



# REPORT TO COUNCIL

## City of Sacramento

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Staff Report  
**June 17, 2008**

**Honorable Mayor and  
Members of the City Council**

**Title: Ordinance: Utility User Tax Reduction and Fairness Measure for  
Communications Services**

**Location/Council District: Citywide**

**Recommendation:** 1) Approve attached ordinance effective upon voter approval;  
2) Adopt resolution approving ballot measure text for placement on November 4, 2008  
ballot.

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**Presenters:** Russ Fehr, City Treasurer, (916) 808-5168

**Department:** City Manager's Office

**Division:** Governmental Affairs

**Organization No:** 0310

### **Description/Analysis**

**Issue:** With emerging technologies now providing traditional telephone services, the City's Utility User Tax ordinance is not applied to all communications users fairly. The proposed ordinance will ensure that all communications users are treated fairly, regardless of the technology used. The proposed ordinance also addresses changes in federal law. Once adopted, the ordinance will become effective upon voter approval.

**Policy Considerations:** The City seeks to treat users of communications services fairly, regardless of the means of transmission or technology used. The proposed ordinance is consistent with this objective. It also will continue the existing tax refunds for low-income residents and require annual financial audits.

**Environmental Considerations:** None.

**Rationale for Recommendation:** The City's current ordinance uses out-dated definitions and, as a result, the tax burden is not being shared fairly. The proposed ordinance will address this fairness issue as well as recent changes in federal law. A number of California cities have adopted similar voter-approved ordinances in recent years.

**Financial Considerations:** As technologies for communication have evolved in recent years, the City has experienced a gradual erosion of revenue from the Utility User Tax for telecommunications-related services. As communication services continue to evolve from traditional land-line telephones to newer technologies, the erosion of this important General Fund revenue source will diminish the City's ability to maintain existing service levels for many of its most important services including Police, Fire Protection, and youth programs.

An updated ordinance will ensure all communications users are treated fairly for tax purposes. It is anticipated that updating the ordinance definitions to include modern communications technologies within the tax base will likely result in some revenue increase. Therefore, in an effort to make this update revenue-neutral at this time, the proposed ordinance reduces the tax rate from 7.5% to 7%.

**Emerging Small Business Development (ESBD):** None.

Respectfully Submitted by: M. J. [Signature]

Recommendation Approved:

*for* Ray Kerridge  
Ray Kerridge  
City Manager

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## Background

Since 1969, a utility user tax has been levied on telephone service users within the City of Sacramento ("Telephone User Tax"). The Telephone User Tax is a major source of General Fund revenue and supports essential City services including police, fire protection, and youth programs. In 1993, the City extended the tax to include cellular and wireless telephone service with the advent of these communication technologies. Presently, the tax is applied at a rate of 7.5% of the charges billed. Voters rejected an initiative in 2002 to reduce the rate from 7.5% to 2.5%.

Since original enactment in 1969, the application of the Telephone User Tax has been based on the federal laws governing the Federal Excise Tax (FET), and in applying its Telephone User Tax, the City has historically followed the Internal Revenue Service (IRS) for guidance on the interpretation and application of the FET. However, the IRS has recently made certain policy changes that are inconsistent with its historic interpretation of the FET laws. In addition, because of rapidly changing technology, the out-dated definitions used in the existing Telephone User Tax do not treat all technologies the same. Finally, service providers' use of fixed-fee calling plans, bundled services, and other business practices to simplify billing and reduce costs have complicated the administration of the Telephone User Tax. These developments have exposed cities' telephone user taxes to legal challenges and there is litigation currently pending against the City of Sacramento. To address these issues, it is proposed that the existing ordinance be updated to include modern and emerging technologies, so that a tax is imposed on all communications users fairly (the "Communications User Tax"). Because such a change would increase the tax base, an updated Communications User Tax ordinance will require voter approval.

Submitting the updated Communications User Tax for voter approval will allow the public to confirm that it wishes to reduce the tax rate from 7.5% to 7.0%; assure that users of current and future communications technologies will be treated fairly; and preserve funding for essential municipal services like police, fire protection and youth programs. Under the updated Communications User Tax ordinance, the definition of "communications services" subject to the tax is defined broadly in a technology-neutral manner, so that all technologies, including traditional telephone, wireless and broadband service, are treated fairly.

Some important highlights of the proposed Communications User Tax ordinance include the following:

- The tax rate will be reduced from 7.5% to 7.0%
- The existing tax refunds for low-income residents will continue
- Emerging technology will be included within the tax base as it develops and
- Tax rate increases will be prohibited without voter approval

Updating the ordinance requires voter approval under the California Constitution. Therefore, staff is recommending the Mayor and Council 1) adopt the attached

ordinance effective upon voter approval, and 2) adopt the attached resolution approving ballot measure text for placement on November 4, 2008 ballot. If the measure is approved by voters, it would replace the existing Telephone User Tax. If voters do not pass this measure, there is a risk of loss of revenue due to continued legal challenges to the existing ordinance as well as to changing technology and market forces.

**ORDINANCE NO. \_\_\_\_\_**

**ADOPTED BY THE SACRAMENTO CITY COUNCIL  
ON \_\_\_\_\_**

**AN ORDINANCE AMENDING AND RESTATING SECTION 3.32.030, AND REPEALING SECTION 3.32.040, OF CHAPTER 3.32, TITLE 3 OF THE SACRAMENTO CITY CODE RENAMING THE TELEPHONE USER TAX AND APPLYING IT FAIRLY TO CURRENT AND EMERGING TECHNOLOGIES, AND TO REDUCE THE TAX RATE.**

**BE IT ENACTED BY THE COUNCIL OF THE CITY OF SACRAMENTO:**

**SECTION 1**

This ordinance amends and restates section 3.32.030, and repeals section 3.32.040, of the Sacramento City Code, and is made effective by voter approval of the Utility User Tax Reduction And Fairness Measure.

**SECTION 2**

**BACKGROUND**

- A. The City of Sacramento established a telephone user tax in 1969 for charges on telephone services, extended that tax in 1993 to include cellular and wireless telephone service, and has levied and collected a Utility User Tax on those services, and the current tax rate is 7.5%.
- B. Telephony and related communications services have changed dramatically in recent decades; communications technology, telephone calling and marketing plans and state and federal legislation continue to evolve at a rapid pace.
- C. In particular, communications are no longer accomplished entirely through the switched network, wireless service has become prevalent, communications through other means are increasing in popularity, the overall cost of communications is declining, common charges are no longer based upon distance, and the federal government has been extremely active in adopting laws affecting the telecommunications industry.
- D. Updating the City's tax on communications services to include current and emerging technologies and reflect the realities of the current communications industry require voter approval under the California Constitution.

- E. The City desires to treat users of communications services in a uniform and equitable manner, regardless of the means of transmission or technology used, so that users of communications services transmitted by traditional technologies (such as telephone land lines) do not bear a greater tax burden than users of communications services transmitted via newly developed technologies.
- F. The City desires to reduce the tax rate on communications services from 7.5% to 7% under the Communications User Tax.
- G. The Telephone User Tax contained refunds for low income persons and the City desires to continue those refunds in the Communications User Tax.
- H. The Communications User Tax will require annual financial audits of tax expenditures and will require voter approval of increases to the Communications User Tax.
- I. A measure is proposed for placement on the November 4, 2008 ballot that would give effect to this ordinance reducing the Utility User Tax on communications services and apply it fairly to all communications users.
- J. This Communications User Tax shall not apply to charges for the portion of cable or video television services that are subject to a cable or video television franchise fee.
- K. The City depends upon the revenue generated by the Communications User Tax to continue providing essential City services such as police, fire protection and youth programs.

### SECTION 3

Section 3.32.030 of the Sacramento City Code is amended and restated to read as follows:

#### **Section 3.32.030 Communications User Tax.**

A. There is imposed a tax upon every Person with a billing or service address in the City, other than a Public Agency, who uses intrastate, interstate or international Communications Services, to the maximum extent permitted by state and federal law. The tax imposed by this section shall be at the rate of seven percent of the charges for such services and shall be paid by the Person paying for such services.

B. The following words and phrases whenever used in this section shall be construed as defined herein:

1. **“Ancillary Telecommunications Services”** means services that are associated with or incidental to the provision, use or enjoyment of Communications Services, including but not limited to the following services: Conference Bridging Service, Detailed Telecommunications Billing Service, Directory Assistance Service, Vertical Service, and Voice Mail Service.

2. **“Communications Services”** means the transmission, conveyance, or routing of voice, audio, video, data or any other communications information or signals to a point, or between or among points, whatever the technology used, and whether or not that information is transmitted through interconnected service with the public switched network, or through fiber optic, coaxial cable, power line transmission, broadband connections or technologies, digital subscriber line or other wired technology or any wireless transmission. The term "Communications Services" includes 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 those 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 or data services that are functionally integrated with Communications Services. Communications Services include but are not limited to the following services, regardless of the manner or basis on which those 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; instant messaging; Ancillary Telecommunications Services; prepaid and post-paid telecommunications services (including but not limited to prepaid calling cards); Mobile Telecommunications Services; Private Communications Services; paging services; Video Services; 800 service (or any other toll-free numbers designated by the Federal Communications Commission); and 900 service (or any other similar numbers designated by the Federal Communications Commission for services whereby subscribers call in to pre-recorded or live service). Communications Services does not include either digital downloads such as e-mail or digital products such as books, music, ringtones, games and similar digital products, or that portion of cable or video television services subject to a cable or video television franchise fee.

3. **“Communications User Tax”** means the tax imposed by this section.

4. **“Conference Bridging Service”** means an ancillary service that links two or more participants of an audio or video conference call and may include the provision of a telephone number. Conference bridging service does not include the telecommunications services used to reach the conference bridge.

5. **“Detailed Telecommunications Billing Service”** means an ancillary service of separately stating information pertaining to individual calls on a customer’s billing statement.

6. **“Directory Assistance Service”** means an ancillary service of providing telephone number information or address information.

7. **“Mobile Telecommunications Services”** shall have the same meaning and usage as set forth in the Mobile Telecommunications Sourcing Act (4 U.S.C. Section 124) and the regulations thereunder.

8. **“Private Communications Services”** means any dedicated Communications Services that entitle the user to the exclusive or priority use of communications channels.

9. **“Tax Administrator”** means the Director of Finance of the City of Sacramento or his or her designee.

10. **“Vertical Service”** means an ancillary service that is offered in connection with one or more telecommunications services, which offers advanced calling features that allow customers to identify callers and to manage multiple calls and call connections, including conference bridging services.

11. **“Video Programming”** means those programming services commonly provided to subscribers by a Video Service Supplier including but not limited to basic services, premium services, audio services, video games, pay-per-view services, video on demand, origination programming, or any other similar services, regardless of the content of such Video Programming, or the technology used to deliver such services, and regardless of the manner or basis on which such services are calculated or billed.

12. **“Video Services”** means Video Programming and any and all services related to the providing, recording, delivering, use or enjoyment of Video Programming (including origination programming and programming using Internet Protocol, e.g., IP-TV and IP-Video) using one or more channels by a Video Service Supplier, regardless of the technology used to deliver, store or provide such services, and regardless of the manner or basis on which such services are calculated or billed, and includes ancillary video services, data services, telecommunication services, or interactive communications services that are functionally integrated with Video Services.

13. **“Video Service Supplier”** means any person that provides or sells one or more channels of Video Programming, or provides or sells the capability to receive one or more channels of Video Programming, including any telecommunications that are ancillary, necessary or common to the provision, use or enjoyment of the Video Programming, to or from a business or residential address in the City, where some fee is paid, whether directly or included in dues or rental charges for that service, whether or not public rights-of-way are utilized in the delivery of the Video Programming or telecommunications. A Video Service Supplier includes, but is not limited to, multi-channel Video Programming distributors (as defined in 47 U.S.C.

section 522(13)); open video systems (OVS) suppliers; and suppliers of cable television; master antenna television; satellite master antenna television; multi-channel multipoint distribution services (MMDS); Video Services using internet protocol (e.g., IP-TV and IP-Video), that provide, among other things, broadcasting and video on demand), direct broadcast satellite to the extent federal law permits taxation of its video services, now or in the future; and other suppliers of Video Services (including two-way communications), whatever their technology.

14. **“Voice Mail Service”** means an ancillary service that enables the customer to store, send or receive recorded messages. Voice Mail Service does not include any Vertical Services that the customer may be required to have to utilize the Voice Mail Service.

C. The tax imposed in this section shall be collected from the Service User by the Person providing the intrastate, interstate or international Communication Services. The amount of tax collected in one month shall be remitted to the City collector on or before the last day of the following month. The amount on which the tax is based shall be the sum of all charges for such services included in the bill; except that if a non-taxable service and a taxable service are billed together under a single charge, the entire charge shall be deemed taxable unless the Service Supplier or Service User reasonably identifies actual charges for services not subject to tax. The Service Supplier or Service User seeking a reduction has the burden of proving the proper valuation and apportionment of taxable and non-taxable charges based upon books and records that are kept in the regular course of business and in a manner consistent with generally accepted accounting principles.

D. Charges subject to the Communications User Tax include all amounts billed to the Service User for Communications Services, unless such charge is otherwise exempt from the tax as provided in this section or under state or federal law. Such charges include but are not limited to the following: connection, reconnection, termination, movement, or change of Communications Services; late payment fees; detailed billing; Voice Mail Service and other messaging services; Directory Assistance Service; access and line charges; universal service charges; and regulatory, administrative and other cost recovery charges.

E. Mobile Telecommunications Services shall be sourced in accordance with the sourcing rules set forth in the Mobile Telecommunications Sourcing Act (4 U.S.C. Section 124). The Tax Administrator may issue and disseminate to Service Suppliers who are subject to the tax collection requirements of this section, sourcing rules for the taxation of other Communications Service, including but not limited to prepaid Communications Services, post-paid Communications Services, and Private Communications Services, provided that such rules are based upon custom and common practice that further administrative efficiency and minimize multi-jurisdictional taxation. The Tax Administrator may also issue and disseminate to Communications Services suppliers who are subject to the tax collection requirements of this section, an administrative ruling identifying those Communications Services, or charges therefor,

that are subject to the tax of subsection A. This administrative ruling shall not impose a new tax, revise an existing tax methodology as stated in this section, or increase an existing tax, except as allowed by California Government Code section 53750(h)(2)(A).

F. The following shall be exempt from any tax imposed by this section:

1. News services. No tax shall be imposed under this section, except with respect to local telephone service, on any payment received from any Person 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.

2. International organizations. No tax shall be imposed under this section on any payment received for services furnished to a public international organization in which the United States participates pursuant to treaty or Act of Congress, or to the American National Red Cross.

3. Servicemen in combat zone. No tax shall be imposed under this section on any payment received for any Communications Services which originates within a combat zone from a member of the Armed Forces of the United States performing service in such combat zone, as defined in and determined under Section 112 of Title 26 of the United States Code.

4. Items otherwise taxed. Only one payment of tax under this section shall be required with respect to the tax on any Communications Services.

5. Common carriers and communications companies. No tax shall be imposed under this section on the amount paid for any Communications Services described in this section, 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. Nonprofit hospitals. No tax shall be imposed under this section on any amount paid by a nonprofit hospital for Communications Services furnished to such organization. For purposes of this subsection, the term "nonprofit hospital" means a hospital referred to in Section 170(b)(1)(A)(iii) of Title 26 of the United States Code, that is exempt from federal income tax under section 501(a) of Title 26 of the United States Code.

7. Exemption for nonprofit educational organizations. No tax shall be imposed under this section on any amount 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