

Issue Paper Number 00-016



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

APPLICATION OF THE 911 SURCHARGE ON SERVICE CHARGES DEDUCTED FROM PREPAID TELEPHONE CALLING CARDS

I. Issue

Should the Board adopt regulations to clarify the application of the Emergency Telephone Users Surcharge (the “911 Surcharge”) on dollar amounts or value of minutes deducted upon use from prepaid telephone calling cards?

II. Staff Recommendation

Staff recommends that the Board authorize publication of the attached regulations (See Exhibit 1) which (1) define the term “prepaid telephone calling card”, (2) clarify the application of the 911 Surcharge on dollar amounts or the value of minutes deducted upon use from prepaid telephone calling cards and (3) clarify how a service supplier may be relieved from the liability when that liability resulted from reasonable reliance on written advice given by the Board in a prior audit. The application of the tax to prepaid telephone calling cards has been a subject of confusion within the telecommunications industry because some states now impose sales tax on prepaid telephone calling cards at the point of retail sale, while other states impose either sales tax or 911 tax on prepaid telephone calling cards upon usage of telephone services. Under existing California law, there is no authority to impose sales tax on prepaid telephone calling cards at the point of retail sale.

III. Other Alternative(s) Considered

- A. Alternative 1. Instead of adopting new regulations, issue a special notice to all 911 Surcharge account holders and interested parties which explains the Board’s interpretation of the Emergency Telephone Users Surcharge Law. The 911 Law does not define a “prepaid telephone calling card”. The special notice would describe what the Board understands a prepaid telephone calling card to be and clarify the application of the 911 Surcharge on prepaid telephone calling cards consistent with the staff recommendation.
- B. Alternative 2. Authorize publication of regulations which define a prepaid telephone calling card and require the service supplier to collect and remit the 911 Surcharge based on the amount received by a service supplier upon sale of a prepaid telephone calling card to a non-service supplier, regardless of usage.

IV. Background

The 911 Surcharge was established to fund local implementation of the 911 emergency telephone system. The 911 Surcharge is imposed on service users based on charges for intrastate telecommunication services.

The term “prepaid telephone calling card” means a card, an access code, an authorization number or other identifier which is purchased in advance of telephone use and which entitles the holder to a specified dollar amount or minutes of telephone service. Prepaid telephone calling cards are sold directly by the major interexchange carriers, such as AT&T, MCI and Sprint, or by non-regulated distributors and retailers. Non-regulated entities purchase prepaid telephone calling cards from the major carriers and sell them at various retail outlets, such as drug stores, college bookstores and convenience stores, or purchase units and print their own cards. Prepaid telephone calling cards may also be given away as promotional gifts or provided by employers to employees for business calls.

Cellular prepaid telephone calling cards are similar, except that they function only for the service user’s activated cellular phone. A cellular prepaid telephone calling card represents a set number of dollars of airtime available on the user’s account. The service supplier debits the service user’s cellular account balance as the service user makes and receives calls.

The 911 Law imposes a surcharge on “amounts paid by every person in the state for intrastate telephone communication services in this state...” (Revenue and Taxation Code §41020)¹. The deducting of dollar amounts or value of minutes upon intrastate usage of the card is deemed to be within this statutory provision.

Since the prepaid telephone calling card represents prepayment for a service that may be used in the future, the amount paid for a prepaid telephone calling card could be viewed as an “amount paid for telephone communication services in this state”, thus providing a basis for imposing the 911 Surcharge on the amount received by a service supplier upon sale to a non-service supplier, regardless of usage. A “service supplier”, as defined by §41007, is obligated to collect the 911 Surcharge from service users and remit it to the state.

Currently, our survey of the 10 largest service suppliers providing service in California (including AT&T, MCI and Sprint) disclosed that the telecommunications industry collects and remits the 911 Surcharge on prepaid telephone calling cards based on the dollar amount or value of minutes deducted upon use of the prepaid telephone calling card. That is, the 911 Surcharge is calculated using the dollar amount or value of minutes which the service supplier deducted from prepaid telephone calling cards for intrastate telephone service. A service supplier may occasionally calculate the 911 Surcharge on total amounts received if it is unable to determine the lower dollar amount or value of minutes deducted upon intrastate use of the prepaid telephone calling card. All cards are sold at a tax-included price and the aggregate 911 Surcharge for all service users is factored into the sales price of each card.

¹Hereafter, all code references shall be to the Revenue and Taxation Code.

Issue Paper Number 00-016

No sales tax is imposed on the value of the service represented by the card because the card represents an intangible that is not subject to the California sales or use tax. The *1999 Multistate Corporate Tax Guide*, reports on page II-226 that a majority of states that impose sales tax on telecommunication services tax prepaid telephone calling cards as the service is used, but that the number of states imposing sales and use tax at the point of sale is “significantly increasing”.

Federal statutes impose the federal excise tax (FET) on the amount paid for communication services. In the case of communication services acquired by means of a prepaid telephone calling card, the “amount” is the face amount of the card and it is “paid” when the service supplier transfers the prepaid telephone calling card to someone other than a telecommunications carrier (26 U.S.C. 4251 (d)). If the card does not specify a dollar amount, the “face amount” is to be determined by regulations. The Internal Revenue Service adopted final regulations January 7, 2000 which clarify the tax treatment of prepaid telephone calling cards.

While service suppliers do not maintain detailed records on a card by card basis for intrastate telecommunication charges, most service suppliers maintain aggregate totals of charges for services debited on all prepaid telephone calling cards, separately stated as interstate charges and intrastate charges. In certain cases, a service supplier may estimate the amount of 911 Surcharge due from other available information. Absent an amendment of the law which would allow a sales tax to be imposed at the point of retail sale of a prepaid telephone calling card, the most feasible approach from the service supplier’s and the Board’s perspectives will be to continue to calculate the 911 Surcharge on the aggregate total of dollar amounts or value of minutes deducted by the service supplier upon use of the prepaid telephone calling cards for intrastate calls or on a reasonable estimate of card use.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends authorizing publication of the attached regulations to clarify that under existing law the 911 Surcharge applies to dollar amounts or value of minutes for intrastate calls deducted upon use of the prepaid telephone calling card. The amount subject to the 911 Surcharge may be based on the aggregate total of all intrastate dollar amounts or value of minutes deducted during the reporting period from all prepaid telephone calling cards issued by the service supplier or on the basis of a reasonable estimate of intrastate card use.

The staff is aware that wholesalers, distributors and/or retailers mark up the prepaid telephone calling cards before they are sold to the service users. However, interested parties have commented that a service supplier does not control nor know the actual sales price of the card to the service user and therefore it would be very difficult for the service supplier to calculate and remit the 911 Surcharge on this basis.

Issue Paper Number 00-016

The Staff has reviewed written submissions from interested parties and listened to comments presented at the March 2, 2000 Meeting of Interested Parties. The Staff determined that some of the comments presented by the interested parties would require statutory changes to the 911 Law for implementation. The Staff has concluded that the Staff's Recommendation best accommodates existing industry reporting practices while still meeting the statutory requirements of the 911 Law. The addition of Regulation 2432, *Relief from Liability*, is recommended to clarify how a service supplier may be relieved from liability when that liability resulted from reasonable reliance on written advice given by the Board in a prior audit.

B. Pros of the Staff Recommendation

The proposed regulations will provide guidance to service suppliers and others involved in the distribution and sale of prepaid telephone calling cards so that the correct measure will be used to calculate and collect the 911 Surcharge and to remit it to the Board.

The proposed basis of reporting the 911 Surcharge reflects current industry reporting practices in California. Service suppliers unable to meet the reporting requirements, as clarified, will be provided guidance on a case by case basis.

C. Cons of the Staff Recommendation

This is a new and emerging technology and the regulation process may not allow for timely changes as the telecommunications industry evolves. The amount of 911 Surcharge collected and remitted to the State by the service supplier is the dollar amount or the value of minutes deducted from the prepaid telephone calling card. This amount represents a lower 911 Surcharge amount than under any other alternative reporting method because it does not include the markup added by wholesalers, distributors and/or retailers of the prepaid telephone calling card.

D. Statutory or Regulatory Change

Legislation is not deemed to be necessary to adopt this regulation. In staff's opinion, there is sufficient statutory basis in the current 911 Law to support the proposed regulation.

E. Administrative Impact

The adoption of this regulation will define "prepaid telephone calling card" and clarify the application of the 911 Surcharge to the use of prepaid telephone calling cards, thereby providing clear direction to service suppliers on the proper measure of tax, reducing the regulatory and audit burden on the service suppliers, and to the extent the 911 Surcharge is properly reported, reducing staff time required to correct accounting mistakes of service suppliers. Service suppliers unable to meet the reporting requirements, as clarified, will be provided guidance on a case by case basis.

F. Fiscal Impact

1. Cost Impact

No significant cost impact. The proposed regulation reflects the existing industry reporting practice in California, and the current Board interpretation of the law. Service suppliers

FORMAL ISSUE PAPERIssue Paper Number 00-016

unable to meet the reporting requirements, as clarified, will be provided guidance on a case by case basis.

2. Revenue Impact

No significant revenue impact. The proposed regulation reflects the existing industry reporting practice and the current Board interpretation of the law. Service suppliers unable to meet the reporting requirements, as clarified, will be provided guidance on a case by case basis.

G. Taxpayer/Customer Impact

No significant taxpayer impact. The proposed regulation reflects the existing industry reporting practice. It is not anticipated that any taxpayer will need to implement significant changes to current billing procedures, bookkeeping practices, recordkeeping or reporting methods for the 911 Surcharge. Service suppliers unable to meet the reporting requirements, as clarified, will be provided guidance on a case by case basis.

H. Critical Time Frames

None.

VI. Alternative 1**A. Description of the Alternative**

Instead of adopting regulations, the Board could send a notice to all registered service suppliers clarifying the application of the 911 Surcharge to dollar amounts or value of minutes deducted upon use from prepaid telephone calling cards.

B. Pros of the Alternative

A notice to service suppliers would effectively inform all currently registered taxpayers of the correct application of the 911 Surcharge on dollar amounts or value of minutes deducted upon use from prepaid telephone calling cards. This procedure would require less staff time for approval than the regulation process, and would allow the Board to notify taxpayers more quickly if evolving technology requires changes in the Board's interpretation of the 911 Law.

C. Cons of the Alternative

A notice to service suppliers is distributed less widely than a regulation, and is less readily available to new taxpayers, non-registered interested parties and the public. While the regulatory process includes a public hearing and comment period, the prepaid telephone calling card industry would not have an opportunity to review and comment on the Board's interpretation of the law and application of the 911 Surcharge or on the contents of the notice because issuance of an administrative notice is not subject to the same notice and hearing requirements as adoption of a regulation.

Issue Paper Number 00-016

D. Statutory or Regulatory Change

Legislation is not deemed to be necessary to approve the mailing of a notice to service suppliers. In staff's opinion, there is sufficient statutory basis in the current 911 Law to support the proposed interpretation and notice.

E. Administrative Impact

A notice to service suppliers will require less administrative time to approve than approval of the regulations. There will be no significant change in workload since the notice reflects the existing industry reporting practice.

F. Fiscal Impact

1. Cost Impact

No significant cost impact since the proposed Board interpretation and notice reflect the existing industry reporting practice.

2. Revenue Impact

No significant revenue impact since the proposed Board interpretation and notice reflect the existing industry reporting practice.

G. Taxpayer/Customer Impact

No significant taxpayer impact. The proposed Board interpretation and notice reflect the existing industry reporting practice. It is not anticipated that any taxpayer will need to implement significant changes to current billing procedures, bookkeeping practices or recordkeeping or reporting methods in collecting and remitting the 911 Surcharge.

H. Critical Time Frames

None.

VII. Alternative 2

A. Description of the Alternative

Adopt regulations which impose the 911 Surcharge on the amount received by a service supplier upon sale of the prepaid telephone calling card to a non-service supplier, regardless of usage, within the parameters of the existing 911 law. Thus this alternative suggests regulations clarifying application of the 911 Surcharge on amounts received upon sale of the prepaid telephone calling card by a service supplier to a non-service supplier.

B. Pros of the Alternative

The amount subject to the 911 Surcharge would be easy for the service supplier to determine and report, since it would be based on the amount charged by the service supplier to the first purchaser of the prepaid telephone calling cards.

C. Cons of the Alternative

Service users would be paying more 911 Surcharge than currently due under the more accurate intrastate usage model recommended because service users would pay the 911 Surcharge based on the amount received on the sale of the card and not on actual telephone usage. Under this alternative, if the prepaid telephone calling card is used for interstate telephone calls the 911 Surcharge would unavoidably be collected on non-taxable interstate telephone communication charges. And if any portion of the card were unused, then the 911 Surcharge would also be collected when no telecommunication service is utilized.

D. Statutory or Regulatory Change

A regulation would be necessary to define “amounts paid for intrastate telephone communication services in this state”. If this alternative were selected, the Board should consider defining the term in a fashion similar to the federal law, calculating the amount in relation to the amount received by a service supplier upon sale of a prepaid telephone calling card to a non-service supplier for purposes of imposing the 911 Surcharge. Adopting a uniform basis for both state and federal tax on telephone communication services would ease the compliance burden for industry. In staff’s opinion, there is sufficient statutory basis in the current 911 law to support the interpretation that the 911 Surcharge is due on the amount received by a service supplier upon sale of the telephone prepaid calling card because the amount received represents a flat-rate charge where intrastate telephone usage is bundled with interstate telephone usage.

E. Administrative Impact

Regulations to implement this alternative will clarify how the 911 Surcharge applies to prepaid telephone calling cards. It would provide clear direction to service suppliers on the proper measure of tax, reducing the regulatory and audit burden on the service suppliers, and to the extent the 911 Surcharge is properly reported, reduce staff time required to correct accounting mistakes of service suppliers.

F. Fiscal Impact

1. Cost Impact

No significant cost impact to the state or to service suppliers. Although the proposed regulations change the existing industry reporting practice and the current Board interpretation of the law, the amounts received by the service supplier on the sale of the prepaid telephone calling cards to a non-service supplier is readily available information. Accordingly, the service supplier should

FORMAL ISSUE PAPERIssue Paper Number 00-016

easily be able to report and document the 911 Surcharge, based on the amount it charges to the first purchaser of its prepaid telephone calling cards.

2. Revenue Impact

No significant revenue impact. Although the proposed regulations in this alternative would cause the 911 Surcharge to be based on a larger measure than the staff's recommendation, (i.e., the amount received on the sale of the card to a non-service supplier regardless of usage as compared to the dollar amounts or value of the minutes sold upon intrastate usage), the increase is not deemed to be significant.

G. Taxpayer/Customer Impact

The service supplier would be liable to collect and remit an additional amount of 911 Surcharge than due under the staff's recommendation. The service supplier may choose to absorb the additional 911 Surcharge or pass it on to the service user by increasing the price of the prepaid telephone calling card. However, this approach should make collection and remittance of the 911 Surcharge on prepaid telephone calling cards less burdensome.

Some service users may be paying more 911 Surcharge than actually due, depending on the way the card is used. For example, if the card is used strictly for interstate calls (or for purposes other than telecommunication service) the service user will pay a surcharge where no surcharge is due. Since the prepaid telephone calling card is sold at a tax included price (adjusted for non-taxable usage and unused minutes) there may be an increase in the price of the prepaid telephone calling card to the service user. This alternative should be selected only if it is found that the ease of administration outweighs the burden on service users of potential 911 Surcharge overpayments.

H. Critical Time Frames

None.

Prepared by: Special Taxes Department

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Regulation 2401. Definitions

(a) Service Supplier. "Service Supplier" means any person supplying intrastate telephone communication services to any service user in this state, provided however:

(1) Where intrastate telephone communication services are supplied through a prepaid telephone calling card, the "service supplier" means the person that provides access to its lines and switches for telephone services and is responsible for deducting the amounts charged for telephone services used from amounts of service available on the prepaid telephone calling card.

(2) A wholesaler or retailer of prepaid telephone calling cards is not a service supplier unless it provides access to its lines and switches for telephone services and is responsible for deducting the amounts charged for telephone services used from amounts of service available on the prepaid telephone calling card..

(b) Intrastate Telephone Communication Services. "Intrastate telephone communication services" means all local or toll telephone services where the point or points of origin and the point or points of destination of the services are all located in this state. It includes 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 a local telephone system and any facility or service provided in connection with local telephone service. It also includes telephonic quality communication for which there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication as well as a service which entitles the subscriber, upon payment of a periodic charge (whether a flat charge or a charge based upon 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 the service is located.

(c) Billing Agent. "Billing Agent" shall mean any person that submits a bill to a service user on behalf of another person who is a service supplier, reseller or billing aggregator. A billing agent is not considered to be a service supplier for intrastate telephone communication services provided by or billed on behalf of that person.

(d) Billing Aggregator. "Billing Aggregator" shall mean any person engaged in the business of facilitating the billing and collection of charges for intrastate telephone communication services by aggregating the information about telephone communication services provided by one or more service suppliers and submitting the combined information to one or more local exchange carriers for billing and collection. The billing aggregator may contract with service suppliers to (i) receive call information detail from one or more service suppliers and submit that call information detail to one or more local exchange carriers acting as billing agents (ii) receive payments from local exchange carriers acting as billing agents for disbursement as

Regulations 2401, 2403 & 2432.
Service Supplier, Prepaid Telephone Calling Cards,
Relief from Liability

directed by service suppliers and (iii) prepare and file returns and remit the surcharge to the Board in the manner provided in the applicable contract. A billing aggregator shall identify all service suppliers on whose behalf it will prepare and file returns at such the time and in such form as the Board requests.

(e) Prepaid Telephone Calling Card. “Prepaid telephone calling card” means any card, or other identifier such as an authorization number or access code, which is purchased in advance of use of telephone services, and entitles the holder of the card or user of the authorization number or access code to a specified dollar amount or number of minutes of telephone service, where dollar amounts or minutes for telephone services used are deducted from the amount of prepaid service available on the prepaid telephone calling card as local and long distance telephone services are provided to the user of the prepaid telephone calling card.

Regulation 2403. Prepaid Telephone Calling Cards

(a) The surcharge applies to the dollar amounts deducted or the value of the minutes deducted from the prepaid telephone calling card by the providing service supplier to the extent that those dollar amounts or minutes were deducted to pay for intrastate telephone communication services provided to the user of the prepaid telephone calling card. Dollar amounts or minutes deducted for interstate telephone communication services are exempt from the surcharge. Dollar amounts or minutes of telephone service which are forfeited because they have not been used prior to the expiration of the prepaid telephone calling card are not subject to the surcharge.

(b) Where intrastate telephone communication services are supplied through a prepaid telephone calling card, the providing service supplier may apply the surcharge to an estimate of the charges for intrastate services subject to the surcharge. The estimate of charges may be based on such call information as the providing service supplier reasonably believes demonstrates the approximate amount of intrastate telephone communication service charges subject to the surcharge.

(c) If a prepaid telephone calling card contains a statement that the price of the card includes applicable taxes and fees, the service supplier responsible for collecting and paying the surcharge on intrastate telephone communications services provided pursuant to the card may reduce the taxable measure of such services by taxes and fees which are not subject to the 911 surcharge. Taxes and fees which are not subject to the 911 surcharge include the federal excise tax and the 911 surcharge. Taxes and fees imposed on the service supplier by statute, such as those imposed by the California Public Utilities Commission, may not be deducted from the taxable measure.

Regulations 2401, 2403 & 2432.
Service Supplier, Prepaid Telephone Calling Cards,
Relief from Liability

Regulation 2432. Relief from Liability

(a) IN GENERAL. A person may be relieved from the liability for the payment of the Emergency Telephone Users Surcharge, including any penalties and interest added to the surcharge, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit of that person under the conditions set forth in subdivision (c) below. As used in this regulation, the term “prior audit” means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person.

The term “written advice” includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term “written advice” includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) ADVICE PROVIDED IN A PRIOR COMMUNICATION. Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

Regulations 2401, 2403 & 2432.
Service Supplier, Prepaid Telephone Calling Cards,
Relief from Liability

(c) WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

(d) ANNOTATIONS AND LEGAL RULINGS OF COUNSEL. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above;
or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body or a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) TRADE OR INDUSTRY ASSOCIATIONS. A trade or industry association seeking advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation.