



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	05/03/07	Bill No:	SB 1024
Tax:	Emergency Telephone Users Surcharge	Author:	Kehoe
Related Bills:	AB 231 (Eng)		

BILL SUMMARY

Among other things, this bill would make the following changes to the Emergency Telephone Users (911) Surcharge Act¹:

- Impose the 911 surcharge on amounts paid by every person in the state for Voice over Internet Protocol (VoIP) service.
- Revise the definition of “service supplier” to mean any person supplying intrastate telephone communication services pursuant to California intrastate tariffs to any service user in this state and any person supplying VoIP service capable of originating a “911” emergency call from any service user in the state.
- Clarify the definition of “toll telephone service.”

SUMMARY OF AMENDMENTS

Since the previous analysis of the bill, the amendments, among other things, specifically impose the 911 surcharge on amounts paid by every person in the state for VoIP service, revise the definition of service supplier to include any person supplying VoIP service capable of originating a “911” emergency call from any service user in the state, make conforming changes to the provisions related to the Federal Mobile Telecommunications Sourcing Act with respect to the taxation of nomadic VoIP service, and delete language stating that the changes to the definition of “toll telephone service” do not constitute a change in, but is declaratory of, existing law.

ANALYSIS

CURRENT LAW

Emergency Telephone Users (911) Surcharge Act

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. 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.

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.

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

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
- (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.

Section 41021 requires every service supplier to collect the surcharge from each service user at the time it collects its billing from the service user. A service provider is defined in Section 41007 to mean any person supplying intrastate telephone communication services pursuant to California intrastate tariffs to any service user in this state. The term also includes any person supplying intrastate telephone communications services for whom the California Public Utilities Commission (CPUC), by rule or order, modifies or eliminates the requirement for that person to prepare and file California intrastate tariffs.

Section 41020 provides, in accordance with the federal Mobile Telecommunications Sourcing Act (P.L. 106-252), that the surcharge does not apply to any charges for mobile telecommunications services billed to a customer where those services are provided, or deemed provided, to a customer whose place of primary use is outside this state.

"Charges for mobile telecommunications services" is defined to mean any charge for, or associated with, the provision of commercial mobile radio service, as defined in Section 20.3 of Title 47 of the Code of Federal Regulations, as in effect on June 1, 1999, or any charge for, or associated with, a service provided as an adjunct to a commercial mobile radio service, that is billed to the customer by or for the customer's home service provider, regardless of whether individual transmissions originate or terminate within the licensed service area of the home service provider.

"Mobile telecommunications service" is defined to mean commercial mobile radio service, as defined in Section 20.3 of Title 47 of the Code of Federal Regulations, as in effect on June 1, 1999.

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

Among other things, this bill would impose the 911 surcharge on amounts paid by every person in the state for intrastate telephone communication service or VoIP service, whether or not the service is billed separately, or in conjunction with other services unrelated to telephone communication for which the surcharge does not apply.

The definition of “service supplier” would be amended to include any person supplying intrastate telephone communication services pursuant to California intrastate tariffs and any person supplying VoIP service capable of originating a “911” emergency call from any service user in this state.

This bill would define “VoIP service” to mean any service that does both of the following:

- Enables real-time or two-way communication that originates or terminates from the user’s location using Internet Protocol, or any successor protocol.
- Uses a broadband connection from the user’s location, including any service that permits users generally to receive calls that originate on the public switched telephone network and to terminate calls to the public switched telephone network

This bill would also amend the provisions of the Act that conform to the Federal Mobile Telecommunications Sourcing Act with respect to the taxation of mobile telecommunications services to include VoIP service, which can also be nomadic. Specifically it would provide that the surcharge does not apply to any charges for VoIP service billed to a customer where those services are provided, or deemed provided, to a customer whose place of primary use is outside this state.

Section 41007.5 would be added to the Act to provide it is the intent of the Legislature that VoIP service not be regulated by the enactment of this bill, and to clarify that the bill’s sole purpose is to ensure that all forms of telephonic quality communication that connect to the “911” emergency system contribute to the State Emergency Telephone Number Account.

This bill would amend Section 41016 to revise the definition of “toll telephone service” to clarify that 1) either of the services described in subdivisions (a) and (b) constitutes a “toll telephone service,” and 2) toll charges may vary in amount with either the distance or elapsed transmission time, or the distance and elapsed transmission time, of each individual communication.

Furthermore, the bill makes various non-substantive, technical corrections to the Act.

And lastly, this bill would add Section 41152 to incorporate the Legislature’s findings and declarations, which are as follows:

- Access to emergency telephone service has been a longstanding goal of the state.
- The Act remains an important means for making emergency telephone service available to every person in this state.
- Every reasonable means should be employed by telephone corporations and every provider of telephonic quality communication to ensure that every person using their service is informed of, and is afforded the opportunity to use, emergency telephone service, regardless of the means by which emergency telephone calls are placed.
- The furnishing of emergency telephone service is in the public interest and should be supported fairly and equitably by every telephone corporation and every provider of telephonic quality communication in a way that is equitable, nondiscriminatory, and competitively neutral.

The bill would become effective immediately as an urgency statute.

IN GENERAL

According to the Department of General Services (DGS) staff, there are 500 official public safety answering points (PSAPs) that are funded by the 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.

Toll telephone service. 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.

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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.

BACKGROUND

In 2001, Assembly Bill 1458 (Kelley) would have revised the Emergency Telephone Users Surcharge Law to instead impose a surcharge upon service users for each access line for each month a service user subscribes or contracts with the service supplier. This Board-sponsored measure was intended to simplify the application of the surcharge for service suppliers by eliminating the complicated calculations and interpretations of what charges are subject to the 911 surcharge. That bill was amended to remove these provisions before the bill was heard in its first policy committee.

COMMENTS

- 1. Sponsor and purpose.** This bill is sponsored by the DGS and is intended to:
 - Change the definition of “toll charges “ to include time or distance in addition to time and distance, in response to an IRS ruling which announced that, under the current federal definition, toll charges are not subject to the federal excise tax, and
 - Address the growth of VOIP services that will further reduce the 911 base, citing Montana as a jurisdiction that recently expanded their 911 surcharge base to include VOIP services. The shrinking of the base upon which the 911 surcharge is levied potentially jeopardizes the ability of the state to fully fund the 911 program. Moreover, it creates a competitive inequity where some telecommunications services are assessed to pay for the state's 911 program while other equivalent services are not.
- 2. Summary of amendments.** The **May 3, 2007, amendments** specifically impose the 911 surcharge on amounts paid by every person in the state for VoIP service, revise the definition of service supplier to include any person supplying VoIP service capable of originating a “911” emergency call from any service user in the state, make conforming changes to the provisions related to the Federal Mobile Telecommunications Sourcing Act with respect to the taxation of nomadic VoIP service, and delete language stating that the changes to the definition of “toll telephone service” does not constitute a change in, but is declaratory of, existing law. In addition, the amendments codify the Legislature’s intent that VoIP Service is not to be regulated by the enactment of the bill, and make other non-substantive clarifying changes.

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The **March 28, 2007, amendments** deleted the federal statutory references from the definitions of “bundled services” and “toll telephone services,” and provided that the surcharge does not apply to any charges billed to a customer for telephonic quality voice communication services where the customer’s primary place of use of such services is outside this state.

3. **What is VoIP?** According to the Federal Communications Commission (FCC), VoIP “is a technology that allows you to make voice calls using a broadband Internet connection instead of a regular (or analog) phone line. Some VoIP services may only allow you to call other people using the same service, but others may allow you to call anyone who has a telephone number - including local, long distance, mobile, and international numbers. Also, while some VoIP services only work over your computer or a special VoIP phone, other services allow you to use a traditional phone connected to a VoIP adapter.”

In June 2005, the FCC imposed Enhanced 911² (E911) obligations on providers of “interconnected” VoIP services. Interconnected VoIP service allows you to make and receive calls to and from traditional phone numbers, usually using an Internet connection, possibly a high-speed (broadband) Internet connection, such as Digital Subscriber Line (DSL), cable modem, or wireless broadband.

While interconnected VoIP service may be used from a single location, like a residence, some interconnected VoIP services can be used wherever you travel, as long as a broadband Internet connection is available. Companies offering interconnected VoIP service call it by a number of different brand names, but for purposes of this analysis, such services are referred to as “nomadic.”

4. **How would the imposition of the 911 surcharge differ for VoIP service?** This measure would expand the imposition of the 911 surcharge to include amounts paid by every person in the state for VoIP service. This language, however, does not limit the imposition of the surcharge to only intrastate VoIP service; it would also capture interstate communications (where the point of origin is located in this state and the point of destination of the service is located outside this state). Board staff understands based on discussions with industry that current technology does not allow VoIP suppliers to differentiate between intrastate and interstate communications.

The current imposition of the 911 surcharge would continue to apply only to amounts paid for intrastate telephone communication services. However, the surcharge does apply to a charge that includes interstate, long distance services when bundled with intrastate telephone services and the service supplier cannot clearly breakdown the interstate, long distance service charges.

5. **Has the state’s definition of “toll telephone service” been challenged?** As of the date of this analysis, neither the Federal Ninth Circuit Court of Appeals 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

² E911 systems automatically provide to emergency service personnel a 911 caller’s call back number and, in most cases, location information.

vary by both elapsed time and distance, as “toll telephone service” is presently defined.

6. **Suggested amendments.** It is recommended that declaratory language be included in the legislation for purposes of Section 41016, which defines “toll telephone service,” 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 would have, 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.

In addition, there are several places within the 911 Act that the term “VoIP service” should be referenced in conjunction with “intrastate telephone communication service.” Board staff is working with DGS staff in drafting appropriate amendments. Board staff understands that this measure is a work in process and that the DGS is continuing to work with all interested parties, including Board staff, in developing and further refining the language in the bill.

7. **Related legislation.** Assembly Bill 231 (Eng) would amend Section 41016 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 time, or both the distance and elapsed transmission time, to be consistent with existing billing practices and advances in technology. In addition, that 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.

COST ESTIMATE

The Board would incur additional costs in administering the proposed changes because this bill would result in an increase in the number of service suppliers that are required to report and pay the 911 surcharge. The start-up costs would include identifying and registering additional surcharge payers, revising Board publications, and training Board staff. On-going costs would include the mailing and processing of additional returns and surcharge payments and increases in compliance and audit efforts, due to the increase in the number of surcharge payers. A detailed cost estimate is pending.

REVENUE ESTIMATE

This measure would not affect the state’s revenues. The 911 surcharge is set at a rate necessary to fully fund the 911 program.

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