voters approve, the City would have a revised

ordinance that would be designed to ensure that all communication services available now and in the foreseeable future are equally taken into account.

The cost to the City to hold a general election is approximately $160,000. The additional election cost to place this measure on the June 2008 ballot is estimated to be approximately $10,000 to $20,000. Other costs such as attorneys' fees and professional consultants are estimated at $40,000 to $60,000.

Staff is aware of seventeen (17) cities that have placed UUT measures on the ballot since November 2006 and five (5) cities will be placing a measure on the February 2008 election (see attachment).

At this time, staff is recommending that the Council direct staff to return with an ordinance that modernizes the telecommunications (which would include cable) portions of the existing Utility Users' Tax ordinance without changing or increasing the long established tax rate that would be placed on the ballot for the June 2008 General election.

Other options for the Council to consider would be to:

1) Amend through Council action the definitions of the City's UUT ordinance as they pertain to telecommunications. The City would likely get challenged at some point in time unless the County of Los Angeles or another agency prevails in litigation;

2) Continue to "wait and see" what happens to the class action litigations. Should the class action litigations be favorable to the City, no further action would be required.

Respectfully submitted,

Eric E. Tsao
Finance Director

CONCUR:

LeRoy J. Jackson
for City Manager

Attachment:
A. List of cities

ATTACHMENT A

Cities that have brought UUT measure to voters:

November 2006:

Compton
Portola Valley
Daly City
Fowler
San Marino
Eureka
Menlo Park (new)

March 2007:

Covina (didn't pass)

November 2007:

Benicia
El Monte
Gilroy
Emeryville
Hermosa Beach
Los Altos
Redwood City
Ventura
Rialto
South Pasadena

February 2008: Pending

Los Angeles
Inglewood
Pasadena (they are not dropping their rate)
Huntington Park
Richmond
Culver City
San Bernardino