City of Culver City, California

City Council Agenda Item Report

Meeting Date: 07/24/06		Item Number: A-9
AGENDA ITEM: Adoption of an Urgency Ordinance and Introduction of an Ordinance for First Reading, Amending Chapter 3.08 of the Culver City Municipal Code, “Utility Users Tax” relating to application of the Telephone Users Tax.		
Contact Person/Dept.: Crystal C. Alexander, City Treasurer	Phone Number: 310-253-5865	
Fiscal Impact: Yes [X] No []	General Fund: Yes [X] No []	
Public Hearing: []	Action Item: [X]	Attachments: [X]
Public Notification: Master Notification List (07/21/06)		
Department Approval: Crystal C. Alexander (07/21/06)	City Manager Approval: Jerry B. Fulwood (07/21/06)	
City Controller Approval:		

RECOMMENDATION:

That the City Council adopt an urgency ordinance and introduce an ordinance for first reading amending Chapter 3.08 of the Culver City Municipal Code, “Utility Users Tax” clarifying the City's application of the telephone users’ tax to telephone communications services.

BACKGROUND:

Since 1969, the City of Culver City has imposed a telephone users' tax on every person (including businesses) in the City. As of 1988, the tax applied to intrastate calls, and as of 1994, the tax applied to wireless telephone communication services. Presently, the tax is imposed at a rate of 11% of the charges billed. Some exemptions are given as provided by law, including to low income seniors and certain persons with disabilities.

For the ease of administration and for the convenience of the telephone communication services providers, the City has generally looked to federal interpretation of the Federal Excise Tax for guidance on the scope and application of the City’s utility users’ tax with respect to telephone communication services. The City's tax has been applied consistent with the application of the Federal Excise Tax (FET) upon local and long distance telecommunication services as the FET is interpreted by the Internal Revenue Service (IRS), which was clarified in a 2000 amendment to the City’s utility users’ tax ordinance.

With the growth of wireless communications, a national dispute arose regarding the application of the FET to long distance cell phone calls. The FET defined long distance or "toll" calls as those for which charges varied according to both the elapsed time of the call and the distance between the persons on the call. Unlike traditional "land line" services, cell phone providers began to offer long distance service on a flat or monthly rate without consideration of the distance of the calls made.

In 1979, the IRS had issued a Revenue Ruling (79-404) determining that a variable for distance was not necessary for a toll call to be subject to the tax. The IRS defended lawsuits around the country challenging the application of Revenue Ruling 79-404 and the FET to such phone charges.

On May 25, 2006, the IRS issued Revenue Notice 2006-50 which announced that the IRS was reversing its position held since 1979, and would no longer interpret the FET as applying to wireless communications which were billed based on time only, and not both time and distance. Revenue Notice 2006-50 goes on to create a new service category called "bundled services" which could extend the reach of this interpretation to different billing practices by traditional phone companies as well as the wireless providers. Consequently, effective August 1, 2006, the IRS will no longer apply the FET to long distance and bundled service.

Bundled service is local and long distance service provided under a single plan that does not separately state the charges for local telephone service. The Treasury Department's May 25th Notice reversed its prior Revenue Rulings and interpretation of the FET, which the City has relied upon in applying its telephone users' tax to telecommunication services. This leaves only about 25% of all the telecommunications services as federally taxable.

In addition to conceding that the FET no longer applies to wired and wireless long distances (and other bundled services) the Treasury Secretary has further urged Congress to repeal the FET, arguing that it does not make sense to continue the tax on such a small segment of the telecommunications industry. There are Congressional amendments pending which would accomplish that total repeal.

DISCUSSION:

Since the May 25, 2006 interpretation of the FET by the IRS is not binding on the City of Culver City for purposes of levying or collecting the UUT on telephone communications services, staff recommends that the UUT be amended to clarify that the reference to the FET in the utility users' tax ordinance is as interpreted by the IRS prior to the issuance of Revenue Notice 2006-50. In doing so, the City will continue to apply its UUT to telephone services as it has historically, consistent with IRS Ruling 79-404. This proposed amendment will also prevent future ad hoc reaction to changes in Federal law that otherwise do not affect the City's ability to levy the UUT.

The proposed ordinances are not intended to be construed as imposing a new tax, or extending or increasing an existing tax and therefore, Proposition 218 does not apply to these ordinances. Instead, by this amendment to the telephone users' tax, the City reaffirms that it will continue its long-standing practice of applying its tax in a manner consistent with the IRS' interpretation of the FET prior to Notice 2006-50 issued by the U.S. Treasury Department on May 25, 2006.

The proposed ordinances clarify that the City is not changing its application of its telephone users' tax based on the IRS' decision to discontinue taxing long distance and bundled services in order to resolve legal disputes with telephone customers. Rather, the City wishes to continue to tax local, long distance, and bundled services as it always has - consistent with upon the IRS' interpretation of the FET prior to May 25, 2006.

Further, the ordinances clarify that when the City limited its tax base to charges "subject to" the Federal Excise Tax, it did not intend, and did not adopt, either federal law or federal enforcement policy as to how to treat bundled charges, some of which are "subject to" the FET and some of which are not. The current, in place ordinance's provisions regarding the taxation of bundled plans (when a non-taxable service and a taxable service are billed together under a single charge) makes collection of the tax, as currently done, obligatory. This provision of the local ordinance would take precedence over federal regulations and law.

Pursuant to Culver City Charter Section 614 and Cal. Gov't Code § 36937, the proposed urgency ordinance will become effective immediately upon its adoption by a four-fifths vote. Adoption of the proposed urgency ordinance is necessary for the immediate preservation of public peace, health or safety. The revenues from the telephone users tax are significant and critical to the continuation of essential services, including public safety.

Also before you tonight is the introduction of a regular ordinance adopting the same amendment.

FISCAL ANALYSIS:

The revenues from the telephone users' tax are anticipated to be approximately $5.2 million dollars for Fiscal Year 2006-2007 if the telephone users' tax is applied consistent with the IRS' interpretation of the FET prior to the issuance of Notice 2006-50. In the event that the City's telephone users' tax were to be applied consistent with Notice 2006-50, staff projects that the total telephone users' tax revenues for Fiscal Year 2006-07 could decrease by approximately $3.9 million dollars. The revenues from the telephone users' tax are critical to the public peace, health and safety in that these revenues pay the costs associated with essential services, including public safety. Both the proposed urgency ordinance and the regular ordinance are attached to this agenda report.

Were the aforementioned action to occur, the immediate cash flow impact would be negligible, given the level of current holdings in the City's investment portfolio. However, so as not to cause a quick and substantial drain on the City's reserves, the City Council would need to take immediate action to adjust the City's budget expenditures to the reality of substantially reduced projected revenues, noted above at approximately $3.9 million.

ATTACHMENTS:

1. Proposed Urgency Ordinance.
2. Proposed Ordinance.

MOTION:

That the City Council:

1. Adopt and waive further reading of the urgency ordinance amending Chapter 3.08 of the Culver City Municipal Code, "Utility Users Tax" clarifying the City's application of the telephone users' tax to telephone communications services.

2. Introduce and waive further reading of an ordinance amending Chapter 3.08 of the Culver City Municipal Code clarifying the City's application of the telephone users' tax to intrastate telephone communications services.