

Updated Informative Digest for the State Board of Equalization's
Adoption of California Code of Regulations,
Title 18, Sections 2460, Administration,
2461, Exemptions, Deductions, Credits, and Specific Applications of Tax, and
2462, Refunds of Excess Charges Collected

The State Board of Equalization (Board) held a public hearing regarding the proposed adoption of California Code of Regulations, title 18, sections (Regulations) 2460, *Administration*, 2461, *Exemptions, Deductions, Credits, and Specific Applications of Tax*, and 2462, *Refunds of Excess Charges Collected*, on January 26, 2016. During the public hearing, the Board unanimously voted to adopt proposed Regulations 2460, 2461, and 2462 without making any changes.

The Board did not receive any written public comments regarding the proposed regulatory action. Ms. Brenda Narayan, Director of Government Relations for MuniServices, appeared at the public hearing and stated that MuniServices appreciates all of the work done by Board staff on this matter and is pleased to support the adoption of proposed Regulations 2460, 2461, and 2462. The Board considered Ms. Narayan's comments prior to the adoption of proposed Regulations 2460, 2461, and 2462. Ms. Narayan was the only interested party that appeared at the public hearing on January 26, 2016, to comment on the proposed regulatory action.

The Board is proposing to adopt Regulations 2460, 2461, and 2462 to implement, interpret, and make specific the Revenue and Taxation Code's (RTC's) statutes regarding the application of the prepaid mobile telephony services (MTS) surcharge and local charges to the purchase of prepaid MTS, and provide guidance to sellers and purchasers of prepaid MTS with respect to statutory registration, reporting, payment, and collection requirements, which became effective January 1, 2016. Therefore, the Board has determined that there is good cause to request an early effective date for Regulations 2460, 2461, and 2462, in order to ensure that the regulations are effective as soon possible after the statutory requirements are effective. So, pursuant to Government Code section 11343.4, subdivision (b)(3), the Board requests that Regulations 2460, 2461, and 2462 be effective immediately upon filing with the Secretary of State.

There have not been any changes to the applicable laws or the effect of, the objectives of, and anticipated benefits from the adoption of the proposed Regulations 2460, 2461, and 2462 described in the informative digest included in the notice of proposed regulatory action. The informative digest included in the notice of proposed regulation action provides:

Summary of Existing Laws and Regulations

Assembly Bill No. 1717 (AB 1717) (Stats. 2014, ch. 885) established the Prepaid Mobile Telephony Services Surcharge Collection Act (Prepaid

MTS Act) and the Local Prepaid Mobile Telephony Services Collection Act (Local Act) (commencing with RTC sections 42001 and 42100, respectively). The bill also amended and added certain RTC sections with respect to the Emergency Telephone Users Surcharge Act (commencing with RTC section 41001), which imposes what has come to be commonly known as the “911 surcharge” because it funds the “911” emergency system utilizing the digits 9-1-1.

Prepaid MTS Act

I. Surcharge Imposed by Prepaid MTS Act

Mobile Telephony Service (MTS), Prepaid MTS, and Prepaid MTS Surcharge

The term “‘mobile telephony service’ or ‘MTS’” means “commercially available interconnected mobile phone services that provide access to the public switched telephone network (PSTN) via mobile communication devices employing radiowave technology to transmit calls, including cellular radiotelephone, broadband Personal Communications Services (PCS), and digital Specialized Mobile Radio (SMR).” The term “mobile telephony services” does not include “mobile satellite telephone services or mobile data services used exclusively for the delivery of nonvoice information to a mobile device.” “Prepaid MTS” means “the right to utilize a mobile device for mobile telecommunications services or information services [(as defined in 47 U.S.C. § 1530)], including the download of digital products delivered electronically, content, and ancillary services, or both telecommunications services and information services, that must be purchased in advance of usage in predetermined units or dollars.” (Pub. Util. Code section 224.4; RTC section 42004.)

On and after January 1, 2016, a prepaid MTS surcharge is imposed on each “prepaid consumer” purchasing prepaid MTS. A “seller” is required to collect the surcharge. The surcharge is imposed as a percentage of the sales price from each retail transaction involving the purchase of prepaid MTS that occurs in this state. The prepaid MTS surcharge is in lieu of the surcharges and user fees imposed on amounts paid for prepaid MTS under the law in effect through December 31, 2015, and collected and paid to the California Public Utilities Commission (PUC), the Board, and local agencies or jurisdictions by providers and suppliers of telephone communication services. (RTC section 42010.)

Definitions of Prepaid Consumer, Seller, and Direct Seller

Pursuant to RTC section 42004, “prepaid consumer” means “a person who purchases prepaid [MTS] in a retail transaction,” and “seller” means “a person that sells prepaid [MTS] to a person in a retail transaction.” RTC section 42004 further provides that a “direct seller” means “a prepaid

[MTS] provider or service supplier, as defined in [RTC section] 41007, that makes a sale of prepaid [MTS] directly to a prepaid consumer for any purpose other than for resale in the regular course of business.” A direct seller includes, but is not limited to, a telephone corporation, as defined in section 234 of the Public Utilities Code, a person that provides interconnected Voice over Internet Protocol (VoIP) service, as defined in section 285 of the Public Utilities Code, and a retailer that is a member of the same commonly controlled group or combined reporting group as a telephone corporation or provider of VoIP service under the Corporation Tax Law (commencing with RTC section 23001).

According to the above definitions, the term seller is inclusive of direct sellers. However, as further discussed in this paper, a seller who is further defined as a direct seller has different registration and reporting requirements than those sellers who do not meet the definition of a direct seller.

Retail Sale Location / Transaction Location in this State

Pursuant to RTC section 42004, “in this state” means “within the exterior limits of the State of California and includes all territory within those limits owned by or ceded to the United States of America.” Also, “retail transaction” means “the purchase of prepaid MTS, either alone or in combination with mobile data or other services, from a seller for any purpose other than resale in the regular course of business.”

Pursuant to RTC section 42014, a retail transaction *occurs* in this state for purposes of the prepaid MTS surcharge if the consumer makes the retail transaction in person at a business location in this state (point-of-sale transaction). If this is not applicable, a retail transaction *occurs* in this state if the consumer’s address is in this state (known-address transaction). For this purpose, a known-address transaction occurs in this state under any one of the following circumstances:

- The retail sale involves the shipping of an item to be delivered to, or picked up by, the prepaid consumer at a location in this state.
- The prepaid consumer’s address is known by the seller to be in this state. For this purpose, the consumer’s address is considered to be known by the seller if the seller’s records maintained in the ordinary course of business indicate that the prepaid consumer’s address is in this state and the records are not made or kept in bad faith.
- The prepaid consumer provides an address during consummation of the retail transaction that is in this state, including an address provided with respect to the payment instrument if no other address is available and the address is not given in bad faith.

- The mobile telephone number is associated with a location in this state.

For purposes of determining local charges (discussed further below), a retail transaction occurs at only one location. When the retail transaction occurs in person at a business location in this state (point-of-sale transaction), it is presumed the consumption of, use of, or access to prepaid MTS occurs at the business location. If the retail transaction is not a point-of-sale transaction, it is presumed the consumption of, use of, or access to prepaid MTS occurs at the known address, and the known address location is determined by the circumstances bulleted above, in descending order.

Determining the Prepaid MTS Surcharge Rate

Pursuant to RTC section 42010, the Board is required to calculate the prepaid MTS surcharge rate annually by November 1 by adding the 911 surcharge rate (as determined and reported to the Board by the Office of Emergency Services under RTC section 41030) and the PUC reimbursement fee and telecommunications universal services surcharges (as determined by the PUC under Pub. Util. Code section 319, subs. (a) and (b)).

Pursuant to RTC section 42010, the Board is also required to post on its website, for each local jurisdiction, the combined total of the rates of the prepaid MTS surcharge (as calculated above) and the rate(s) of local charges. (See below for information regarding local charges.) The Board is also required to separately post on its website individual rates for each of the PUC surcharges included in the calculation of the prepaid MTS surcharge, the 911 surcharge rate, and each of the individual local charges applicable to prepaid MTS.

II. Administration of Surcharge

Registration

Pursuant to RTC sections 42020 and 42022, every person that sells prepaid MTS to a person in a retail transaction in this state is required to register with the Board. RTC section 42022 provides that the Board is required to establish a method for registration that uses “the existing registration process for registering for a seller’s permit” under the Sales and Use Tax Law (commencing with RTC section 6001). RTC section 42022 provides that “[e]very application for registration shall be upon a form prescribed by the [B]oard and shall set forth the name under which the applicant transacts or intends to transact business, the location of its place or places of business, and such other information as the Board may require.” RTC section 42022 also provides that “applications for registration shall be authenticated in a form or pursuant to methods as may be prescribed by the [B]oard.”

However, pursuant to RTC Section 42010, “direct sellers,” as defined in RTC section 42004, must remit that portion of the prepaid MTS surcharge that consists of the emergency telephone users surcharge to the Board pursuant to the Emergency Telephone Users Surcharge Act. As such, direct sellers must register with the Board pursuant to RTC section 41040.

RTC section 41040 requires service suppliers, including direct sellers, to register “with the [B]oard upon a form prescribed by the [B]oard” and requires each registrant to “set forth the name under which it transacts or intends to transact business and such other information as the [B]oard may require.” The Board previously adopted Regulation 2421, *Registration*, to incorporate and implement RTC section 41040. Regulation 2421 reiterates the statutory requirement and provides notice to service suppliers regarding their statutory registration requirements by reiterating that registration is required “with the Board upon a form prescribed by the Board.”

Payment and Collection

Pursuant to RTC section 42010, every prepaid consumer of MTS in this state is liable for the prepaid MTS surcharge and any local charges until those amounts are paid to this state. However, a prepaid consumer’s payment to a registered seller relieves the consumer from further liability. A seller is required to separately state the combined prepaid MTS surcharge and local charges on an invoice, receipt, or other similar document provided to the prepaid consumer, or otherwise disclose the combined prepaid MTS surcharge and local charges electronically to the prepaid consumer, at the time of the retail transaction. (RTC section 42010.) A prepaid MTS provider must also offer prepaid consumers the option to make payment for additional prepaid usage directly to the prepaid MTS provider at the provider’s retail location or website. (RTC section 42010.)

The prepaid MTS surcharge that is required to be collected by a seller and any amount unreturned to the prepaid consumer that is not owed as part of the surcharge but was collected under the seller’s representation that it was owed as part of the surcharge, constitute a seller’s debt to the state. The local charge (discussed further below) shall also be collected by a seller and any amount unreturned to the prepaid consumer that is not owed as part of the local charge, but was collected under the seller’s representation that it was owed as part of the local charge, constitutes a seller’s debt jointly to the local jurisdiction imposing the local charge and the state, for purposes of collection on behalf of, and payment to, the local jurisdiction. (RTC section 42010.)

Furthermore, a prepaid MTS surcharge that has been collected and not yet remitted to the Board constitutes a seller’s debt to the state. With respect

to local charges collected and not yet remitted to the Board, such amounts shall constitute a seller's debt jointly to the local jurisdiction imposing the charge and the state, for purposes of collection on behalf of, and payment to, the local jurisdiction.

Seller Reimbursement of 2%

Pursuant to RTC section 42010, a seller that is not a direct seller is allowed to deduct and retain an amount equal to two percent of the amounts it collects from prepaid consumers for the prepaid MTS surcharge and local charges, on a pro rata basis, according to that portion of the revenues collected for the 911 surcharge, the PUC surcharges, and local charges.

Reporting

For seller's, other than direct seller's, the prepaid MTS surcharge, less the two percent retailer reimbursement amount, is due and payable to the Board quarterly on or before the last day of the next month following each calendar quarter, pursuant to RTC section 42021. However, the Board administers and collects the prepaid MTS surcharge under the Fee Collections Procedure Law (FCPL) (commencing with RTC section 55001), and the FCPL also specifies that the Board may require the payment of the amount due and the filing of returns for periods other than a quarterly reporting period. (RTC sections 42020, 55041.1.) In addition, a return must be filed with the Board using electronic media at the time of payment. (RTC section 42021.)

For direct sellers, the portion of the prepaid MTS surcharge that consists of the 911 surcharge is due and payable to the Board under the same reporting and payment periods as their 911 surcharge is due and payable under the Emergency Telephone Users Surcharge Act, on a return filed using electronic media, pursuant to RTC section 42010. A direct seller is also required to remit the portion of the prepaid MTS surcharge that consists of the PUC surcharges to the PUC and, if applicable, the portion that consists of the local charges to the local jurisdiction or agency imposing the local charge, and not to the Board. (RTC section 42010.)

Electronic Funds Transfer

The FCPL contains general requirements for making payments by electronic funds transfer (EFT). However, under RTC section 42020, a seller, other than a direct seller, that is required to, or elects to, remit payments by EFT for sales and use tax purposes must remit the prepaid MTS surcharge to the Board by EFT. The Board has previously adopted Regulation 1707, *Electronic Funds Transfers*, to further define the term EFT, prescribe the circumstances under which persons are required to remit payments by EFT, and provide procedures for persons to elect to remit payments by EFT, for sales and use tax purposes.

Reliance on the Board's Website

Pursuant to RTC section 42010, a seller may rely on the accuracy of the information posted on the Board's website when collecting and remitting all amounts of the prepaid MTS surcharge and local charges. A direct seller must utilize the rates posted on the Board's website when determining what amounts to collect and remit to the PUC, Board, and each local jurisdiction or local agency.

Pursuant to RTC section 42014, a seller is discharged from any liability for additional prepaid MTS surcharge or local charges and is also relieved from refunding to the customer amounts collected and remitted to the Board if:

- A seller relies in good faith on Board-provided information to match either a point-of-sale transaction location, or the five digit postal ZIP Code of the prepaid consumer's known-address, to the applicable prepaid MTS surcharge and local charges amount;
- A seller collects that amount from the prepaid consumer; and
- A seller remits the amount to the Board in compliance with the Prepaid MTS Act.

The provisions above are applicable even if the ZIP code of the prepaid consumer's address in a known-address transaction corresponds to more than one local charge.

III. Exemptions, Deductions, Credits, and Bundled Transactions

Lifeline Exemption

Pursuant to RTC section 42012, a prepaid consumer's purchase of prepaid MTS, either alone or in combination with mobile data or other services, is exempt from the prepaid MTS surcharge, if all of the following apply:

- The prepaid consumer is certified as eligible for the state or federal lifeline program.
- The seller is an authorized lifeline service provider, under the state or federal lifeline program.
- The exemption is only applied to the portion of the charge for prepaid MTS that the lifeline program specifies is exempt from the surcharges and fees comprising the prepaid MTS surcharge.

Bad Debts

Pursuant to RTC section 42010, a seller is relieved from the liability to collect the prepaid MTS surcharge that became due and payable, insofar as the base upon which the surcharge is imposed is represented by accounts found to be worthless and charged off for income tax purposes or, if the seller is not required to file income tax returns, charged off in accordance

with generally accepted accounting principles. A seller that has previously paid the prepaid MTS surcharge on accounts found to be worthless and charged off for income tax purposes may, under rules and regulations prescribed by the Board, take a “bad debt” deduction on its return for the amount found worthless and charged off by the seller. If a seller subsequently collects any amounts for which a bad debt deduction was taken, the amount so collected is required to be reported and the prepaid MTS surcharge on such amount must be paid to the Board on the first return subsequently filed.

Credit for Charges Paid to Other States

Pursuant to RTC section 42010, a credit against, but not to exceed, the prepaid MTS surcharge and local charges is allowed where the prepaid consumer paid a 911 surcharge, state utility regulatory commission fees, state universal service charges, or local charges on the purchase to any other state, political subdivision thereof, or the District of Columbia. The credit shall be apportioned to the charges against which it is allowed in proportion to the amounts of those charges.

Bundled Transactions

Pursuant to RTC section 42018, the prepaid MTS surcharge and local charges apply to the entire price where prepaid MTS is sold in combination with mobile data services or any other services or products for a single non-itemized price in a “bundled transaction.” If prepaid MTS is sold with a cellular telephone for a single non-itemized price, the prepaid MTS surcharge applies to the entire charge; however, if the purchase price for the cellular telephone is disclosed to the consumer on a receipt, invoice, or other written or electronic documentation provided to the prepaid consumer, the charge for the cellular telephone is not subject to the prepaid MTS surcharge and local charges. Furthermore, the prepaid MTS surcharge and local charges do not apply to a transaction where a minimal amount of prepaid MTS amount is sold with a cellular telephone for a single, non-itemized bundled price. For this purpose, a minimal amount includes a service allotment denominated as 10 minutes or less, or \$5 or less.

IV. Refunds

Pursuant to RTC section 42010, a seller that collects an amount in excess of the prepaid MTS surcharge and local charges owed may refund those amounts to the prepaid consumer. The seller may refund those amounts even though the surcharge amount was paid to the Board and no corresponding credit or refund has yet been secured. Under the FCPL, every person required to collect or pay the prepaid MTS surcharge or local charges that overpaid an amount to the Board, may file a claim for refund with the Board for such amount, unless otherwise specified. (RTC

sections 55221, 55222; Cal. Code Regs., tit 18, § 5230.)

Local Act

I. Local Charges Imposed under Local Ordinances

Legislative Intent

The Local Act applies to local ordinances of local jurisdictions and local agencies that impose “local charges” on prepaid MTS. The terms “local jurisdiction” and “local agency” both mean “a city, county, or city and county, which includes a charter city, county, or city and county.” (RTC sections 42004, 42101.)

The Local Act recognizes that “[l]ocal charges on telecommunication services represent an important source of tax revenue for many cities and counties and are used to pay for” essential governmental services. The Local Act provides that “[i]t is a matter of statewide concern that the local charges for local prepaid [MTS] be collected in a uniform manner in order for the collection to be fair and uniform on a statewide basis.” The Local Act also provides that it “is the intention of the Legislature that this part shall preempt the provisions pertaining to the tax or charge rate, base, and method of collection contained in all local ordinances, rules, or regulations concerning the imposition of a local charge upon the consumption of prepaid mobile telephony services, to the extent those provisions are inconsistent with the provisions of this part and Part 21 (commencing with Section 42000.) It is not the intent of the Legislature to otherwise preempt, limit, or affect the general authority of local jurisdictions to impose a utility user tax [(UUT)], local 911 charge, or any other local charges.” (RTC section 42100.)

In General

On and after January 1, 2016, a local charge imposed by a local agency on prepaid MTS is required to be collected by a seller from the prepaid consumer at the same time and in the same manner as the prepaid MTS surcharge is collected under the Prepaid MTS Act; provided that on or before September 1, 2015, the local agency enters into a contract with the Board to collect and administer the local charge, so that the Board can administer such local charge in a uniform manner with other local charges under the Local Act. (RTC sections 42101.5, 42103.)

In the event a local agency adopts a new local charge after September 1, 2015, the Local Act requires the local agency to enter into a contract with the Board, as provided above, on or before December 1, with collection of the local charge to commence April 1 of the next calendar year. Also, with respect to a local agency that contracts with the Board and thereafter increases its existing local charge, the Local Act requires the local agency

to notify the Board in writing of the increase on or before December 1, with collection of the increased local charge to commence April 1 of the next calendar year. (RTC section 42101.5.)

In addition, in the event that a local agency reduces or eliminates its local charge, the Local Act requires the local agency to notify the Board in writing of the change (RTC section 42101.5). Also, when a local agency notifies the Board in writing that the rate of its local charge posted on the Board's website is inaccurate, or that it no longer imposes a local charge, or that the rate of its local charge has decreased, then the Prepaid MTS Act requires that the Board promptly post the recalculated rate, and provides that the change becomes operative on the first day of the calendar quarter commencing more than 60 days from the date the local agency provided the written notification to the Board. (RTC section 42010.)

Notwithstanding any other law, on and after January 1, 2016, the Local Act also:

- Suspends the utility user tax on the consumption of prepaid MTS in the city or county at the rate specified in its ordinance and replaces it with specific tiered rates set forth in statute, based on the existing city or county rate (RTC section 42102); and
- Suspends a local charge applicable to prepaid MTS for communication services or local "911" emergency telephone access at a rate as specified in a local ordinance and replaces it with a rate as specified by statute. (RTC section 42102.5.)

Furthermore, on and after January 1, 2016, the Local Act shall be:

- The exclusive collection method for the local UUT, local 911 charges, and any other local charge imposed on consumers using prepaid MTS, and for defining the scope of the local tax or charge on prepaid MTS; and
- With respect to taxation of prepaid MTS, the complete substitute for the UUT rate set forth in the local ordinance at the specified tiered rate. (RTC section 42102.)

The Local Act also states that it "shall not preempt, limit, or affect the general authority of local jurisdictions to impose a utility user tax, local 911 charge, or any other local charges." (RTC section 42102.)

Contract

The Local Act requires that, in its contract with the Board, the local agency must certify to the Board that its ordinance applies its local charge to prepaid MTS and that the local agency agrees to indemnify, and hold harmless, the Board, its officers, agents, and employees for any and all liability for damages that may result from collection pursuant to the

contract. The Local Act also requires that the local agency must certify the amount of the “access to communications” or local 911 charge, or the applicable tiered rate for a UUT in its contract with the Board. (RTC section 42101.5.)

II. Administration of Local Charges

In General

Under the Local Act, the Board is required to perform all functions incident to the collection of a local charge after the local agency imposing the charge has entered into the required contract with the Board, except with respect to direct sellers. The Board must collect such local charges from sellers, other than direct sellers, in the same manner as it collects the prepaid MTS surcharge under the Prepaid MTS Act and the FCPL, subject to specified limitations. (RTC section 42103.)

Local Jurisdiction or Local Agency Responsibilities

Under the Local Act, the local jurisdiction or local agency that has adopted an ordinance imposing a local charge is solely responsible for the following functions:

- Defending any claim regarding the validity of the ordinance in its application to prepaid MTS;
- Interpreting any provision of the ordinance, except to the extent specifically superseded by the Local Act;
- Responding to specified claims for refund by prepaid MTS consumers involving: (1) the presumed location of the retail transaction; (2) an exemption from the local charge under the local enactment; or (3) a challenge to the validity of a local tax ordinance, in whole or part;
- Reallocating local charges as a result of correcting errors relating to the location of the point of sale transaction of a seller, or the known address of a consumer, for up to two prior quarters from the date of knowledge of the error;
- Enforcing, including auditing, the collection and remittance of local charges by direct sellers pursuant to the ordinance; and
- Certifying that the ordinance applies the local charge to prepaid MTS and agreeing to indemnify and hold harmless the Board, its officers, agents, and employees for any and all liability for damages that may result from collection of the local charge. (RTC section 42105.)

The local jurisdiction or local agency is also required to certify to the Board the amount of the local 911 charge, as set out in RTC Section

42102.5, or the applicable tiered rate for a utility user tax, as set out in RTC Section 42102. (RTC section 42101.5.)

Deposit of Local Revenues

The Local Act provides that all local charges collected by the Board are to be deposited in the Local Charges for Prepaid Mobile Telephony Services Fund in the State Treasury and held in trust for the local taxing jurisdictions. Local charges consist of all taxes, charges, interest, penalties, and other amounts collected and paid to the Board, less payments for refunds and reimbursement to the Board for expenses to administer and collect the local charges. (RTC section 42103.)

The Local Act requires the Board to periodically transmit the funds to the local jurisdictions as promptly as feasible and at least once in each calendar quarter. The Board must also furnish a quarterly statement to the local jurisdictions indicating the amounts paid and costs withheld. Each local jurisdiction shall pay to the Board its pro rata share of the Board's cost of collection and administration, based on revenues collected. (RTC sections 42020, 42103.)

Board's Duties

The Local Act allows the Board to perform, or to contract with third parties to perform, the following duties of the Board:

- Allocate and transmit collected local charges in the Prepaid Mobile Telephony Services Fund to the appropriate local jurisdictions.
- Audit proper collection and remittance of the local charge.
- Respond to requests from sellers, consumers, boards, and others regarding issues pertaining to local charges that are within the scope of the Board's duties. (RTC section 42103.)

Also, the FCPL's current provisions prohibiting the Board from disclosing fee payers' confidential information, in RTC section 55381, apply to any third party performing the Board's functions under a third-party contract. And, contingent fee arrangements, as payment for services rendered, are prohibited in any third-party contract. (RTC section 42103.)

Disclosing Information to Local Jurisdictions and Agencies

The Local Act requires the Board to make available to a requesting local jurisdiction or local agency any information that is reasonably available to the Board regarding the proper collection and remittance of a local charge of that local jurisdiction or local agency by a seller, including a direct seller. Such information is subject to the confidentiality requirements of RTC sections 7284.6, 7284.7, and 19542. (RTC section 42103.)

Other Current Board Regulations

The Sales and Use Tax Law provides a retailer relief from liability to collect or pay taxes and a bad debt deduction for taxes previously paid on accounts found worthless and charged off by the retailer (RTC section 6203.5), which are similar to the Prepaid MTS Act's provisions providing a seller relief from liability to collect surcharges and local charges and a "bad debt" deduction for surcharges and local charges paid on accounts found worthless and charged off by the seller. Also, the Board has previously adopted Regulation 1642, *Bad Debts*, to prescribe the circumstances under which a retailer may be relieved from liability to collect or pay tax and be eligible to claim a bad debt deduction on its return for taxes previously paid on accounts found worthless and charged off by the retailer, for sales and use tax purposes.

In addition, the Sales and Use Tax Law provides that the terms "retail sale" and "sale at retail" mean "a sale for any purpose other than resale in the regular course of business in the form of tangible personal property" (RTC section 6007), and this definition is similar to the Prepaid MTS Act's definition of "retail transaction." Also, the Board has previously adopted Regulation 1668, *Sales for Resale*, to prescribe the circumstances under which tangible personal property is purchased for resale in the regular course of business, and prescribe the form of a resale certificate that may be used to document that a sale of tangible personal property is for resale in the regular course of business, for sales and use tax purposes.

Furthermore, the Board has previously adopted Regulation 4901, *Records*, to prescribe the records that taxpayers and feepayers must maintain and make available to the Board to substantiate that they have properly reported and paid a number of Board-administered taxes and fees, including records required to be maintained and made available regarding taxes and fee administered under the FCPL (RTC section 55302.). The Board has previously adopted Regulation 4902, *Relief from Liability*, to prescribe the circumstances under which a person is relieved from liability for a number of Board-administered taxes and fees, including taxes and fees administered under the FCPL (RTC section 55045), due to reasonable reliance on written advice from the Board. The Board has also previously adopted Regulation 4903, *Innocent Spouse or Registered Domestic Partner Relief from Liability*, to prescribe the circumstances under which a spouse or registered domestic partner may be relieved of liability for a number of Board-administered taxes and fees if it is inequitable to hold the person liable for such taxes or fees, including taxes and fees administered under the FCPL (RTC section 55045.1).

Effect, Objectives, and Benefits of the Proposed Adoption of Regulations 2460, 2461, and 2462

There are issues because there are currently no regulations that specifically implement, interpret, or make specific the Prepaid MTS Act's and Local Act's statutes regarding the application of the prepaid MTS surcharge and local charges to the purchase of prepaid MTS and sellers need additional guidance to collect the prepaid MTS surcharge and local charges from prepaid consumers of prepaid MTS beginning on January 1, 2016, including guidance regarding reporting prepaid MTS surcharges and local charges, making payment by EFT, record keeping, relief from liability due to reasonable reliance on written advice from the Board, relief from liability and deductions for bad debts, and innocent spouse and registered domestic partner relief from liability. In addition, there are issues because there is currently no regulation that prescribes the circumstances under which prepaid MTS is purchased for resale in the regular course of business or prescribes the form of the resale certificate that may be used to document that the prepaid MTS surcharge and local charges are inapplicable because the purchase of prepaid MTS was for purposes of resale in the regular course of business.

Business Taxes Committee Process

Board staff determined that it was necessary to draft three proposed regulations, entitled "Administration," "Exemptions, Deductions, Credits, and Specific Applications of Tax," and "Refunds of Excess Charges Collected," to fully implement, interpret, and make specific the statutes regarding the application of the prepaid MTS surcharge and local charges to the purchase of prepaid MTS, and specifically address the issues identified above. Therefore, Board staff prepared drafts of the regulations and an Initial Discussion Paper, which Board staff distributed to the interested parties on December 22, 2014, prior to holding its first meeting to discuss the draft regulations with interested parties on January 6, 2015.

Board staff did not receive comments from any interested parties prior to the January 6, 2015, interested parties meeting. During the meeting, interested parties appeared to be in agreement with staff's draft regulations. There was general discussion regarding a direct seller's reporting period for local charges and the process for claiming a lifeline exemption, among other items. Subsequent to the meeting, staff received written comments from interested parties: expressing support for the draft regulations; suggesting that the draft regulations clarify that direct sellers remit local charges to local jurisdictions on a monthly basis; suggesting that staff clarify the definition of prepaid MTS in the draft regulations by using the phrase "right to utilize and/or access," rather than "right to access," MTS or information services; and suggesting that staff clarify in the draft regulations that prepaid MTS may be sold to a consumer on a "tax-included basis," meaning a price that includes all applicable taxes and fees.

In response, staff agreed to revise the definition of prepaid MTS in the draft regulations so that it uses the phrase “right to utilize and/or access” and staff agreed to revise the definition of “receipt” in the draft regulations to clarify that prepaid MTS can be sold on a tax-included basis, so long as the receipt or other document provided to the consumer includes a separate statement of the amount which is for the combined prepaid MTS surcharge and local charges, as required by RTC section 42010, subdivision (i). However, staff did not agree to prescribe the reporting basis for direct sellers to report local charges. Staff determined that per RTC section 42010, subdivision (f)(3), direct sellers are required to remit local charges directly to the local jurisdictions imposing the charges, and not to the Board. Staff also determined that the Board’s functions with regard to the collection and administration of local charges are limited, and RTC section 42105, subdivision (a)(6), expressly provides that local jurisdictions are solely responsible for “the collection and remittance of local charges by direct sellers” pursuant to their own ordinances. Thus, staff concluded that the Board does not have authority to promulgate regulations specifying how direct sellers remit a charge imposed by a local ordinance to the local jurisdiction imposing that charge.

Staff subsequently incorporated the agreed to suggestions into a revised draft of the regulations, numbered the regulations as Regulations 2460, 2461, and 2462 for inclusion in a new chapter 5.7 to be added to division 2 of title 18 of the California Code of Regulations, prepared a second discussion paper regarding the draft regulations, which was distributed to the interested parties on February 20, 2015, and conducted a second meeting to discuss the draft regulations with the interested parties on March 4, 2015. During the second interested parties meeting, there was general approval of the revised draft regulations. Interested parties also expressed their appreciation of the Board’s efforts to clarify the issues referred to above. After the second interested parties meeting, staff also received written comments expressing support and offering no further recommendations regarding revisions to the draft regulations.

Therefore, Board staff subsequently prepared Formal Issue Paper 15-009, which recommended that the Board propose to adopt staff’s revised drafts of Regulations 2460, 2461, and 2462 to implement, interpret, and make specific the Prepaid MTS Act’s and Local Act’s statutes regarding the application of the prepaid MTS surcharge and local charges to the purchase of prepaid MTS.

Specifically, the revised draft of Regulation 2460, *Administration*:

- Incorporates statutory terms from the Prepaid MTS Act and Local Act, and further defines the key statutory terms used in the prepaid MTS regulations.

- Clarifies that the term “direct seller” includes “a person that provides” the “Voice over Internet Protocol (VoIP) service” referred to in the statutory definition of direct seller, and clarifies that the reference to a “retailer, as defined by [RTC] Section 6203,” in the statutory definition of direct seller, refers to a retailer “engaged in business in this state” as defined by RTC section 6203.
- Clarifies that the terms “prepaid mobile telephony services” and “prepaid MTS” mean the right to “utilize and/or access” mobile telecommunications services which are prepaid and “utilized by means of a mobile device,” and not some other right, such as the right to utilize a mobile device to access the services.
- Clarifies the registration requirements for sellers and direct sellers.
- Reiterates and incorporates the statutory requirement in RTC section 42022 that every application for registration shall be made in a form prescribed by the Board, in a similar manner to the way that Regulation 2421 incorporates and implements RTC section 41040’s similar registration requirement.
- Emphasizes that the prepaid MTS surcharge and local charges are imposed on the prepaid consumer, and that sellers are obligated to collect the prepaid MTS surcharge and local charges from prepaid consumers and separately state the combined prepaid MTS surcharge and local charges on their receipts.
- Clarifies that prepaid MTS may be sold to a prepaid consumer on a tax-included basis.
- Facilitates compliance by specifying that a seller is statutorily obligated to provide a “receipt” to a prepaid consumer and prescribing the elements that a document, including an electronic document, must contain to satisfy the receipt requirement, including a separate statement of the combined prepaid MTS surcharge and local charges even if the prepaid MTS is sold for a price that includes all applicable taxes and fees.
- Incorporates and clarifies the statutory provisions requiring sellers, including direct sellers, to report and pay the prepaid MTS surcharge and local charges they collect;
- Reiterates that direct sellers shall continue to remit the portion of the prepaid MTS surcharge that consists of the 911 surcharge to the Board pursuant to the Emergency Telephone Users Surcharge Act, and the portion of the prepaid MTS surcharge that consists of the PUC surcharges to the PUC, and reiterates that a direct seller shall remit local charges to the local jurisdiction or local agency imposing the charge.

- Specifies that returns are required to be filed online with the Board through the Board’s website and the amounts required to be reported to the Board are generally required to be reported and paid on a quarterly basis, unless the Board specifically requires a seller to report and pay on another basis, which may be for quarterly periods other than calendar quarters and for periods other than quarterly periods.
- Clarifies that a deduction for statutory “seller reimbursement retention” must be taken in the corresponding period in which the sale of the prepaid MTS surcharge occurred, otherwise a claim for refund must be filed.
- Clarifies that sellers, other than direct sellers, are required to remit payment for the prepaid MTS surcharges and local charges they collect by EFT if they are required, or have elected, to remit their sales and use tax liabilities by EFT, and incorporates Regulation 1707’s definition of the term EFT by reference.
- Clarifies that a seller shall maintain records and make such records available for examination in the manner set forth in Regulation 4901.
- Provides that the provisions for granting relief from liabilities due to reasonable reliance on written advice from the Board and the provisions for granting relief from liabilities to spouses and registered domestic partners in Regulations 4902 and 4903 apply to liabilities for the prepaid MTS surcharge and local charges.
- Incorporates and clarifies the statutory provisions providing relief from additional liabilities to sellers that rely in good faith on information provided by the Board to determine the prepaid MTS surcharge and local charges applicable to point-of-sale and known-address transactions.
- Specifies that a local agency or local jurisdiction must enter into a contract with the Board by September 1, 2015, in order to require sellers to collect existing local charges beginning on January 1, 2016.
- Specifies that December 1 is the annual contract due date and the following April 1 is the effective date for the collection of new local charges adopted after September 1, 2015.
- Consistently provides that December 1 is the annual contract due date and the following April 1 is the effective date for the collection of existing local charges when a local agency or jurisdiction does not meet the September 1, 2015, deadline, and thereafter first contracts with the Board to collect existing local charges after September 1, 2015.
- Explains the advance notice requirements for increases and decreases in the rates of local charges, corrections to inaccurately

posted rates of local charges, and the expiration of local charges, and the effective dates for such changes.

- States how the Board shall annually calculate the prepaid MTS surcharge rate by November 1 of each year, beginning in 2015.
- Clarifies that the total combined prepaid MTS surcharge rate and rate(s) of local charges required to be collected beginning January 1, 2016, will be calculated by the Board by November 1, 2015, and posted on the Board's website by December 1, 2015.
- Clarifies that the current combined prepaid MTS rate and rate(s) of local charges will be recalculated and posted on the Board's website by March 1 of each year, beginning in 2016, for changes made after September 1, 2015, and that the recalculated rates will be effective the following April 1.

Specifically, the revised draft of Regulation 2461, *Exemptions, Deductions, Credits, and Specific Applications of Tax*:

- Prescribes the circumstances under which prepaid MTS is purchased for resale in the regular course of business and the form of a resale certificate that may be used to document that a sale of prepaid MTS is a sale for resale, sets forth a sample "California Resale Certificate – Prepaid Mobile Telephony Services" form that meets the regulation's requirements, and establishes an alternate process to document that a sale was not a retail transaction in the event a resale certificate is not timely obtained by the seller, using provisions that are consistent with Regulation 1668 (discussed above).
- Clarifies that a seller is relieved from the liability to collect the prepaid MTS surcharge insofar as the base upon which the surcharge is imposed is represented by accounts found to be worthless and charged off for income tax purposes or, if the seller is not required to file income tax returns or report its income on another person's return, charged off in accordance with generally accepted accounting principles.
- Clarifies when a seller may take a "bad debt" deduction for the prepaid MTS surcharge and local charges paid on accounts found worthless and charged off for income tax purposes, using provisions that are consistent with Regulation 1642 (discussed above), and clarifies how to calculate the amount of an allowable deduction.
- Clarifies the application of the prepaid MTS surcharge and local charges when an account that was previously found worthless and charged off for income tax purposes is subsequently collected, using provisions that are consistent with Regulation 1642.

- Specifies the types of records a seller needs to maintain to support a bad debt deduction or claim for refund based upon worthless accounts that were charged off for income tax purposes.
- Clarifies the amount subject to the prepaid MTS surcharge and local charges when prepaid MTS is sold in combination with mobile data services, other services, or products for a single non-itemized price in a bundled transaction.
- Clarifies how the lifeline exemption from the prepaid MTS surcharge and local charges applies to “lifeline transactions” in which prepaid MTS is purchased from a seller authorized to provide lifeline services under a state or federal lifeline program.
- Specifies the credit against the prepaid MTS surcharge and local charges for prepaid consumers that previously paid 911 surcharges, state utility regulatory commission fees, state universal service charges, or local charges on the purchase of prepaid MTS to any other state, political subdivision thereof, or the District of Columbia.

Specifically, the revised draft of Regulation 2462, *Refunds of Excess Charges Collected*:

- Clarifies the meaning of “excess charges.”
- Clarifies that sellers may refund excess charges to prepaid consumers, but that excess charges collected, but not refunded to prepaid consumers, represent a debt owed to the state or jointly to a local jurisdiction imposing a local charge and the state.
- Clarifies that either a seller of prepaid MTS or a prepaid consumer may generally file a claim for refund, within the statute of limitations established by RTC sections 55222, 55222.1, and 55222.2 (in the FCPL).
- Specifies that certain claims for refund of local charges must be filed with a local agency or local jurisdiction, and not the Board.
- Cross references draft Regulation 2460’s provisions providing relief from additional liabilities to sellers that rely in good faith on information provided by the Board to determine the prepaid MTS surcharge and local charges applicable to point-of-sale and known-address transactions.

Furthermore, Formal Issue Paper 15-009 informed the Board that Board staff and the interested parties had agreed to the provisions of the revised drafts of Proposed Regulations 2460, 2461, and 2462.

Business Taxes Committee Meeting

The Board considered Formal Issue Paper 15-009 during its Business Taxes Committee meeting on September 16, 2015. During the meeting, the Board heard public comments from Mr. Fran Mancia, Director of Government Relations for MUNI Services, which represents 60 local jurisdictions and agencies, and Mr. Mancia strongly supported, and urged the Board to vote to adopt, the recommended regulations. The Board also discussed the recommended regulations.

During the Business Taxes Committee meeting, the Board agreed with staff's recommendation to propose to adopt staff's revised drafts of Regulations 2460, 2461, and 2462. Therefore, the Board Members unanimously voted to propose the adoption of the regulations.

The Board determined that the adoption of the proposed regulations is reasonably necessary to have the effect and accomplish the objective of addressing the issues referred to above, by implementing, interpreting, and making specific the Prepaid MTS Act's and Local Act's statutes regarding the application of the prepaid MTS surcharge and local charges to the purchase of prepaid MTS, and providing guidance to sellers that are required to collect the prepaid MTS surcharge and local charges from prepaid consumers, including guidance with respect to their registration and reporting requirements, the payment and collection of the prepaid MTS surcharge and local charges, record keeping, sales of prepaid MTS for resale, bad debts, bundled transactions, lifeline transactions, credits, relief from liability, excess charges, and claims for refund.

The Board further determined that the adoption of the proposed regulations is reasonably necessary to have the effect and accomplish the objective of providing guidance to local agencies and jurisdictions with respect to local charges, their notice requirements, contracting with the Board, the Board's posting and calculation of combined rates, and the Board's and local jurisdictions' and agencies' functions with regard to the administration of local charges.

The Board anticipates that the adoption of the proposed regulations will benefit the Board, Board staff, sellers and consumers of prepaid MTS, and local jurisdictions and agencies by:

- Clarifying the application of the prepaid MTS surcharge and local charges for sellers and consumers of prepaid MTS.
- Providing regulatory guidance to sellers, including direct sellers, of prepaid MTS regarding their registration, collection, reporting, and payment requirements under the Prepaid MTS Act and Local Act.
- Clarifying the Board's and local agencies' and local jurisdictions' duties with respect to the collection and administration of local charges, including clarifying that it is the responsibility of a local

agency or local jurisdiction to contract with the Board to collect and administer its local charges, and provide adequate written notice to the Board when adding, increasing, or decreasing local charges, when local charges are expiring, or there is an error in the rate of local charges posted on the Board's website.

- Adding an alternative contract due date and effective date for the collection and administration of existing local charges when a local agency or jurisdiction first contracts with the Board to collect existing local charges after September 1, 2015.
- Prescribing the form of a resale certificate that may be used to document that a sale of prepaid MTS was for purposes of resale in the regular course of business.

The Board has performed an evaluation of whether proposed Regulations 2460, 2461, and 2462 are inconsistent or incompatible with existing state regulations and determined that the proposed regulations are not inconsistent or incompatible with existing state regulations. This is because proposed Regulations 2460, 2461, and 2462 are the only state regulations that specifically implement, interpret, and makes specific the statutes regarding the application of the prepaid MTS surcharge and local charges to the purchase of prepaid MTS, and prescribe the form of the California resale certificate that the purchaser must furnish to document that the sale is for purposes of resale in the regular course of business. In addition, the Board has determined that there are no comparable federal regulations or statutes to proposed Regulations 2460, 2461, and 2462.