City of Culver City, California

City Council Agenda Item Report

Meeting Date: 09/24/07	Item Number: A-1
AGENDA ITEM: Discussion of a Proposed Draft Ordinance Modernizing Title 3, Chapter 3.08.200, et seq., of the Culver City Municipal Code, Utility Users' Tax.	
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Fiscal Impact: Yes [X] No []	General Fund: Yes [X] No []
Public Hearing: [] Action Item: [X]	Attachments: [X]
Public Notification: Master Notification List (09/19/07)	
Department Approval: Marlee Chang (9/17/07)	City Attorney Approval: Carol Schwab (9/19/07)
City Controller Approval: Marlee Chang (9/19/07)	City Manager Approval: Jerry B. Fulwood (09/19/07)

RECOMMENDATION:

Discuss the proposed draft ordinance to modernize provisions of the City's Utility Users' Tax at its existing rate and give staff direction.

BACKGROUND:

On June 18, 2007, staff presented the City Council with fourteen (14) options to address some of the City's outstanding financial issues, including an option to place a ballot measure on the April 8, 2008 general municipal election to modernize the current Utility Users' Tax (UUT) provisions related to communications, found in Title 3, Chapter 3.08.200, et seq. of the Culver City Municipal Code. The City Council unanimously directed staff to return with a draft UUT ordinance for further discussion.

A UUT is a tax levied on each user of a utility (i.e. telephone, electricity, gas, water, or video services) within the City's boundaries. The City's current Utility Users' Tax rate is 11% of applicable charges and has been in force (at various rates) since the 1960's. Since then, communication technology has changed tremendously with the invention of cell phones, the internet, satellite communication, and other communication media.

Similar to many cities in California, Culver City's UUT ordinance excluded from the tax base amounts paid for communication services that were "exempt from" or "not subject to" the Federal Excise Tax (FET). Prior to May 2006, the IRS had followed a policy of imposing the FET on telephone service charges based on either time OR distance and Culver City did the same. In May 2006, the IRS announced that, due to a number of legal challenges, it would no longer impose the FET on telephone charges unless those charges are based on both time AND distance.

Charges for many current telephone plans, especially cellular phone plans, are based on time only, not on time and distance. Since Culver City's telephone UUT referenced the FET definition, there was concern about the impact of the IRS' change in practice on the City's practice of collecting UUT on telephone charges based on either time OR distance.

In response to the IRS' change, the City amended its UUT ordinance on July 24, 2006 to clarify that it 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.

Submitting an ordinance for voter approval will allow the public to confirm this action and will also serve to modernize the language and include new communications technology within the tax base as they are developed in the future. Since the UUT issue significantly impacts a large number of California cities (as well as cities outside of California), Council directed staff to explore the possibility of federal or state legislation being drafted to address the legal issues. Staff subsequently contacted the City's federal and state lobbyists. Both lobbyists indicated that there is currently nothing in the pipeline related to the UUT issue, and they do not believe that anything will be drafted in the near future. Therefore, staff proceeded with preparing a draft ordinance per Council direction.

DISCUSSION:

On June 18, 2007, Council directed staff to move forward with the process of drafting an ordinance to modernize the current language of the communications portion of the UUT ordinance, hereafter referred to as Communications Users Tax (CUT), in order to preserve the City's CUT tax base. Over the past few months, lawsuits have been filed by telecommunications companies in a few jurisdictions challenging the ability of local governments to continue to apply their CUT based on the former IRS approach without voter approval. As a result, many California cities are going to the voters to reaffirm the collection methodology, modernize their ordinances, and ensure application of the tax on new or emerging technologies.

Staff from the City Attorney's Office, City Treasurer's Office, City Manager's Office, and Budget & Finance have been meeting continuously since the IRS decision in May 2006. This team has worked with legal counsel from Colantuono & Levin, PC, who have extensive experience with Utility Users' Tax issues, to draft a modernized ordinance.

The definitions in the current Municipal Code are based upon the technology that existed at the time of the adoption of these definitions, more than 30 years ago. At that time, the primary medium for communication technology was the public switched network (i.e. land line technology). The current trend in communication technology has been away from the public switched network towards technologies that operate on different media. Modernizing the language in the ordinance will reaffirm the City's intent to tax the communication technologies of the future, regardless which medium is being used to deliver the communication services.

Additionally, as telecommunication technology advances and competition between service providers increases, the cost of service is driven downward (e.g. cheaper calling packages and per minute charges). As costs decrease and taxpayers pay less for telecommunication services, the City's tax revenues decrease accordingly. This loss of revenue is compounded by the trend away from the public switched network and toward broadband network communications. This has become increasingly apparent over the last few years as the revenues from the telecommunications portion of the UUT have steadily decreased (see Fiscal Analysis section of this report). Modernizing the UUT language and including the City's intent to tax emerging technology as it develops may offset some of the revenues that are lost as a result of decreasing consumer costs.

A summary of the proposed changes to the UUT is included as Attachment 1. Some important highlights of the proposed UUT ordinance include:

- The tax rate will remain unchanged at 11%;
- Existing exemptions, including those for income-eligible individuals 60 years of age or older, or disabled, will continue; and
- Emerging technology is included within the tax base as it develops.

Modernizing the City's UUT ordinance, as proposed, is governed by Proposition 218 and requires majority approval (50% + 1) by the voters at the City's next general election, which is April 8, 2008. It should be noted that, if voters do not pass a modernized UUT measure, the existing UUT would remain in place and there may be some risk of a challenge to the existing ordinance. Regardless of voters' approval, CUT revenue may vary over time due to pricing and market changes that are not within the City's control.

In order to gather public opinion data related to modernizing the UUT ordinance, many California cities have retained public opinion research and public education advisory firms. Staff has also solicited proposals from public opinion research and public education advisory firms. Consideration of those proposals will be forthcoming at a future Council meeting as noted below.

Estimated Timeline

Activity	**Timeline**
Receive City Council Comments on Draft UUT Ordinance	September 24th
Consideration of Contract Award for Public Opinion Research and Advisory Services	October 1st
Incorporate Council Comments into Final UUT Ordinance	October/November
Council Consideration of Final UUT Ordinance and Possible Presentation of Public Opinion Survey Results, Recommendations for Public Education (if directed by Council)	November 12th
City Clerk Presents Resolution Calling April ’08 Election	November 26th
Ballot Measure Argument(s) Filed	December 10th
Rebuttal Argument(s) May Be Filed	December 20th
Begin Public Education Activities	January/February 2008
Election	April 8, 2008

FISCAL ANALYSIS:

The City's UUT revenue is General Fund revenue and is used to fund crucial City services, such as police and fire services, street and park maintenance, and recreation programs. UUT revenue is the City's second largest source of revenue, accounting for nearly 20% of total General Fund revenues. The CUT alone accounts for nearly 7% of total General Fund revenues. The following table shows the historical revenues collected from UUT:

	2003-04	2004-05	2005-06	2006-07*
Electricity	$4,941,302	$4,942,240	$5,468,241	$6,128,805
Gas	1,009,576	1,193,226	1,268,783	1,257,923
Water	707,248	811,386	813,609	942,317
Telecomm	5,270,405	5,103,307	5,019,061	4,935,930
Cable TV	477,900	567,115	585,927	637,756
Total	**$12,406,431**	**$12,617,274**	**$13,155,621**	**$13,902,731**

*Pre-audit figures

While most UUT revenues have remained relatively stable, total Telecommunication revenues have steadily declined since 2003-04. As previously discussed, competition between providers and rapid advances in communications technology has driven down costs, resulting in price reductions of communications equipment and usage plans for consumers. Consequently, revenues have also decreased.

The current legal challenges to some cities' ordinances primarily threaten revenues collected on cellular charges. The table below details the estimated cellular vs. non-cellular UUT revenues for Culver City:

	2003-04	2004-05	2005-06	2006-07*
Cellular	$2,590,931	$2,576,757	$2,710,795	$2,679,575
Non-cellular	2,679,474	2,429,219	2,308,266	2,256,355
TOTAL	**$5,270,405**	**$5,103,307**	**$5,019,061**	**$4,935,930**

*Pre-audit figures

Cellular charges typically account for approximately 50 – 55% of the total CUT revenue receipts. Overall, CUT revenues have been steadily declining since 2003-04, which is mainly the result of declining non-cellular revenues.

Non-cellular revenues have declined by almost 16% since 2003-04, while cellular revenues have increased a little more than 3 ½%. This suggests that consumers are using non-cellular forms of telecommunications (primarily publicly switched land lines) less.

If the City were to lose the cellular portion of the CUT revenue, there would be an immediate negative impact as approximately $2.5 million in revenue would be lost. Additionally, it is expected that revenues from non-cellular sources would continue to decline as other forms of communication become more prolific.

The negative impacts of lost revenue of this magnitude would be significant. Many City staff and the programs and services they support would be cut as the City would need to reduce the budget initially by approximately $2.5 – 3 million (based on the current revenue stream).

ATTACHMENTS:

Attachment 1: Summary of Proposed Changes to UUT
Attachment 2: Utility Users Tax, Chapter 3.08.200, et seq. of the Culver City Municipal Code
Attachment 3: Proposed Modernized UUT Ordinance (Redline Version)
Attachment 4: Proposed Modernized UUT Ordinance (Non-Redline Version)

MOTIONS:

That the City Council:

Discuss the proposed ordinance and direct staff as appropriate.