

Agenda Report

TO: City Council April 24, 2000

THROUGH: Legislative Committee

FROM: Cynthia J. Kurtz, City Manager

SUBJECT: Opposition to legislation that creates a loss or potential loss of revenue pertaining to Internet related activities

RECOMMENDATION

It is recommended that the City Council adopt the attached resolution and authorize the Mayor to send letters to the appropriate officials opposing:

1. Legislation that creates a potential loss of future revenue from Internet access fees and produces a potential administrative burden for the City by requiring separation of Internet access revenues from other revenues that are subject to local taxes;
2. Legislation that creates a loss or potential loss of existing and future revenues by exempting Internet orders from local sales and use taxes;
3. Legislation that creates a potential loss of revenues by exempting specified telecommunications purchases related to Internet services from State sales and use taxes, and creates an administrative burden and cost for the City by separating the collection of state sales tax and local sales tax;
4. Legislation that preempts the City's ability to impose taxes on activities that fall under the jurisdiction of local government
5. The following legislation: AB 1784 (Lempert): Internet Tax Freedom Act: Permanent Extension, SB 1377 (Haynes): Sales and Use Tax Exemption: Internet Orders, AB 2188 (Baldwin): Sales and Use Taxes: Exemption: Internet Purchases, SB 1556 (Brulte): Sales and use Tax Exemption: Telecommunications Services.

BACKGROUND

The issues of appropriate taxation on Internet transactions and the mechanisms that would be required for collection of said taxes are being reviewed at all levels of government - Federal, State and Local. Comprehensive guidelines need to be established at the Federal and State levels to address these issues and to avoid creating arbitrary or conflicting legislation. Legislation introduced absent these guidelines is premature and could negatively impact the City. The City needs to voice its opposition to legislation that restricts the City's rights on issues pertaining to Internet transactions pending development of comprehensive guidelines and coordination of the issues.

There are currently four bills before the State Legislature that would negatively impact the City financially. These bills would be fiscally damaging to the City because they restrict the ability of local governments to generate revenues from Internet related activities.

Discussion

Assembly Bill 1784: Internet Tax Freedom Act: Permanent Extension

In 1998, the California Internet Tax Freedom Act, AB 1614 (Lempert) placed a moratorium on specific taxation on the Internet until January 1, 2002. Assembly Bill 1784 (Lempert) would extend the moratorium for taxation on the access fee portion of Internet service indefinitely, making it permanent. Cable and telephone providers are currently offering each other's services, as well as Internet services, in cities across the state. Cable providers offering Internet access services are paying a franchise fee on revenue derived from providing that service to their cable customers. With the convergence of services, it may be extremely difficult or impossible for Cities to separate traditional municipal tax streams, such as a video transmission subject to a cable franchise fee, or a telephone call subject to a utility user tax, from the "tax free" Internet access realm. This bill is premature because both the federal and state governments are still in the process of studying this issue, and the existing moratorium on Internet access fee taxation is not scheduled to expire until January 1, 2002.

AB 1784 was introduced by Assemblyman Lempert on January 26, 2000, as a non-urgency statute. The bill was referred to the Assembly Committee on Revenue and Taxation and the Assembly Committee on Information Technology on January 31, 2000.

Senate Bill 1377 and Assembly Bill 2188: Sales and Use Tax Exemption: Internet Orders/Purchases

Senate Bill 1377 (Haynes) and Assembly Bill 2188 (Baldwin) are identical bills that would amend the State Revenue and Taxation Code to exempt tangible personal property ordered over the Internet from local sales and use taxes. Both bills also provide that the State would not reimburse local agencies for revenues lost as a result of the bills. These bills would create a sales tax haven for Internet transactions that would result in a dramatic reduction in current and future revenues for local governments.

SB 1377 was introduced by Senator Haynes on January 20, 2000, as a non-urgency statute. The bill was referred to the Senate Committee on Revenue and Taxation on February 3, 2000. On March 9, 2000 the bill was received from committee with the author's amendments, read a second time, amended and re-referred to Committee. The bill is currently set for hearing on March 29, 2000.

AB 2188 was introduced by Assemblyman Baldwin on February 23, 2000, as a non-urgency statute. The bill was referred to the Assembly Committee on Revenue and Taxation and the Assembly Committee on Information Technology on February 24, 2000. The bill may be heard in committee on March 25, 2000.

Senate Bill 1556: Sales and Use Tax Exemption: Telecommunications Services

Senate Bill 1556 (Brulte) would amend the State Revenue and Taxation Code to exempt tangible personal property purchased primarily for furnishing telecommunications services for Internet services or to upgrade cable TV facilities to enable telecommunications and digital subscriber line equipment from state sales and use taxes. In addition, purchases related primarily to research and development for furnishing those services or to maintain, repair, measure, or test the property used primarily in furnishing those services would also be exempt from state sales and use taxes. The exemption does not apply to local sales and use taxes or transactions and use taxes or specified additions to state sales and use tax for public safety and local revenue purposes. This bill establishes a precedent that could eventually be extended to local taxes, resulting in a reduction of current and future revenues for local governments. The bill also creates an administrative burden for local governments by separating the collection of state sales tax and local sales tax.

SB 1556 was introduced by Senator Brulte on February 17, 2000, as a non-urgency statute. The bill was referred to the Senate Committee on Revenue and Taxation on March 9, 2000. The bill is currently set for hearing on April 12, 2000.

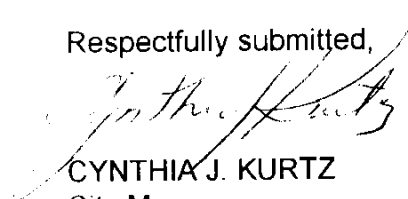
FISCAL IMPACT

AB 1784 would have no immediate fiscal impact to the City of Pasadena because of the existing moratorium on taxation of Internet access fees. Nevertheless, the passage of this bill establishes a bad precedent of further State preemption of local control. The permanent moratorium could result in the potential loss of a major revenue source as the demand for Internet access grows and is provided by more and diverse companies.

SB 1377 and AB 2188 would be fiscally damaging because of the reduction in sales and use tax revenues for tangible personal property ordered over the Internet. As the use of the Internet to obtain products and services increases, the potential loss of future revenues also increases. These bills also represent further erosion of local government's control and ability to generate revenues, with no corresponding reimbursement from the State for imposing restrictions on taxation.

SB 1556 has the potential to negatively impact the City's ability to generate revenues from Internet related purchases. The proposed exemption from State taxes could result in the extension of a similar tax exemption to the local level in the future. In addition, the proposed exemption from State taxes would create administrative costs for the City to enable collection of local sales tax.

Respectfully submitted,



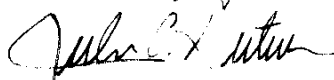
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