



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

Date Amended:	07/10/07	Bill No:	AB 231
Tax:	Emergency Telephone Users Surcharge	Author:	Eng
Related Bills:	SB 1024 (Kehoe)		

BILL SUMMARY

This bill would make several clarifying changes to the definition of “toll telephone service” as that term is defined in the Emergency Telephone Users Surcharge Act.

SUMMARY OF AMENDMENTS

Since the previous analysis, this bill was amended to clarify that “toll telephone service” includes flat rate pricing plans where customers can purchase a fixed amount of minutes.

ANALYSIS

CURRENT LAW

Emergency Users Telephone Users Surcharge Act¹

Under existing law, Section 41020 of the Revenue and Taxation Code imposes a surcharge on amounts paid by every person in the state for intrastate telephone communication services.

Section 41010 defines intrastate telephone communication services to mean all local or toll telephone services where the point or points of origin and the point or points of destination of the service are all located in this state.

Section 41015 defines “local telephone service” to mean both of the following:

- (a) The access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radiotelephone stations constituting a part of the local telephone system.
- (b) Any facility or service provided in connection with a service described in subdivision (a).

The term "local telephone service" does not include any service which is a "toll telephone service" or a "private communication service."

Section 41016 defines “toll telephone service” to mean:

- (a) A telephonic quality communication for which (1) there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication and (2) the charge is paid within the United States, and

¹ Part 20 (commencing with Section 41001) of Division 2 of the Revenue and Taxation Code.

(b) A service which entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radiotelephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

The current surcharge rate is 0.50 percent of the amounts paid for intrastate telephone services in this state.

The surcharge is paid to the Board of Equalization (Board) and deposited in the State Treasury to the credit of the State Emergency Telephone Number Account in the General Fund. The funds in this account are used to pay for the costs of administration of the 911 emergency telephone number system.

Federal Law

Under existing federal law, an excise tax is imposed on amounts paid for communications services. The term "communication services" is defined to mean, in part, local telephone service and toll telephone service. "Toll telephone service" is defined in Section 4252(b) of Title 26 of the United States Code to mean:

1. A telephonic quality communication for which (A) there is a toll charge which varies in amount with the distance **and** elapsed transmission time of each individual communication and (B) the charge is paid within the United States, and
2. A service which entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radio telephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

The federal excise tax on telephone services is administered and collected by the Internal Revenue Service (IRS).

PROPOSED LAW

This bill would amend Section 41016(a) of the Revenue and Taxation Code to clarify that "toll telephone service" means, in part, toll charges that vary in amount with either the distance **or** elapsed transmission time, or both the distance and elapsed transmission time, to be consistent with existing billing practices and advances in technology. In addition, the bill would remove the reference to "and" at the end of subdivision (a), to clarify that subdivision (a) and (b) describe separate types of toll telephone services, and would clarify that subdivision (b) includes flat rate service plans with a fixed number of minutes.

This bill would only become operative if Senate Bill 1024 (Kehoe) of the 2007-08 Regular Session is enacted and becomes operative.

BACKGROUND

With the advent of telephone services where the charges vary based only on the elapsed time, and not on the distance between the caller and the recipient of the call, questions arose as to whether such services constituted “toll” services under the federal definition. A number of cases were brought to challenge the imposition of the federal excise tax on these services. Five federal appellate courts agreed with the claimants that the tax could not be imposed on the charges for these services because, since the charges for the services did not vary with the distance of the call, the services did not come within the federal definition of toll telephone services, nor did they constitute local telephone services. (*American Bankers Insurance Group v. United States* (11th Cir. 2005) 408 F.3d 1328; *OfficeMax, Inc. v. United States* (6th Cir. 2005) 428 F.3d 583; *National Railroad Passenger Corp. v. United States* (D.C.Cir. 2005) 431 F.3d 374; *Fortis, Inc. v. United States* (2d Cir. 2006) 447 F.3d 190; and *Reese Brothers, Inc. v. United States* (3d Cir. 2006) 447 F.3d 229.)

The courts held that, with respect to the definition of “toll telephone service” as provided in Section 4252(b)(1)(A) of the United States Code, the word “and” (emphasized above) is used “conjunctively” and could not be construed to be used “disjunctively” to mean “or.” Neither the Ninth Circuit nor the U.S. Supreme Court has issued an opinion on this legal issue.

On May 25, 2006, the IRS announced that it would stop collecting the federal excise tax imposed on long-distance telephone service. In addition, the IRS published IRS Notice 2006-50 (see http://www.irs.gov/irb/2006-25_IRB/ar09.html), which provided the background and basis for its decision and the rules for obtaining refunds of federal excise tax paid during the period March 1, 2003, through July 31, 2006.

IN GENERAL

According to the Department of General Services staff, there are 500 official public safety answering points (PSAPs) that are funded by the Emergency Telephone Users (911) Surcharge. PSAPs include primarily law enforcement agencies, such as local police and sheriff departments, and fire departments. The 911 Surcharge revenues pay for all of the network and infrastructure that support 911 services, and ongoing support for refreshing equipment, the network, and database information that appears at each site when someone calls “911.” The annual budget is approximately \$108 million, plus \$49 million this year to deploy wireless enhanced 911 service. As of July 1, 2006, the State Emergency Telephone Number Account had a \$132 million reserve. Effective November 1, 2006, the rate was reduced from 0.65 percent to 0.50 percent, which is the lowest rate allowed in the statute, and cannot be increased until November 1, 2007. Revenues had been running at approximately \$130 million per year. The reduced rate is expected to produce only \$112 million for the 2006/07 fiscal year.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to ensure that every Californian has access to a reliable 911 emergency response communications system.

2. **Summary of amendments.** The **July 10, 2007, amendments** clarify that “toll telephone service” includes flat rate pricing plans where customers can purchase a fixed amount of minutes.

The **April 30, 2007, amendments** 1) clarified that “toll telephone service” means, in part, a telephonic quality communication for which there is a toll charge that varies in amount with either the distance or elapsed transmission time, or both the distance and elapsed transmission time, of each individual communication, and 2) deleted provisions addressing a bundled service for local and long distance telephonic quality communication and prepaid calling cards.

3. **Current application of the surcharge.** As currently administered, the 911 surcharge is imposed on long distance toll charges that vary by elapsed time and/or distance. Therefore, this bill would clarify existing law and confirm current application. As such, this bill would not broaden the definition of “toll telephone service,” but would correct the wording to account for current billing practices and advances in technology and changes in the manner in which many long distance and toll charges are billed, particularly by wireless telecommunications service providers. Wireless telecommunication service charges are no longer computed based on time and distance; they are based primarily on elapsed time.
4. **Suggested amendments.** In order to meet the intent of the author, it is recommended that declaratory language be included in the legislation, stating that the Legislature meant “and” to also mean “or” when it enacted the program in 1976. This recommended language would strengthen the state’s litigation position and help avoid the potentially devastating effect that a refund of three years’ worth of 911 Surcharge paid on long distance charges that varied only by elapsed time, should this come before a court for an interpretation. An unfavorable ruling would have a major impact on the 500 local public safety agencies whose 911 services are supported by the 911 Surcharge revenues.

Board staff is willing to work with the author’s office in drafting appropriate amendments.

5. **Types of toll telephone services.** Section 41016 defines “toll telephone service” and describes the types of services that fall within this definition. The described toll telephone services are as follows:

- Proposed Subdivision (a)(1) describes a long distance service that is based on time or distance. For example, a service for which the charge is a per-minute rate billed with each long distance call would fall within the service described in subdivision (a).
- Proposed Subdivision (a)(2) describes a long distance service that provides an unlimited or a specified number of long distance minutes for a flat-rate charge .

To make clear that the definition of “toll telephone services” describes separate types of services and not criteria for a single service, this measure strikes the “and” after proposed Section 41016(a)(1). However, by not replacing the “and” with an “or,” the amendment does not accomplish the author’s intent.

Also, the July 10, 2007, amendment to Section 41016(b) could compromise the application of the surcharge to wide-area telephone service (WATS). Board staff suggests adding the clarifying language to existing law without deleting the existing language, to state that "toll telephone service" includes flat rate pricing plans where customers can purchase a fixed amount of minutes.

To address these potential areas of ambiguity, the following amendment is suggested:

41016. "Toll telephone service" shall mean:

(a) A telephonic quality communication for which (1) there is a toll charge that varies in amount with either the distance or elapsed transmission time, or both the distance and elapsed transmission time, of each individual communication and (2) the charge is paid within the United States; or

(b) A service that entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of a predetermined amount of units or dollars of telephonic communications or an unlimited number of telephonic communications or an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radiotelephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

6. **Has the state's definition of "toll telephone service" been challenged?** As of the date of this analysis, neither the Ninth Circuit nor any California state court of appeals has addressed the subject of the state's definition of "toll telephone service." It is reasonable to expect that a California state court will be asked to consider the definition, and it is possible that the court could decide that the 911 surcharge may not be imposed on charges for toll telephone service that do not vary by both elapsed time and distance, as "toll telephone service" is presently defined.

7. **Related legislation.** Senate Bill 1024 (Kehoe) would revise the definition of "service supplier" to mean any person supplying intrastate telephone communication services capable of originating a "911" emergency telephone call from any service user in the state, and make several clarifying changes to the definitions contained in the Act.

Double joining language may be necessary since Assembly Bill 231 and Senate Bill 1024 both amend Section 41016 to revise the definition of "toll telephone service." As of the date of this analysis, only Assembly Bill 231 proposes to amend subdivision (b), which makes the double-joining language necessary. However, both bills would amend subdivision (a) with the intent to clarify that toll telephone services means, in part, a telephonic quality communication for which there is a toll charge that may vary in amount with either the distance or elapsed transmission time. Since the two bills take a different approach to make that clarification, it is necessary for the language contained in subdivision (a) to be identical for each of the measures if they are double-joined.

COST ESTIMATE

Enactment of this measure would not impact the Board's administrative costs.

REVENUE ESTIMATE

This bill would not affect the state's revenues.

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