

Agenda Report

TO: CITY COUNCIL

DATE: September 17, 2007

FROM: CITY MANAGER

SUBJECT: SPECIAL MUNICIPAL ELECTION REGARDING A MEASURE
RELATED TO THE CITY'S UTILITY USERS TAX AMENDING
CHAPTER 4.56 OF THE CITY OF PASADENA MUNICIPAL CODE
TO MODERNIZE THE APPLICATION OF THE UTILITY USERS
TAX

RECOMMENDATION:

It is recommended that the City Council direct the City Attorney to prepare and return by October 22, 2007 with the necessary resolutions of the City Council to submit to the qualified electors of the city at a February 5, 2008, Special Municipal Election a Measure related to the City's Utility Users Tax amending Chapter 4.56 of the City of Pasadena Municipal Code to modernize the application of the Utility Users Tax.

EXECUTIVE SUMMARY:

As a result of changes in federal regulations, litigation and potential legislation, the City of Pasadena, along with all other cities in California with Utility Users Taxes (UUT), face the possible loss of these revenues as they relate to telecommunications. In order to protect these revenues an update to the definitions contained in the City's UUT ordinance is required. In accordance with the requirements of proposition 218 such an update necessitates a vote of the people. Staff recommends that the City Council proceed in this fashion.

Without the revenue from the existing UUT, the City could be forced to make cuts in programs and services that would affect all residents, such as street repair, park maintenance, and public safety such as 9-1-1 emergency and ambulance services.

BACKGROUND:

Since 1969, the City of Pasadena, like many other cities throughout California, has used a Utility Users Tax (UUT) to fund critical community services such as parks, public safety, recreation and after-school programs. And since 1976, the City has applied a telephone users tax on the use of telephone communications

services. Presently, the tax is applied at a rate of 8.28% of the charges billed. The City's tax has been historically applied in a similar manner as the application of the Federal Excise Tax (FET) upon local and long distance telecommunication services as the FET is interpreted by the Internal Revenue Service (IRS).

With the growth of wireless communications, a national dispute arose regarding the application of the FET to long distance phone calls. The FET statute defines long distance or "toll" calls as those for which charges varied according to both the elapsed time of the call and the distance between the persons on the call. Today, long distance calls are based on time only, or in the case of cellular calls, they are based on a flat monthly rate.

On May 25, 2006, the IRS issued a Notice that it intended to stop applying the Federal Excise Tax (FET) to nearly all telephone communication services, except local exchange services, which leaves only about 25% of all the telecommunication services as federally taxable. This IRS action came following many federal court losses involving the outdated definition of "toll telephone service" (or long distance) contained in the FET. In addition to conceding that the FET no longer applies to wired and wireless long distance services which are billed on time only, and not both time and distance (and other bundled services such as Voice Over Internet Protocol and prepaid cards), the Secretary of the Treasury has further urged Congress to repeal the FET, arguing that it does not make sense to continue the tax on such a small segment of the telecommunication industry.

Like the vast majority of California cities that have a UUT, Pasadena's ordinance referred to the FET and some of its many exemptions, in response to the telephone companies' request of many years ago to do so to achieve administrative ease. The Treasury Department's May 25th Notice reversed its prior Revenue Rulings and interpretation of the FET, which the City relied upon in applying the telephone users tax to telecommunications services. There is now a legal question as to whether the IRS Ruling, which dramatically reduces the scope of taxable services, applies to the City's UUT. This issue is now in litigation in three class action lawsuits against UUT public agencies in the Los Angeles area. Furthermore, there have been efforts in Congress to repeal this body of law in its entirety. In response on April 2, 2007, City Council amended the UUT ordinance, declaring that the repeal of the FET has no effect (i.e., "de-link" UUT from FET) because the City's ordinance is based on the understanding of the FET in effect when the ordinance was adopted. The merits of this approach have yet to be tested.

In addition to the FET issue and its application to the City's UUT ordinance, there is another lawsuit pending against the City of Los Angeles, which raises additional legal issues as a result of outdated definitions that are typical of most California UUT ordinances. This lawsuit poses additional threat to the City's

telecomm wireless UUT revenues. The City of Los Angeles lost at the trial court, and an appellate court decision is expected as early as next spring.

In fiscal year 2008 total budgeted UUT revenues were \$28.8 million; of which UUT related to telecommunications represented \$10.4 million or 5% of General Fund revenues. Potentially, 75% or more of the telecommunications revenues are at risk, and an amount equivalent to one year's collections may be required to be refunded upon request of individual taxpayers. And although the City has established a reserve of approximately \$7 million should the loss of UUT telecommunications revenues become reality, the concurrent imposition of refunds and the ongoing loss of revenues provides for a potentially devastating impact on the General Fund.

Updating the definitions of telecommunications in the City's UUT ordinance would eliminate the issues raised by the repeal of the FET and the LA lawsuit. And while the City's UUT has been in place nearly 40 years, the provisions of California's proposition 218 necessitate that any such update be subject to vote of the people. Accordingly, staff is recommending that the City Council direct the City Attorney to develop an amendment to modernize the UUT ordinance related to telecommunications and prepare the necessary resolution to submit the item to voters at a February 5, 2008, special municipal election to coincide with the statewide primary election.

The proposed amendment would update the telecommunications definitions and other provisions, including not limited to, the elimination of reference to the FET. Importantly, the new definitions will be technology-neutral and reflect the modern use of communications so that all taxpayers will be treated equitably. Importantly, these changes are expected to be cost-neutral to current users of telecommunications. The following is a brief summary of the proposed amendments/updates to the City's UUT relative to telecommunication services:

- A modern, functional definition of telecommunication services that is technology-neutral, and includes the use of internet protocol (VoIP), broadband service, Wi-Fi, DSL and private networks for providing data, video and voice services (all of which are now defined as taxable "communication services"), including ancillary services such as caller identification and text messaging. In addition to protecting the tax base, this updated definition will achieve tax equity, insofar as those consumers who are able to afford newly developed technology will be subject to the same tax as those who must rely upon the traditional public switched network;
- Anticipation of new technologies and services to provide telecommunication and video services, or changes in state or federal law, so that all taxpayers will be treated the same;

- Assurance that the communications tax will be properly collected and that are revenues will be properly expended through the use of third-party auditors;
- Guidelines for sourcing and nexus issues with respect to the taxation of cellular telephony.

As described above, this is not a new tax, and the rate will not increase. This measure will simply update and continue an existing tax that residents are currently paying, while maintaining important exemptions for low-income seniors and disabled residents. The updates would include tough fiscal accountability provisions including annual independent financial audits for the public to review. Funds generated will continue to stay in Pasadena and can only be used to protect and maintain the services local residents rely on for their quality of life.

The utility user tax is an important revenue source to the city. Modernizing this ordinance allows the City to continue to provide programs and services for local children. For example, updating and extending the UUT ensures that over 2,000 Pasadena youth will continue to have recreation and summer camp programs available to them, which will keep them off the streets and out of trouble.

The continuation of the UUT will also ensure that the Police Department will maintain its special Neighborhood Action Team, which plays such an important role in keeping gang members and drug dealers out of local neighborhoods. With 80,000 gang members and 1,200 gangs in Los Angeles County, we cannot afford to reduce public safety funding. Without the renewal of the existing UUT, the City could be forced to make significant cuts in programs and services that could affect every constituent such as public safety, anti-gang programs and youth recreation programs.

Upon returning to City Council staff will present a series of resolutions for adoption. These resolutions will include: a resolution calling and giving notice to place the measure on the ballot; A resolution requesting the Board of Supervisors of the County of Los Angeles to authorize and order the consolidation of the special municipal election with the statewide presidential primary and requesting the County Clerk/Registrar to provide certain services; and a resolution setting priorities for filing written arguments and directing the City Attorney to prepare an impartial analysis. And, should the Council desire a resolution to authorize rebuttal arguments.

FISCAL IMPACT:

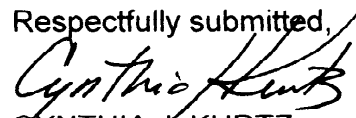
Failure to modernize the City's UUT relative to telecommunication services could result in a loss of 75 to 100% of the telecommunications related portion of the UUT or upwards to approximately \$10.4 million dollars annually from the General Fund, which could have a substantial impact on the City's ability to provide essential services, including public safety.

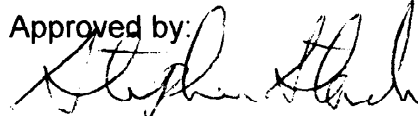
The costs associated with consolidating a special municipal election with the state presidential primary election are estimated as follows:

- County/Registrar consolidation cost:
 - Sharing with state and county \$230,000
 - Sharing with state only (i.e. no county measures) \$305,000
- Publications of legal notices in English, Spanish and Chinese \$4,000
- Translation of election materials in Spanish and Chinese \$7,000
- Optional - Printing and mailing of supplemental bilingual voter information pamphlet \$71,000

Total estimated costs \$241,000 - \$387,000

Funding is to be provided through use of the UUT reserve which has a current balance of \$6.99 million.

Respectfully submitted,

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City Manager

Approved by:

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Prepared by:

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