

Council Meeting
March 4, 2008

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

Members of the Council:

SUBJECT: City Manager & Finance – Placement of UUT Ordinance on the Ballot for Voter Approval at the Election of June 3, 2008

RECOMMENDATION

Recommendation of the City Manager and the Finance Director that the City Council direct the City Clerk to place the Utility Users' Tax ordinance on the ballot for voter approval at the election of June 3, 2008.

BACKGROUND

City Staff has prepared the materials necessary to place a measure on the ballot on June 3, 2008 to modernize the current Utility Users' Tax (UUT), to confirm its independence from the Federal Excise Tax on telephony (FET) and to account for past and future changes in telephone technology. The proposed measure does not change the rate of the existing tax and future voter approval would be required if the City ever wishes to do so. Staff recommends that Council adopt the attached RESOLUTION to place this measure on the June 3, 2008 General Election ballot.

A utility users' tax or UUT is a tax levied on each user of a utility (e.g. telephone, electricity, gas, water, or cable services) within the City's boundaries. The City's current telephone tax (rate is 6.5% of applicable charges, has been in force since 1972, and is based upon a model ordinance developed by the League of California Cities in consultation with Pacific Telephone & Telegraph Company in the 1970s shortly after the break-up of the AT&T monopoly.

Need for Modernization of the UUT Ordinance

Since the inception of UUTs in California, communication technology has changed dramatically, with the invention of cell phones, internet communications, satellite communication, and other communication media, as well as the advent of fixed fee calling plans and other marketing trends tending to simplify billing and reduce costs. These changes have led to legal and practical challenges to UUTs in other California cities, including litigation now ongoing against the City of Los Angeles, the County of Los Angeles, Long Beach and Sacramento. The proposed UUT ordinance presented here is intended to modernize the language of the UUT and avoid potential challenges by obtaining voter approval of the UUT. As background, the principal challenges are described here:

The Nexus Issue: In 2002, new Federal legislation was enacted by Congress, allowing cities to collect utility users' tax on the entire calling portion of wireless telephone bills.

California cities, like those in other states, therefore requested that wireless carriers collect the tax on the entire calling portion of wireless telephone bills. Two cellular telephone carriers sued the City of Los Angeles, alleging that in California, cities are prohibited from availing themselves of the new Federal legislation, because the imposition of tax on the entire calling portion of wireless phone plans would require voter approval under Proposition 218. The appellate court holding created ambiguity for all cities by holding that Los Angeles could not tax all calls, but could tax those calls that either originated or terminated within the city. To date, carriers have not provided information identifying which calls originate or terminate within the City and the impact of this decision therefore remains uncertain. Voter approval of a clarified UUT ordinance would eliminate this issue.

The FET Issue: In the current era, charges for many telephone plans, especially cellular phone plans, are based on the duration of a call only, regardless of the distance between the two phones served (so-called "one-rate" plans). Similar to the ordinances of most of the 110 UUT jurisdictions in California, the City's ordinance contained language referencing the exclusion of charges that paid for communication services that were "exempt from" or "not subject to" the Federal Excise Tax (FET). For many years, the IRS followed a policy of imposing the FET on most telephone service charges, including all telephone charges that were based on either time OR distance; the City did the same and there was no conflict. In May 2006, however, the IRS announced that, due to a number of legal challenges, it would no longer impose the FET on telephone charges not based on both time AND distance. In response to the IRS' change, and pursuant to a separate ordinance on this agenda, City staff recommends the City Council amend the City's UUT ordinance to clarify that the City did not wish to adopt the IRS' new practice, but rather wished to continue to impose the UUT as it had historically been imposed (i.e. for charges based on time OR distance). Many other cities chose to protect their UUT revenue by adopting similar amendments. Lawsuits challenging the right of cities to continue to collect this revenue are now pending against the City of Los Angeles and other cities. Voter approval of a clarified UUT ordinance would eliminate this issue as well.

Future Issues: It is likely that older technologies (e.g., land lines) will continue to be replaced by newer technologies such as Voice over the Internet Protocol (VOIP). Indeed, some predict that web-based communications will take over a significant portion of the communications market in the next decade, perhaps even overtaking cellular telephones in market share. It is expected that new lawsuits will be filed challenging whether older ordinances can be applied to new technologies as they develop. Failure to tax newer technologies would not only result in a substantial loss of revenue for City general fund services including police and fire services, but would also create an inequitable situation where those who can afford newer technologies are not taxed, while those using older technologies continue to be taxed. Similarly, the trend also appears to be to combine multiple services on a single device (like a Blackberry personal digital assistant (PDA) which is also a telephone). In the future, it is expected that telephony will be marketed and sold in packages of bundled services, raising questions about how to tax those services under older ordinances like the City's current UUT ordinance. These potential challenges, too, would be eliminated by voter approval of an updated and modernized UUT ordinance.

Proposed Ordinance

Submitting an ordinance for voter approval will allow the public to confirm that it wishes to modernize the language to include developing communications technology and to treat all communication services the same, regardless of the technology used.

The proposed UUT is attached as an exhibit to the resolution placing the question on the ballot. Some important highlights of the proposed UUT ordinance include:

- The existing exemption for low-income senior and disabled residents has been retained.
- The definitions have been updated to include emerging technology within the tax base as it develops. The intent is to have an equitable tax that applies to all users of telephone services, whether traditional "land line," wireless, or broadband telephone service to the extent permitted by federal law (which prevents taxation of internet access). As noted above, this is necessary to preserve the tax base and treat all utility users equal in light of technological change to date, changes in federal law, and likely future legal and technological developments.
- Because of voter sensitivity about taxation of internet purchases and downloads, the ordinance includes an express statement that internet access is not taxed, nor are digital downloads such as books, music, ring tones, games and similar digital products within the tax base or the provision of television signals by satellite dish or other wireless means. The proposed ordinance also does not reference the federal excise tax.
- To assure accountability and transparency in the collection and expenditure of the proceeds of the telecommunications tax, the measure will require annual independent audits.

Finally, Council must approve a ballot question, not to exceed 75 words in length, for inclusion on the ballot itself. Staff has prepared the following suggested ballot question:

Shall an ordinance be adopted to ratify and update Torrance's existing telephone utility users' tax, to continue to maintain such essential city services as police, fire, street repair, parks, libraries, recreation programs and other services that are presently paid for from the city's general fund; provided that the present tax rate will not change; low-income seniors and disabled persons will remain exempt; and independent annual audits will be required?

Accordingly, City staff recommends that your Council approve a ballot question for inclusion in the elections resolution this evening.

Fiscal Impact:

In the short run, this measure, if adopted by the City's voters, will maintain the City's existing telecommunications revenues. Over time these revenues are expected to continue to trend downward as telephone communications continue to get cheaper and to be provided via means on which it is more challenging for the City to enforce its tax (such as VOIP), but this ordinance will postpone the time when the City and those it serves will be required to find other revenue

sources to maintain current levels of service for such general fund programs as police and fire services.

Procedure:

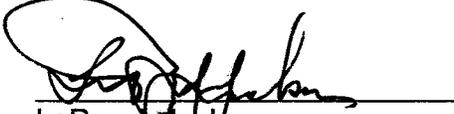
Modernizing the City's UUT ordinance, as proposed, requires majority approval (50% + 1) under Proposition 218. It should be noted that, if voters do not pass the modernized UUT measure, the existing UUT would remain in place and be preserved. If the measure is approved by the voters, it would replace and supersede the existing UUT.

Respectfully submitted,



Eric E. Tsao
Finance Director

CONCUR:



LeRoy J. Jackson
City Manager

Attachment – Ordinance (for information only)

INFORMATION ONLY**ORDINANCE NO.****AN ORDINANCE OF THE CITY OF TORRANCE,
CALIFORNIA AMENDING CHAPTER 25 OF THE
TORRANCE MUNICIPAL CODE TO MODERNIZE
THE APPLICATION OF THE UTILITY USERS' TAX**

THE PEOPLE OF THE CITY OF TORRANCE DO ORDAIN AS FOLLOWS:

Section 1. *Code Amendment.* Section 225.1.1 of the Torrance Municipal Code is hereby amended to read as follows:

“SECTION 225.1.1 DEFINITIONS

The following words and phrases whenever used in this Chapter shall be construed as defined in this Section:

- a). ‘Ancillary telecommunications services’ means services that are associated with or incidental to the provision, use or enjoyment of telecommunications services including, but not limited to:
- (1) Services that link two or more participants of an audio or video conference call, including the provision of a telephone number.
 - (2) Services that separately state information pertaining to individual calls on a customer’s billing statement.
 - (3) Services that provide telephone number information, and/or address information.
 - (4) Services offered in connection with one or more telecommunications services, which offer advanced calling features that allow customers to identify callers and to manage multiple calls and call connections.
 - (5) Services that enable customers to store, send or receive recorded messages.
- b). ‘Billing address’ means the mailing address of the service user to which the service supplier addresses invoices or bills for payment by the customer.
- c) ‘City’ shall mean the City of Torrance.
- d) ‘Director’ shall mean the Director of Finance of the City of Torrance or his or her designee.
- e) ‘Month’ shall mean a calendar month.

f) 'Non-utility supplier' shall mean a service supplier, other than an electrical corporation franchised to serve the City, which generates electrical energy in capacities of at least fifty (50) kilowatts for its own use or for sale to others.

g) 'Person' shall mean all domestic and foreign corporations, associations, syndicates, joint stock companies, partnerships of every kind, joint ventures, clubs, Massachusetts business or common law trusts, societies, and individuals, and shall include a municipal corporation.

h). 'Service address' means the residential street address or the business street address of the service user's primary place of usage of the service which is subject to tax under this Chapter.

i) 'Service supplier' shall mean a person required to collect or self-impose and remit a tax imposed by this Chapter.

j) 'Service user' shall mean a person required to pay a tax imposed by this Chapter.

k). 'Telephone communication services' includes the transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points, whether or not such information is transmitted through interconnected service with the public switched network, whatever the technology used, whether such transmission, conveyance or routing occurs by wire, cable, fiber-optic, light wave, laser, microwave, radio wave (including, but not limited to, cellular service, commercial mobile service, personal communications service (PCS), specialized mobile radio (SMR), and other types of personal wireless service – see 47 USCA Section 332(c) (7) (C) (i) – regardless of radio spectrum used), switching facilities, satellite or any other technology now existing or developed after the adoption of this ordinance, and includes, without limitation, fiber optic, coaxial cable, and wireless. The term "telephone communication services" includes such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code or protocol of the content for purposes of transmission, conveyance or routing without regard to whether such services are referred to as voice over internet protocol (VoIP) services or are classified by the Federal Communications Commission as enhanced or value added, and includes video and/or data services that are functionally integrated with telecommunications services. "Telephone communication services" include, but are not limited to, the following services, regardless of the manner or basis on which such services are calculated or billed: central office and custom calling features (including but not limited to call waiting, call forwarding, caller identification and three-way calling), local number portability, text messaging, ancillary telecommunication services, prepaid and post-paid telecommunications services (including but not limited to prepaid calling cards); mobile telecommunications service; private telecommunication service; paging service; 800 service (or any other toll-free numbers designated by the Federal

Communications Commission); and value-added non-voice data service. For purposes of this section, "private telecommunication service" means any dedicated telephone communications service that entitles a user to exclusive or priority use of communications channels. Telephone Communication Service does not include charges for access to the internet or digital downloads, such as downloads of books, music, ringtones, games and similar digital products or the provision of television signals by satellite dish or other wireless means.

l) 'Telephone corporation,' 'electrical corporation,' 'gas corporation,' 'water corporation,' and 'cable television corporation' shall have the same meanings as defined in Section 234, 218, 222, 241, and 215.5, respectively, of the Public Utilities Code of the State of California, as said sections existed on January 1, 1969. Electrical corporation and water corporation, shall be construed to include any City-franchised organization or agency and any municipality or agency engaged in the selling or supplying of electrical power or water to a service user."

Section 2. Code Amendment. Section 225.1.3 of the Torrance Municipal Code is hereby amended to read as follows:

"SECTION 225.1.3 TELEPHONE COMMUNICATIONS SERVICES TAX

a). There is imposed a tax upon every person, other than a telephone corporation, who uses telephone communication services in the city, including intrastate, interstate, and international telephone communication services, to the extent permitted by federal and state law. The telephone users tax is intended to, and does, apply to all charges within the city's tax jurisdiction, such as charges billed to a telephone account having a situs in the city as permitted by the Mobile Telecommunications Sourcing Act of 2000, 4 U.S.C. § 116 et seq. The tax imposed by this section shall be at the rate of 6½ percent. The tax shall apply to all charges made for such telephone communication services and shall be collected from the service user by the telephone communication services supplier or its billing agent. There is a rebuttable presumption that telephone communication services billed to a billing or service address in the city are used, in whole or in part, within the city's boundaries, and that such services are subject to taxation under this chapter. There is also a rebuttable presumption that telephone communication services sold within the city that are not billed to a billing address or provided to a primary physical location, including, without limitation, calling card services, are used, in whole or in part, within the city's boundaries and that such services are subject to taxation under this chapter.

b) The tax imposed in this Section shall be collected from the service user by the person providing the telephone communication services. The amount of tax collected in one (1) month shall be remitted to the Director on or before the 20th day of the following month.

c) The following shall be exempt from the tax imposed by this section:

(1) Charges paid for by inserting coins in coin-operated telephones available to the public with respect to local telephone service, or with respect to long distance telephone service if the charge for such long distance telephone service is less than 25 cents; except that where such coin-operated telephone service is furnished for a guaranteed amount, the amounts paid under such guarantee plus any fixed monthly or other periodic charge shall be subject to the tax.

(2) Except with respect to local telephone service, on any charges for services used in the collection of news for the public press, or a news ticker service furnishing a general news service similar to that of the public press, or radio broadcasting, or in the dissemination of news through the public press, or a news ticker service furnishing a general news service similar to that of the public press, or by means of radio broadcasting, if the charge for such service is billed in writing to such person.

(3) Charges for services furnished to an international organization or to the American National Red Cross.

(4) Charges for any long distance telephone service which originates within a combat zone, as defined in section 112 of the Internal Revenue Code, from a member of the Armed Forces of the United States performing service in such combat zone, as determined under such section, provided a certificate, setting forth such facts as the Secretary of the U.S. Treasury may by regulations prescribe, is furnished to the person receiving such payment.

(5) Charges for any long distance telephone service to the extent that the amount so paid is for use by a common carrier, telephone or telegraph company, or radio broadcasting station or network in the conduct of its business as such.

(6) Amounts paid by a nonprofit hospital for services furnished to such organization. For purposes of this subsection, the term 'nonprofit hospital' means a hospital referred to in Internal Revenue Code section 170(b)(1)(A)(iii) which is exempt from income tax under Internal Revenue Code section 501(a).

(7) Charges for services or facilities furnished to the government of any State, or any political subdivision thereof, or the District of Columbia.

(8) Charges paid by a nonprofit educational organization for services or facilities furnished to such organization. For purposes of this subsection, the term 'nonprofit educational organization' means an educational organization described in Internal Revenue Code section 170(b)(1)(A)(ii) which is exempt from income tax under Internal Revenue Code section 501(a). The term also includes a school operated as an activity of an organization described in Internal Revenue Code

section 501(c)(3) which is exempt from income tax under Internal Revenue Code section 501(a), if such school normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

(9) Charges for maritime mobile services as defined in Section 2.1 of Title 47 of the Code of Federal Regulations as such section existed on October 1, 1967.”

d) As used in this section, the term ‘charges’ shall include the value of any other services, credits, property of every kind or nature, or other consideration provided by the service user in exchange for the telephone communication services.

e) The Director may, from time to time, issue and disseminate to telecommunication service suppliers which are subject to the tax collection requirements of this chapter administrative rulings identifying those telecommunication services that are subject to the tax of subsection A of this section. Such administrative rulings shall be consistent with legal nexus and laws pertaining to telephone communications services and shall not impose a new tax, revise an existing tax methodology, or increase an existing tax, except as permitted by California Government Code Section 53750(h) (2) and (3) or other law. The Director may consider state-wide interpretive rules and guidelines promulgated by any government agency or association of government agencies as a factor in determining the intent of voters adopting this section. To the extent that the tax administrator determines that the tax imposed under this section shall not be collected in full for any period of time, such an administrative ruling falls within the tax administrator’s discretion to settle disputes. The tax administrator’s exercise of prosecutorial forbearance under this Chapter does not constitute a change in taxing methodology for purposes of Government Code section 53750(h), and the city does not waive or abrogate its ability to impose the telephone users’ tax in full as a result of issuing such administrative rulings and may suspend such rulings and recommence collection of the tax without additional voter approval.”

Section 3. *Code Addition.* Section 225.1.23 of the Torrance Municipal Code is hereby adopted to read as follows:

“SECTION 225.1.23 EFFECT OF STATE AND FEDERAL AUTHORIZATION

To the extent that the City’s authorization to impose or collect any tax imposed under this chapter is expanded or limited as a result of changes in state or federal law, no amendment or modification of this chapter shall be required to conform the tax to those changes, and the tax shall be imposed and collected to the full extent of the city’s authorization up to the full amount of the tax imposed under this chapter.”

Section 4. *Code Addition.* Section 225.1.24 of the Torrance Municipal Code is hereby adopted to read as follows:

“SECTION 225.1.24 INDEPENDENT AUDIT

The City shall annually verify that the taxes owed under this chapter have been properly applied, exempted, collected, and remitted in accordance with this chapter, and properly expended according to applicable law. The annual verification shall be performed by a qualified independent third party and the review shall employ reasonable, cost-effective steps to assure compliance, including the use of sampling audits. The verification shall not be required of as to a service supplier where the cost of the verification is expected to exceed the tax revenues to be reviewed.”

Section 5. *Utility Rates.* This Ordinance does not change the existing rate of any tax imposed under Chapter 25 of the Torrance Municipal Code.

Section 6. *Low-Income Senior and Disabled Persons Exemptions.* This Ordinance does not change the existing exemptions for low-income seniors and disabled persons from the any tax imposed under Chapter 25 of the Torrance Municipal Code as specified in Section 225.1.17 of that Chapter. Any change to those exemptions which constitutes a tax increase within the meaning of Government Code Section 53750(h) shall require a vote of the People of the City of Torrance.

Section 7. *Amendment of Ordinance.* Chapter 25 of the Torrance Municipal Code as amended by this Ordinance may be repealed or amended by the City Council without a vote of the people except as follows: as required by Proposition 218, any amendment to that chapter that increases the amount or rate of tax beyond the levels authorized by this Ordinance may not take effect unless approved by a vote of the people. The City Council may impose the taxes authorized by that chapter in any amount or rate which does not exceed the rate approved by the voters of the City.

Section 8. *Severability.* If any section, sentence, clause, phrase, or portion of this Ordinance is for any reason held to be invalid or unenforceable by a court of competent jurisdiction, the remaining sections, sentences, clauses, phrases, or portions of this ordinance shall nonetheless remain in full force and effect. The people of the City of Torrance hereby declare that they would have adopted each section, sentence, clause, phrase, or portion of this Ordinance, irrespective of the fact that any one or more sections, sentences, clauses, phrases, or portions of this Ordinance be declared invalid or unenforceable and, to that end, the provisions of this Ordinance are severable.

Section 9. Majority Approval; Effective Date. This Ordinance shall be effective only if approved by a majority of the voters voting thereon and shall go into effect ten (10) days after the vote is declared by the City Council.

Section 10. Certification. The Mayor is hereby authorized to sign where indicated below to certify to the adoption of this Ordinance.

PASSED, APPROVED and ADOPTED by the People of the City of Torrance this 3rd day of June 2008.

Frank Scotto
MAYOR

ATTEST:

Sue Herbers
CITY CLERK

APPROVED AS TO FORM:

John Fellows
CITY ATTORNEY