

Communications Services Tax Working Group

January 18, 2013 Meeting Materials

Agenda Item #1

No Materials

Agenda Item #2
Draft Meeting Minutes

COMMUNICATIONS SERVICES TAX WORKING GROUP

October 31, 2012

ROOM 1820, BUILDING ONE, 2450 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA

DRAFT MINUTES

MEMBERS PRESENT: Marshall Stranburg, Chair
Charles Dudley
Sharon R. Fox
Kathleen Kittrick
Gary S. Lindsey
The Honorable Gary Resnick
Alan S. Rosenzweig
Brian D. Smith
Davin J. Suggs

Agenda Items:

1. *Call to Order*

Chair Stranburg called the meeting to order.

Roll call was taken and all Working Group members were present in the room except for Mayor Resnick who attended via WebEx.

Chair Stranburg discussed the following:

- This is a non-rule public meeting held under Section 120.525, Florida Statutes.
- A court reporter is present who is creating a transcript.
- Speaker cards were available for anyone who would like to speak.
- The Department of Revenue has created a web page for the Working Group where agendas, meeting materials, transcripts and other information relative to the Working Group will be posted. Hard copies of the materials were available at the meeting for the public.
- It was announced that if anyone would like to receive updates about the working group by email, they could provide their email address with the understanding that their email address will be considered a public record and subject to disclosure if requested.
- The procedures for persons participating in the meeting via WebEx were explained.

Chair Stranburg outlined a potential schedule for members for completion of the Working Group's tasks and asked members to review their schedules for potential meetings in November and December in order to accomplish that goal.

2. Follow-up from previous meeting

Chair Stranburg discussed that information and materials requested by members from the previous meetings were provided in the back-up materials.

Mr. Suggs provided information he indicated at the previous meeting he would research. These materials were handed out to members that morning and discussed during the meeting.

Working Group members asked Bob McKee, Chief Economist of the Department of Revenue's Office of Tax Research, to discuss the materials they had asked his office to prepare at the previous meeting. The Working Group requested information on a potential revenue estimate from assessing a flat rate of \$.50 on prepaid transactions; the rate of discretionary sales surtax necessary to replace local Communications Services Tax (CST); and, an estimate on the rate of sales and use tax necessary to replace CST revenues.

3. Discussion of written comments and options

Chair Stranburg noted that potential options from Alan Rosenzweig had been received and were now included in the materials with all potential options that had been previously submitted. The discussion was continued on the Working Group members' potential options from the prior meeting.

Mr. Suggs discussed the draft materials from the Florida Association of Counties concerning the Working Group's charge.

Members discussed the potential options related to prepaid communications services. Potential options that were discussed included the modernization of the definition of prepaid communications services as well as alternative methods of taxation.

4. Continued discussion of written comments and options

After the lunch break, the members discussed the last two issues that remained on the summary document of potential options.

Mr. Suggs suggested that the potential solutions appeared to fall into three categories: Fix the CST; Partial Replacement of the CST; and Holistic Replacement of the CST with sales and use tax.

Each of the Working Group members discussed their own view on the priority order of these three potential solutions and identified concerns about the choices. Mayor Resnick added he felt there were two additional options of leaving the CST alone or going back to the system that was in place prior to the CST.

The view of Working Group members indicated that the holistic solution of replacing the CST with sales and use tax may be the best recommendation to resolve issues. The Working Group members then began working on a list of issues that may need to be addressed if the law is changed in this manner. Examples of issues to be addressed included:

- Address how digital goods would be handled in sales and use tax
- Address definitions to simplify implementation – consider Streamlined Sales and Use Tax Agreement definitions
- Address local revenue sharing and distributions with a need to be able to adjust for annexations
- Provide a policy analysis showing the impact on end users
- Identify technical implementation issues
- Ensure neutral fiscal impact for all parties (state, local, and PECO)
- Include a definition of neutrality, and address absence of prepaid and unused capacity
- Recognize need for unrestricted revenues for local governments
- Specify that the sales and use tax is a replacement revenue for CST
- Recognize that the CST was a trade of local taxes and fees
- Recognize this approach would simplify administration, compliance and audit issues
- Maintain ability for current and future bonding and ensure that current bonding is not jeopardized
- Consider tax policy preamble
- Address bundling issues
- Review Virginia law regarding right-of-way access fees
- Replicate unique CST exemptions in sales and use tax.

The members were asked to compile their own list of any issues they feel should be added to the list of issues and send them to staff for distribution to other members and the public by November 16.

5. Other business

Working Group members decided to hold their next meeting on Friday, December 7.

6. *Adjournment*

The meeting was adjourned.

COMMUNICATIONS SERVICES TAX WORKING GROUP

December 7, 2012

ROOM 1820, BUILDING ONE, 2450 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA

DRAFT MINUTES

MEMBERS PRESENT: Marshall Stranburg, Chair
Charles Dudley
Sharon R. Fox
Kathleen Kittrick
Gary S. Lindsey
The Honorable Gary Resnick
Alan S. Rosenzweig
Brian D. Smith
Davin J. Suggs

Agenda Items:

1. *Call to Order*

Chair Stranburg called the meeting to order.

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- A court reporter is present who is creating a transcript.
- Speaker cards were available for anyone who would like to speak.
- The Department of Revenue has created a web page for the Working Group where agendas, meeting materials, transcripts and other information relative to the Working Group will be posted. Hard copies of the materials were available at the meeting for the public.
- It was announced that if anyone would like to receive updates about the working group by email, they could provide their email address with the understanding that their email address will be considered a public record and subject to disclosure if requested.
- The procedures for persons participating in the meeting via WebEx were explained.

2. *Minutes of the October 16, 2012, meeting were approved.*

3. *Follow-up from previous meeting*

Information from Visit Florida regarding sales tax collections, which related to tourism, was provided.

Information from Working Group member Gary Lindsey regarding Virginia's law on public rights-of-way use fees and his comments regarding the holistic approach were provided.

Comments from Working Group member Sharon Fox regarding the proposed options were provided and discussed.

4. *Discussion of options*

Members continued their discussion of potential options to include in the Working Group's report. The discussion further refined issues under the Holistic Replacement option.

5. *Other business*

Members discussed the approach to preparation and approval of the report. The following schedule was developed. Staff would provide a draft of the report to Working Group members by January 4. Members would submit comments on the draft by January 11. A meeting of the Working Group to review and discuss the report would occur on January 18 by telephone conference; and, if necessary, a final telephone conference meeting would be held on January 28.

John Barnes of MetroPCS appeared by telephone to provide information to the Working Group on the written comments that MetroPCS submitted on December 6, 2012.

6. *Adjournment*

The meeting was adjourned.

Agenda Item #3

Follow-Up from Previous Meeting

Andrea Moreland - Fwd: Draft federal legislation to address taxation of digital goods and services without requiring or prohibiting states from taxing such goods and services

From: Andrea Moreland
To: Moreland, Andrea
Date: 12/14/2012 4:03 PM
Subject: Fwd: Draft federal legislation to address taxation of digital goods and services without requiring or prohibiting states from taxing such goods and services
Attachments: Draft federal legislation to address taxation of digital goods and services without requiring or prohibiting states from taxing such goods and services

Please see the attached e-mail from Mayor Resnick.

Andrea

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Andrea Moreland - Draft federal legislation to address taxation of digital goods and services without requiring or prohibiting states from taxing such goods and services

From: Gary Resnick <Gary.Resnick@gray-robinson.com>
To: 'Andrea Moreland' <morelana@dor.state.fl.us>
Date: 12/14/2012 1:43 PM
Subject: Draft federal legislation to address taxation of digital goods and services without requiring or prohibiting states from taxing such goods and services

Andrea

Please forward this to the CST taskforce. Below is the text of a draft bill that the National Governors Association has developed with industry for introduction in the next Congress. The legislation, according to NGA: "provides a framework for sourcing the taxation of digital goods and services without requiring or prohibiting states from taxing such goods and services. Whether to tax and at what rates are left to the states with the caveat that similar goods and services need to be taxed the same in both the digital and tangible worlds."

While this is in no way the final draft of such bill, and of course, we do not know what, if any, final legislation Congress will pass, if ultimately the federal government authorizes States to tax such digital services and how to source such services, we should examine whether FL would be able to do so. Thanks.

Gary

H.R. _____

To promote neutrality, simplicity, and fairness in the taxation of digital goods and digital services.

IN THE HOUSE OF REPRESENTATIVES

Mr. _____ (for himself, _____) introduced the following bill; which was referred to the Committee on
the Judiciary

A BILL

To promote neutrality, simplicity, and fairness in the taxation of digital goods and digital services.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled

SECTION 1. SHORT TITLE.

This Act may be cited as the “Digital Goods and Services Tax Fairness Act of 2012”.

SEC. 2. MULTIPLE AND DISCRIMINATORY TAXES PROHIBITED.

No State or local jurisdiction shall impose multiple or discriminatory taxes on the sale or use of a digital good or a digital service.

SEC. 3. SOURCING LIMITATION.

Taxes, subject to Section 6(a), on the sale of a digital good or a digital service may only be imposed by a State or local jurisdiction whose territorial limits encompass the customer tax address.

SEC. 4. CUSTOMER TAX ADDRESS.**(a) SELLER OBLIGATION.—**

(1) **IN GENERAL.**—Subject to subsection (e)(2), a seller shall be responsible for obtaining and maintaining in the ordinary course of business the customer tax address with respect to the sale of a digital good or a digital service, and shall be responsible for collecting and remitting the correct amount of tax for the State and local jurisdictions whose territorial limits encompass the customer tax address if the State has the authority to require such collection and remittance by the seller.

(2) **CERTAIN TRANSACTIONS.**—When a customer tax address is not a business location of the seller under paragraph (A) of section 7(2)—

(A) if the sale is a separate and discrete transaction, then a seller must use reasonable efforts to obtain a customer tax address described in paragraph (C), (D), or (E) of section 7(2) of this Act before resorting to using a customer tax address as determined by paragraph (F) of section 7(2) of this Act; and

(B) if the sale is not a separate and discrete transaction, then a seller must use reasonable efforts to obtain a customer tax address described in paragraph (B), (C), (D) or (E) of section 7(2) of this Act before resorting to using a customer tax address as determined by paragraph (F) of section 7(2) of this Act.

(b) **RELIANCE ON CUSTOMER-PROVIDED INFORMATION.**—A seller that relies in good faith on information provided by a customer to determine a customer tax address shall not be held liable for any additional tax based on a different determination of that customer tax address by a State or local jurisdiction or court of competent jurisdiction, except if and until binding notice is given as provided in subsection 4(c).

(c) **ADDRESS CORRECTION.**—If a State or local jurisdiction is authorized under State law to administer a tax, and the jurisdiction determines that the customer tax address determined by a seller is not the customer tax address that would have been determined under section 7(2) if the seller had the additional information provided by the State or local jurisdiction, then the jurisdiction may give binding notice to the seller to correct the customer tax address on a prospective basis, effective not less than 45 days after the date of such notice, if—

(A) if the determination is made by a local jurisdiction, such local jurisdiction obtains the consent of all affected local jurisdictions within the State before giving such notice of determination; and

(B) before the State or local jurisdiction gives such notice of determination, the customer is given an opportunity to demonstrate in accordance with applicable State or local tax administrative procedures that the address used is the customer tax address.

(d) **COORDINATION WITH SOURCING OF MOBILE TELECOMMUNICATIONS SERVICE.**— If (1) a digital good or a digital service is sold to a customer by a home service provider, as defined in section 124 of title 4, United States Code, of mobile telecommunications service, as also defined in such section, that is subject to being sourced under section 117 of such title, or the charges for a digital good or a digital service are billed to the customer by such a home service provider, and (2) the digital good or digital service is delivered, transferred, or provided electronically by means of mobile telecommunications service that is deemed to be provided by such home service provider under section 117 of such title, then the home service provider and, if different, the seller of the digital good or digital service, may presume that the customer’s place of primary use, as defined in section 124 of such title, for such mobile telecommunications service is the customer tax address described in section 7(2)(B) of this Act with respect to the sale of such digital good or digital service.

(e) MULTIPLE LOCATIONS.—

(1) **IN GENERAL.**—If a digital good or a digital service is sold to a customer and available for use by

the customer in multiple locations simultaneously, the seller may determine the customer tax addresses using a reasonable and consistent method based on the addresses of use as provided by the customer and determined in agreement with the customer at the time of sale.

(2) DIRECT CUSTOMER PAYMENT.—Each State and local jurisdiction shall provide reasonable procedures that permit the direct payment by a qualified customer, as determined under procedures established by the State or local jurisdiction, of taxes that are on the sale of digital goods and digital services to multiple locations of the customer and that would, absent such procedures, be required or permitted by law to be collected from the customer by the seller. When a qualified customer elects to pay tax directly under such procedures, the seller shall have no obligation to obtain the multiple customer tax addresses under subsection (a) and will not be liable for such tax, provided the seller follows the State and local procedures and maintains appropriate documentation in its books and records.

SEC. 5. TREATMENT OF BUNDLED TRANSACTIONS AND DIGITAL CODES.

(a) BUNDLED TRANSACTION.—If a charge for a distinct and identifiable digital good or a digital service is aggregated with and not separately stated from one or more charges for other distinct and identifiable goods or services, which may include other digital goods or digital services, and any part of the aggregation is subject to taxation, then the entire aggregation may be subject to taxation except to the extent that the seller can identify, by reasonable and verifiable standards, one or more charges for the nontaxable goods or services from its books and records kept in the regular course of business.

(b) DIGITAL CODE.— The tax treatment of the sale of a digital code shall be the same as the tax treatment of the sale of the digital good or digital service to which the digital code relates. The sale of the digital code shall be considered the sale transaction for purposes of this Act.

SEC. 6. NO INFERENCE.

(a) CUSTOMER LIABILITY.—Nothing in this Act modifies, impairs, supersedes, or authorizes the modification, impairment, or supersession of any law allowing a State or local jurisdiction to impose tax on and collect tax directly from a customer based upon use of a digital good or digital service in such State, subject to the prohibition provided in section 2.

(b) NON-TAX MATTERS. This Act shall not be construed to apply in, or to affect, any non-tax regulatory or other context.

(c) STATE TAX MATTERS. The definitions contained in this Act are intended to be used with respect to interpreting this Act. Nothing in this Act shall prohibit a State or local jurisdiction from adopting different nomenclature to enforce the provisions set forth in this Act.

SEC. 7. DEFINITIONS.

In this Act:

(1) CUSTOMER.— The term “customer” means a person that purchases a digital good, digital service, or digital code.

(2) CUSTOMER TAX ADDRESS.— The term “customer tax address” includes the plural of customer tax addresses, unless the context requires otherwise. The term “customer tax address” means—

(A) with respect to the sale of a digital good or digital service that is received by the customer at a business location of the seller, such business location;

(B) if subparagraph (A) does not apply and the primary use location of the digital good or digital service is known by the seller, such location;

(C) if neither subparagraph (A) nor subparagraph (B) applies, and if the location where the digital good or digital service is received by the customer, or by a donee of the customer that is identified by such customer, is known to the seller and maintained in the ordinary course of the seller’s business, such location;

(D) if none of subparagraphs (A) through (C) applies, the location indicated by an address for the customer that is available from the business records of the seller that are maintained in the ordinary course of the seller’s business, when use of the address does not constitute bad faith;

(E) if none of subparagraphs (A) through (D) applies, the location indicated by an address for the customer obtained during the consummation of the sale, including the address of a customer’s payment instrument, when use of this address does not constitute bad faith; or

(F) if none of subparagraphs (A) through (E) applies, including the circumstance in which

the seller is without sufficient information to apply such paragraphs, the location from which the digital good was first available for transmission by the seller (disregarding for these purposes any location that merely provides for the digital transfer of the product sold), or from which the digital service was provided by the seller.

For purposes of this subsection (2), the term "location" does not include the location of a server, machine, or device, including an intermediary server, that is used simply for routing or storage.

(3) DELIVERED OR TRANSFERRED ELECTRONICALLY; PROVIDED ELECTRONICALLY.—The term "delivered or transferred electronically" means the delivery or transfer by means other than tangible storage media, and the term "provided electronically" means the provision remotely via electronic means. (4) DIGITAL CODE.—The term "digital code" means a code that conveys only the right to obtain a digital good or digital service without making further payment.

(5) DIGITAL GOOD.—The term "digital good" means any software or other good that is delivered or transferred electronically, including sounds, images, data, facts, or combinations thereof, maintained in digital format, where such good is the true object of the transaction, rather than the activity or service performed to create such good, and includes, as an incidental component, charges for the delivery or transfer of the digital good.

(6) DIGITAL SERVICE.—

(A) IN GENERAL.—The term "digital service" means any service that is provided electronically, including the provision of remote access to or use of a digital good, and includes, as an incidental component, charges for the electronic provision of the digital service to the customer.

(B) EXCEPTIONS.—

(i) IN GENERAL.—The term "digital service" does not include a service that is predominantly attributable to the direct, contemporaneous expenditure of live human effort, skill, or expertise, a telecommunications service, an ancillary service, Internet access service, audio or video programming service, or a hotel intermediary service.

(ii) ANCILLARY SERVICE.—For purposes of subclause (i), the term "ancillary service" means a service that is associated with or incidental to the provision of telecommunications services, including but not limited to detailed telecommunications billing, directory assistance, vertical service, and voice mail services.

(iii) TELECOMMUNICATIONS SERVICE.—For purposes of subclause (i), the term "telecommunications service" means the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points. The term "telecommunications service" includes such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code or protocol of the content for purposes of transmission, conveyance or routing, without regard to whether such service is referred to as voice over Internet protocol service, but does not include data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser where such purchaser's primary purpose for the underlying transaction is the processed data or information.

(iv) INTERNET ACCESS SERVICE.—For purposes of subclause (i), the term "Internet access service" means a service that enables users to connect to the Internet, as defined in the Internet Tax Freedom Act (47 U.S.C. 151 note), to access content, information, or other services offered over the Internet.

(v) AUDIO OR VIDEO PROGRAMMING SERVICE.—For purposes of subclause (i), the term "audio or video programming service" means programming provided by, or generally considered comparable to programming provided by, a radio or television broadcast station.

(vi) VIDEO PROGRAMMING SERVICE.—For purposes of subclause (v), the term "video programming service" shall not include interactive on-demand services, as defined in paragraph 12 of section 522 of title 47, United States Code, pay-per-view services, or

services generally considered comparable to such services regardless of the technology used to provide such services.

(vii) HOTEL INTERMEDIARY SERVICE.—For purposes of subclause (i), the term “hotel intermediary service” means a service provided by a person that facilitates the sale, use, or possession of a hotel room or other transient accommodation to the general public. It does not include the purchase of a digital service by a person who provides a hotel intermediary service or by a person who owns, operates or manages hotel rooms or other transient accommodations.

(7) DISCRIMINATORY TAX.—The term “discriminatory tax” means any tax imposed by a State or local jurisdiction on digital goods or digital services that—

(A) is not generally imposed and legally collectible by such State or local jurisdiction on transactions involving similar property, goods, or services accomplished through other means;

(B) is not generally imposed and legally collectible at the same or higher rate by such State or local jurisdiction on transactions involving similar property, goods, or services accomplished through other means;

(C) imposes an obligation to collect or pay the tax on a person, other than the seller, than the State or local jurisdiction would impose in the case of transactions involving similar property, goods, or services accomplished through other means;

(D) establishes a classification of digital services or digital goods providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar property, goods, or services accomplished through other means; or

(E) does not provide a resale and component part exemption for the purchase of digital goods or digital services in a manner consistent with the State’s resale and component part exemption applicable to the purchase of similar property, goods, or services accomplished through other means.

(8) MULTIPLE TAX.—

(A) IN GENERAL.—The term “multiple tax” means any tax that is imposed by one State and/or one or more of that State’s local jurisdictions on the same or essentially the same digital goods and digital services that is also subject to tax imposed by another State and/or one or more local jurisdictions in that State (whether or not at the same rate or on the same basis), without a credit for taxes paid in other jurisdictions.

(B) EXCEPTION.—Such term shall not include a tax imposed by a State and one or more political subdivisions thereof on the same digital goods and digital services or a tax on persons engaged in selling digital goods and digital services which also may have been subject to a sales or use tax thereon.

(9) PRIMARY USE LOCATION.—The term “primary use location” means a street address representative of where the customer’s use of a digital good or digital service will primarily occur, which must be the residential street address or a business street address of the actual end user of the digital good or digital service, including, if applicable, the address of a donee of the customer that is designated by the customer. If the customer is not an individual, the primary use location is determined by the location of the customer’s employees or equipment (machine or device) that make use of the digital good or digital service, but does not include the location of a person who uses the digital good or digital service as the purchaser of a separate good or service from the customer.

(10) SALE AND PURCHASE.—The terms “sale” and “purchase”, and all variations thereof, shall include the provision, lease, rent, license, and corresponding variations thereof.

(11) SELLER.—The term “seller” means a person making sales of digital goods or digital services. A person that provides billing service or electronic delivery or transport service on behalf of another unrelated or unaffiliated person, with respect to the other person’s sale of a digital good or digital service, shall not be treated as a seller of that digital good or digital service. Nothing in this provision shall preclude the person providing the billing service or electronic delivery or transport service from entering into a contract with the seller to assume the tax collection and remittance responsibilities of the seller.

(12) SEPARATE AND DISCRETE TRANSACTION.— The term “separate and discrete transaction” means a

sale of a digital good, digital code or a digital service sold in a single transaction which does not involve any additional charges or continued payment in order to maintain possession of the digital good or access to the digital service.

(13) STATE OR LOCAL JURISDICTION.—The term “State or local jurisdiction” means any of the several States, the District of Columbia, any territory or possession of the United States, a political subdivision of any State, territory, or possession, or any governmental entity or person acting on behalf of such State, territory, possession, or subdivision and with the authority to assess, impose, levy, or collect taxes.

(14) TAX.—The term “tax” means any charge imposed by any State or local jurisdiction for the purpose of generating revenues for governmental purposes, including any tax, charge, or fee levied as a fixed charge or measured by gross amounts charged, regardless of whether such tax, charge, or fee is imposed on the seller or the customer and regardless of the terminology used to describe the tax, charge, or fee. Such term does not include an ad valorem tax, a tax on or measured by capital, a tax on or measured by net income, apportioned gross income, apportioned revenue, apportioned taxable margin, or apportioned gross receipts, or, a State or local jurisdiction business and occupation tax imposed on a broad range of business activity in a State that enacted a State tax on gross receipts after January 1, 1932 and before January 1, 1936.

SEC. 8. EFFECTIVE DATE; APPLICATION.

(a) GENERAL RULE.—This Act shall take effect 60 days after the date of enactment of this Act.

(b) EXCEPTIONS — A State or Local jurisdiction shall have two years from the date of enactment of this Act to modify any state or local tax statute enacted prior to date of enactment of this Act to conform to the provisions set forth in Section 4 and 5 of this Act.

(c) APPLICATION TO LIABILITIES AND PENDING CASES.—Nothing in this Act shall affect liability for taxes accrued and enforced before the effective date of this Act, or affect ongoing litigation relating to such taxes.

SEC. 9. GOVERNMENT ACCOUNTABILITY OFFICE REVIEW.

Not later than 3 years after the date of the enactment of this Act, the Comptroller General of the United States shall carry out, and submit to the Congress a report on the results of, a study that identifies—

(a) Which specific statutes and regulations of each State are invalidated as a result of this Act; and

(b) The amount of revenue lost (if any) by such State (and local government of such State) by the effect of this Act on each such statute and each such regulation so affected.

SEC. 10. SENSE OF CONGRESS.

It is the sense of Congress that each State shall take reasonable steps necessary to prevent multiple taxation of digital goods and digital services in situations where a foreign country has imposed a tax on such goods or services.

SEC. 11. SAVINGS PROVISION.

If any provision or part of this Act is held to be invalid or unenforceable by a court of competent jurisdiction for any reason, such holding shall not affect the validity or enforceability of any other provision or part of this Act unless such holding substantially limits or impairs the essential elements of this Act, in which case this Act shall be deemed invalid and of no legal effect as of the date that the judgment on such holding is final and no longer subject to appeal.

Gary Resnick
Shareholder

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GRAY | ROBINSON
ATTORNEYS AT LAW

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**Comments and Proposal of TracFone Wireless, Inc.
To Florida Communications Services Tax Working Group
December 24, 2012**

TracFone Wireless, Inc. ("TracFone") respectfully requests that the Working Group consider this submission as it develops its recommendations for the Governor and legislature.

TracFone Wireless, Inc.

TracFone provides nationwide, prepaid access to the network facilities of cellular and landline service providers. TracFone sells handsets and prepaid "airtime cards"—either directly to end users over the internet, to third party distributors, or to third party retailers, who themselves sell prepaid handsets and airtime cards to end users. TracFone does not provide post-paid service and does not issue bills to its customers, nor does it own or operate any physical transmission facilities. Rather, the wireless telecommunications networks used to facilitate communications by end users are owned and operated by unrelated licensed commercial mobile radio service ("CMRS") providers with which TracFone contracts for service.

TracFone is headquartered in Miami-Dade County where it has over 680 employees.

Working Group Mission and Results to Date

The Working Group was charged with studying aspects of the CST, and identifying options for improving it from administrative and competitive standpoints without unduly reducing revenue to local governments. But during the course of its study the Working Group has reached the conclusion that the CST suffers from a fundamental problem which cannot be resolved by modifying the mechanics of administration or leveling the competitive playing field. For reasons that are well documented in the Working Group's record, the PECO and local government revenue base is at risk. Thus, the CST can no longer be relied upon to fulfill its purposes.

We encourage the Working Group to make its consensus on this point the primary thrust of its report to the Governor and legislative leadership. Although diverse interests are represented on the Working Group, the dysfunctional nature of the CST is an undisputed fact that demands the attention of Florida lawmakers. The suggestion that a modest increase in the sales tax rate could provide the revenues needed to replace the CST is an option that merits serious consideration, and there are presumably others. However, unlike the central finding of the Working Group that the CST must be replaced, the source of replacement revenues is potentially controversial. Therefore, it is important

that the Working Group's report clearly distinguish between the conclusion the panel has reached on the one hand, and its identification of possible solutions on the other.

As a seller of only prepaid services, TracFone has an interest in the efforts of the Working Group that differs from the interests of other industry participants. The evidence accumulated during this body's proceedings overwhelmingly supports retaining the longstanding system of applying the applicable sales and local surtaxes to prepaid services at the point of sale. All that is required is an update of the relevant definition presently labeled "prepaid calling arrangement" so that there are no further disputes about what transactions qualify for this treatment. This approach has worked in Florida and throughout the country. It would make no sense for a work group empanelled to identify options for improved administration, to select what may be the only aspect of Florida's system of taxing communications that has worked well, and recommend making it more complicated.

The prepaid issue is thus distinguishable from the many other issues associated with the CST that are described in the record of the Working Group. The primary distinctions are that : (1) the solution to the prepaid issue is simple and can be achieved with an update to a single definition; and (2) the present uncertainty occasioned by the Department's March 2012 Taxpayer Information Publication merits prompt attention. Although significant time and effort may be required to develop revenue sources to replace the CST, the solution to the prepaid problem can and should be implemented without delay during the next legislative session.¹

Suggested Findings

At a summary level, the record before the Working Group supports findings that: (1) continued government reliance on the CST is perilous as the revenues it will generate are at best uncertain; (2) nationally, the CST is unique in its complexity and difficulty in administration, and in the magnitude of the tax burden imposed on consumers; and (3) there is no workable model for the taxation of prepaid communications services other than at point of sale. Findings with the additional detail set forth below also merit consideration.

1. Florida state government has historically relied on the gross receipts tax, which is presently a component of the CST, to support the issuance of bonds for public education capital outlay. The issuance of additional bonds depends upon increases in tax collections.
2. Local governments have historically relied on the local CST (and its predecessors) to fund government services, including pledges of CST revenues to secure bonded debt.

¹ Needless to say, a reversal of the position announced in the TIP would also be welcome.

3. The CST revenue base for state and local governments is at risk due to changes in technology and the market, the sales of services by providers lacking nexus with Florida, and the increasing availability of applications that can substitute for communications services through the use of non-taxable Internet access.
4. Florida's transaction tax rate as applied to communications services is among the highest in the nation. No policy reason has been advanced for requiring consumers of communications services to contribute more to the cost of government than other consumers.
5. Florida's CST is also unusual in the disparity between the sales tax and communications tax rates, in the variation in rates across taxable services, and in the variation in local tax rates.
6. Prepaid communications services include a variety of business and distribution models that are distinguishable from other communications services. The seller in most consumer transactions is a retailer of merchandise with no communications facilities.
7. Like virtually all other states, Florida has historically applied the sales tax to prepaid services at the point of sale. There was no evidence that this system has proved unworkable, but ample evidence that alternatives would be difficult to implement.
8. In large part because of the requirement to source communications services to the municipal level, administration of the CST is complex and burdensome for industry and government, and engenders constant conflict. There was no evidence that the administrative burdens in other states remotely approach those imposed by the CST.

These facts, particularly #3, combine to create a strong indictment of the CST as a continued source of funding for government. The prudent course for Florida is to find an alternative. With respect to the prepaid issue, the straightforward solution of updating the relevant definition, so that it is clear the sales tax applies at the point of sale and the CST does not apply, should be implemented without delay.

We thank the Working Group for consideration of our comments.

MEMO

TO: Andrea Moreland

FROM: Scott Mackey

DATE: January 3, 2013

RE: Florida CST Reform Calculations

A member of the Communications Services Tax Reform working group asked me to estimate the amount of taxable purchases that a “typical” Florida taxpayer and a “typical” small business would need to incur to offset the reduction in tax liability under a revenue neutral tax reform that repealed the Communications Services Tax (CST), subjected communications services to state and local sales taxes, and replaced the CST revenue with an increase in the sales tax rate.

The Department of Revenue estimated that the sales and use tax rate would need to increase by three-tenths of one percent (0.3%) to replace the lost CST revenue under a revenue neutral reform. The attached tables show the results of the simulation. For the typical taxpayer, it is assumed that the household has one landline telephone, a wireless “family share” plan with 3 lines, and a typical Cable TV package. For the small business, it is assumed that the small business has 10 business landlines, 10 wireless lines, and a typical Cable TV package.

The representative household pays just under \$400 per year in CST at an average assumed rate of 15.17%. If the CST were repealed, the tax on the same package of communication services would drop to about \$210 assuming that the current average state-local sales tax rate of 7.25% were increased to 7.55%. This household would need to make about \$62,000 in taxable purchases to pay more than the \$190 in net savings from repeal of the CST. If this household filed an itemized federal tax return, and Congress extends deductibility of sales taxes, the threshold in taxable purchases rises to \$86,000 in taxable purchases assuming that the taxpayer is in the 28% tax bracket.

I’ve attached a similar analysis for a representative small business. The business would need to make in excess of \$335,000 in taxable purchases to pay more in sales taxes than they would save in CST under the proposed reform.

Thank you for the opportunity to submit this information for the CST Reform Working Group record.

"Representative Household"

Annual CST Savings vs. Sales Tax Paid Under Proposed Tax Reform

Type of Service	Total Bill Amount	Taxable Amount	Avg. CST Rate	Tax Paid
Wireless Family Share Plan with 3 lines	\$150.00	\$120.00	15.17%	\$18.20
Landline Phone	\$32.50	\$32.50	8.37%	\$2.72
Cable TV	\$80.00	\$80.00	15.17%	\$12.14
Internet Access via Cable Modem	\$42.00	\$0.00	0.00%	\$0.00
TOTAL / MONTH	\$304.50	\$232.50		\$33.06
			12 months	
TOTAL ANNUAL CST PAID				\$396.72
TOTAL ANNUAL TAX PAID IF 7.55% SALES TAX RATE APPLIED TO COMMUNICATIONS				\$210.65
				Reflects increase in sales tax rate from 7.25% avg to 7.55% avg and repeal of residential exclusion for landline service
ANNUAL HOUSEHOLD TAX SAVINGS				\$186.08
TAXABLE PURCHASES THRESHOLD FOR "HOUSEHOLD" REVENUE NEUTRALITY				\$62,026
				Anyone buying less than this amount in taxable goods and services would pay less in total taxes under the reform.
THRESHOLD ASSUMING FEDERAL SALES TAX DEDUCTIBILITY AT 28% P.I.T. RATE				\$86,147
				Anyone deducting sales taxes on their federal tax return and buying less than this amount in taxable goods and services would pay less in total taxes under the reform. Assumes no AMT liability or deductions phaseout.
Scott Mackey				
KSE Parnters LLP				
Montpelier, Vt				
802 236 7725				
mackey@ksepartners.com				

"Representative Small Business -- 10 Employees"

Annual CST Savings vs. Sales Tax Paid Under Proposed Tax Reform

Type of Service	Total Bill Amount	Taxable Amount	Avg. CST Rate	Tax Paid	
10 Business Wireless Lines	\$440.00	\$340.00	15.17%	\$51.58	10 wireless line shared plan includes \$100.00 internet access
10 Business Landlines	\$680.00	\$680.00	15.17%	\$103.16	10 business lines
Cable TV in Office	\$80.00	\$80.00	15.17%	\$12.14	Average cable video bill
10 Internet Access Connections	\$580.00	\$0.00	0.00%	\$0.00	Internet Access not taxable per federal and Florida law
TOTAL / MONTH	\$1,780.00	\$1,100.00		\$166.87	
				12 months	
TOTAL ANNUAL CST PAID				\$2,002.44	
TOTAL ANNUAL TAX PAID IF 7.55% SALES TAX RATE APPLIED TO COMMUNICATIONS				\$996.60	Reflects increase in sales tax rate from 7.25% avg to 7.55% avg and repeal of residential exclusion for landline service
ANNUAL BUSINESS TAX SAVINGS				\$1,005.84	
TAXABLE PURCHASES THRESHOLD FOR "HOUSEHOLD" REVENUE NEUTRALITY				\$335,280	A business buying less than this amount in taxable goods and services would pay less in total taxes under the reform.
(Assume state sales tax rate increase of 0.3%)					
Scott Mackey					
KSE Parnters LLP					
Montpelier, Vt					
802 236 7725					
mackey@ksepartners.com					

Agenda Item #4

Discuss and Finalize Report of the Working Group

COMMUNICATIONS SERVICES TAX WORKING GROUP

REPORT TO:

THE HONORABLE RICK SCOTT
Governor of Florida

THE HONORABLE DON GAETZ
President of the Florida Senate

THE HONORABLE WILL WEATHERFORD
Speaker of the Florida House of Representatives

February 1, 2013

Executive Summary

Recognizing that many changes have occurred since the implementation of the Communications Services Tax in 2001, the Florida Legislature in 2012 created a Communications Services Tax Working Group (“Working Group”) to study issues relevant to the tax and identify options for improving the system. The Legislature sought options that would not only streamline the administrative system, but also remove competitive advantages within the industry as it related to the state’s tax structure. The Legislature was sensitive to the impact that such options could have on local governments and added the caveat that options to remove competitive advantages should not unduly reduce revenues to local governments.

For a tax system to work well, it should be reliable, simple, neutral, transparent, fair, and modern. Florida’s Communications Services Tax could benefit from reform in nearly every one of these areas, especially given the pace of technological change over the last 11 years. Under the status quo, state and local governments will likely experience revenue declines as discriminatory tax policy, technological changes, and consumer preferences continue to undermine the Communications Services Tax base by shifting consumer purchases to services not subject to the tax.

After reviewing numerous options intended to improve the current system, the Working Group concluded that the best approach to modernize the tax structure would be to repeal the Communications Services Tax and bring all communications services under the sales and use tax of Chapter 212, F.S. This approach, termed the “Holistic Replacement” option will:

- 1) Promote competitive neutrality between communications providers;
- 2) Tax like goods and services the same;
- 3) Resolve the current dispute over the taxation of prepaid wireless service;
- 4) Streamline the administrative system; and
- 5) Provide a more reliable and stable revenue stream.

While the tax rate for communications services varies, it is generally more than twice the current sales and use tax rate. Because communications services are taxed at a much higher rate than goods and services under the sales and use tax, a small increase in the sales and use tax rate will be needed to compensate for the repeal of the Communications Services Tax. The Department of Revenue's Office of Tax Research estimates that the state sales and use tax rate would need to be adjusted from the current rate of 6 percent to 6.34 percent to offset the loss of revenue from the repeal of the Communications Services Tax. A mechanism to establish the distribution of revenues would need to be created.

The Holistic Replacement option represents the consensus option of the Working Group. All eight voting members support this option, which include the four members representing industry and the four members representing local government. The two members representing municipalities also support this approach, but conditioned their support upon certain principles that they believe are critical to the proposal's implementation. The Working Group believes that this option is the best solution to modernize the state's taxation of communications services and achieve the stated goals of streamlining the administrative system and removing competitive advantages in the industry without unduly reducing revenues to local governments.

I. Introduction

The Communications Services Tax (CST) was implemented in 2001 as a replacement or swap for existing tax and fee revenues that were critical to the funding of state and local governments in Florida from their inception. The CST was not new-found money, but simply replaced funding that had been received through the separate revenue streams. These revenue streams included: state sales and use tax; Local option sales and use surtax; gross receipts tax; negotiated local franchise fees for private use of the public rights-of-way by telecommunication companies and cable companies; locally imposed utility taxes, which appear to have been put in place in the 1940's to help fund local government; and permit fees for construction and inspections of work performed in local rights-of-way for the safety of the traveling public. Some of these revenues were, and continue to be in their rebirth as the CST, used to secure government bonds.

The design of the CST came about primarily at the request of the communications industry, as a way to simplify the then current multi-tax and fee structure, which included state, municipal, and county taxes and fees. It was intended to tax like services in a like manner no matter what type of business provided the service, and ease the volume of reports required to be filed and the number of governmental entities to which industry reported. In return for creating the CST, local governments were promised a more stable revenue stream, covering a broader tax base, to protect them from income erosion due to changes brought about by the type of business or method of service delivery utilized. Through consensus, the CST language was designed expansively, so that state and local governments would continue to receive bondable funding on communications services and participate in the benefits realized by growth in the market, no matter how the services are provided.

The CST functioned as designed for several years, but regulatory changes and technology developments have again blurred the lines between taxable and non-taxable services, diminishing the taxable base and eroding this vital state and local government revenue

stream. Although the charge for the transmission, conveyance or routing of voice, data, audio, video and any other information or signals is taxable under the CST, communications services providers are migrating to transmitting, conveying, and routing data, audio, video and other signals as applications or files that a customer downloads from the Internet. At least a portion of the charge for transmission, conveyance, and routing of services is now being assigned as a charge for a download, application, or information. A diminishing portion of the charge, or no portion of the charge, is being assigned to the transmission of these services; therefore, the tax base is being eroded.

Furthermore, the federal moratorium on taxing Internet access is taking an increasing toll on the CST taxable base, because an increasing number of services are being offered as Internet access. If the moratorium continues, the sustainability of even current levels of tax revenues is highly unlikely.

Additionally, the communications industry expresses frustration regarding the difficulty in identifying and accounting for the taxes collected within the many Florida jurisdictions; the tax rates which, while lower than the individual rates paid prior to the CST, are higher than for other commodities in the state that do not use local rights-of-ways for provision to their customers; and the disparate treatment of like services, depending upon the method of delivery or the company providing the services.

II. Creation and Charge of the Working Group

In 2012, the Florida Legislature passed Committee Substitute for House Bill 809, relating to the communication services tax. This bill was signed into law as Chapter 2012-70, Laws of Florida. Section 12 of Chapter 2012-70, Laws of Florida, created a nine member Working Group. The law tasked the Working Group with reviewing key issues, relating to the CST, and identifying options to achieve stated goals. The Department of Revenue (Department) provided administrative support to the Working Group. The law provides that a report of the Working

Group is due to the Governor, the President of the Senate, and the Speaker of the House of Representatives by February 1, 2012.

The Department's Executive Director served as a nonvoting Chair of the Working Group. The Executive Director appointed the eight voting members based on criteria outlined in the law. Four of the members were from the private sector with expertise in one or more of the following areas: cable service, satellite service, local telephone service, and wireless communications. The other four members represented local governments. Two members represented Florida's municipalities and two members represented Florida's counties.

The law directed the Working Group to review:

- National and state tax policies relating to the communications industry;
- The historical amount of tax revenue that has been generated or administered pursuant to Chapter 202, Florida Statutes, for the purpose of determining the effect that laws passed in the past 5 years have had on declining revenues;
- The extent to which these revenues have been relied upon to secure bond indebtedness; and
- The fairness of the state's communications tax laws and the administrative burdens it contains, including whether the laws are reasonably clear to communications services providers, retailers, customers, local government entities and state administrators.

Based on that review, the Working Group was charged with identifying options to streamline the administrative system; and remove competitive advantages within the industry as it relates to the state's tax structure without unduly reducing revenues to local governments. This report reflects the Working Group's activities and recommended option for reforming the taxation of communications services.

III. Members

The individuals who served on the Working Group are as follows:

Lisa Vickers, Chair
Executive Director
Florida Department of Revenue
(6-12-12 meeting)

Gary S. Lindsey
Director of External Tax Policy
AT&T

Marshall Stranburg, Chair
Interim Executive Director
Florida Department of Revenue
(All other meetings)

The Honorable Gary Resnick
Mayor, City of Wilton Manors

Charles Dudley
General Counsel
Florida Cable Telecommunications
Association

Alan S. Rosenzweig
Deputy County Administrator
Leon County

Sharon R. Fox
Tax Revenue Coordinator
City of Tampa

Brian D. Smith
Director of Transactional Taxes
The DirecTV Group, Inc.

Kathleen Kittrick
Director of State Government Affairs
Verizon

Davin J. Suggs
Senior Legislative Advocate
Florida Association of Counties

IV. Florida's Communications Services Tax

In 2000, the Florida Legislature enacted the Communications Services Tax, Chapter 202, Florida Statutes, effective October 1, 2001. This new law simplified and restructured numerous state and local taxes and fees imposed on communications services into a single tax centrally administered by the Department. Examples of services that are subject to the tax include: local and long distance telephone service; video service (including cable service); direct-to-home satellite service; mobile communications services; private line services; telephone services provided by a hotel or motel; certain facsimile (FAX) services; voice-over-Internet protocol (VoIP) services; and paging services.

A. Tax Rates

The CST is comprised of a Florida portion and a local portion. Dealers must itemize and separately state the Florida and local tax portions on customer's bills. The taxes must be identified as "Florida Communications Services Tax" and "local Communications Services Tax", respectively.

1. Florida Portion

The state portion of the CST is imposed at the rate of 6.65 percent. Generally, this portion of the CST is collected with the gross receipts tax rate of 2.37 percent and 0.15 percent (imposed per Chapter 203, F.S.), for a combined rate of 9.17 percent. Direct-to-home satellite service is taxed at a state rate of 10.8 percent plus 2.37 percent gross receipts tax for a total of 13.17 percent.

2. Local Portion

Each local taxing jurisdiction (municipality, charter county, or non-charter county) is authorized to levy a specific local CST tax rate. As of January 1, 2012, there were 481 separate jurisdictions that could impose a local CST rate. The local rates range from 0 percent to 7.12 percent with a weighted average of 5.04 percent in 2011. The local component of the CST does not apply to direct-to-home satellite services.

3. Exemptions

Communications services sold to a residential household receive a partial exemption from the tax. A residential household is exempt from the rate of 6.65 percent for the state tax and the rate of 0.15 percent for the gross receipts tax. Residential service is subject to the rate of 2.37 percent gross receipts tax and the local portion, if applicable. This partial exemption does not apply to the sale of mobile communications service, cable service, direct-to-home

satellite service, or any residence that constitutes all or part of a transient public lodging establishment as defined in Chapter 509, Florida Statutes.

Full exemption from the CST and gross receipts tax applies to sales for resale, sales to the government (federal, state, county, municipality or other political subdivision), sales to religious or educational institutions with 501(c)(3), I.R.C. status, and sales to certain homes for the aged with 501(c)(3), I.R.C. status.

4. Services Not Subject to the Tax

There are services the charges for which are not subject to the tax. These include, but are not limited to: Internet access services (electronic mail services, electronic bulletin board services or similar on-line computer services); information services (electronic publishing, web-hosting service, or end-user 900-number service); and the sale or a recharge of prepaid calling arrangement¹. Generally, when taxable and nontaxable services are bundled together and sold as a package for one sales price, the entire charge is subject to tax; however, there are exceptions. For example, if the charge for Internet access service is not separately stated on a customer's bill, but can be reasonably identified in the seller's books and records, tax is not due on the portion of the charge identified as Internet access service. Another example would be the charge for goods and services not subject to CST and not separately stated on a customer's bill. The charge may be excluded from the CST, if the charge can be reasonably identified in the seller's books and records.

5. Sourcing Customers

The law requires sellers of communications services to apply the correct local CST rate based on the applicable service address. The communications services dealer must bill and remit the local CST properly to assure that local governments will receive the appropriate

¹ See definition in Section 202.11(9), Florida Statutes

distribution related to services provided within their boundaries. Florida law permits the use of several qualifying methods to determine the proper taxing jurisdiction. The qualifying methods for address to jurisdiction assignment are:

- Using the Department's Address/Jurisdiction Database
- Using a database that has been certified by the Department
- Using a certified vendor's database
- Using ZIP + 4 and a methodology to determine the jurisdiction when ZIP codes cross jurisdictional lines

Dealers who exercise due diligence in applying one of the qualifying methods may be held harmless from jurisdictional situsing errors and are eligible for an enhanced collection allowance. The Department maintains an electronic database that designates the taxing jurisdiction for Florida addresses. This database is based on information provided by local taxing jurisdictions and is updated every six months.

6. Certification

Dealer or vendor databases can be certified for their accuracy of assignment of street addresses to the proper local taxing jurisdiction. Dealers or database vendors can request certification, and databases may be certified if they meet an overall accuracy rate of 95 percent.

7. Collection Allowance

For the purpose of compensating dealers for the keeping of prescribed records, the filing of timely tax returns, and the proper accounting and remitting of CST and gross receipts taxes, dealers are allowed to deduct a collection allowance equal to 0.25 percent of the tax due on the return. Dealers that use a qualifying method to determine the proper taxing jurisdiction, and

direct-to-home satellite services providers, receive an enhanced collection allowance equal to 0.75 percent of the tax due.

V. Meetings

The Working Group met in Tallahassee on the following dates: June 11, 2012; July 25, 2012; August 21, 2012; October 16, 2012; October 31, 2012; and December 7, 2012. The Working Group also held telephone conference calls on January 18 and 28. All of the members of the Working Group were present at each of the meetings. The meetings were noticed in the Florida Administrative Register and members of the public were invited to participate by teleconferencing or WebEx if they were not able to attend in person. The Department created a web page for the Working Group where agendas, meeting materials, and other information relevant to the Working Group were posted.

VI. Review of Issues

A. National and State Tax Policies Relating to the Communications Industry

At the June 11, 2012, meeting, French Brown, Deputy Director of the Department of Revenue's Office of Technical Assistance & Dispute Resolution, gave an overview of the CST. The presentation provided a foundation for the Working Group on the law. An outline was presented on current tax rates, exemptions, and sourcing requirements. Common terms were suggested to be used by the Working Group with respect to the various components of the tax.

The presentation also focused on prepaid calling arrangements and how Florida's treatment relates to both the communications services and sales and use taxes. The presentation reviewed recent state and federal legislative changes, including the federal Internet Tax Freedom Act and other state legislative amendments to the Florida Statutes.

Also presented were the results of a survey on other states and their tax treatment of communications services.² The results of the survey focused on their responses to information solicited by Department staff in anticipation of the information needs of the Working Group. The initial survey asked for information on each state's administration of their tax on communications services, state and local rates for specific types of services, treatment of prepaid communications services and bundling of services.

Twenty-five states and the District of Columbia responded to the initial survey. Additional surveying and research was conducted on the states that did not respond to the initial survey, and the results were combined with that of those states who responded initially. The following are highlights of the results of the combined surveys:

- Four jurisdictions out of 46 had tax rates higher than Florida (Washington D.C. had a higher state rate, Maryland and New York had a higher local rate, and California had a higher total rate),
- Fifteen of 46 jurisdictions had a tax rate for communications services different from the tax rate for general sales,
- Florida had one of the largest variance in tax rates across taxable services (2.37 percent to 16.29 percent),
- Twelve of 32 jurisdictions source to the state level, six of 32 jurisdictions source to the county level, 10 of 32 jurisdictions source to the city level, four of 32 jurisdictions source below the city level,
- Sixteen of 21 jurisdictions distribute actual collections,
- Twenty-four of 39 jurisdictions use a prepaid definition from the Streamlined Sales and Use Tax Agreement,
- Twenty-six of 39 jurisdictions tax prepaid services solely as sales and use tax, and
- Nineteen of 23 jurisdictions allow services to be unbundled via books and records (15 of these jurisdictions had the same tax rate across services).

² See Appendix ____ for complete survey results

B. Historical Tax Revenue and Effect of Laws Passed in the Past Five Years

At the June 11, 2012, meeting, Bob McKee, Chief Economist of the Department's Office of Tax Research provided an overview of the CST revenue, local rates, and the impact of law changes for the past five years. The historic collections of the CST since its creation in 2001, for each of its components (state portion, including direct-to-home satellite portion, and local portion) and the gross receipts tax were discussed. Also provided was information on the structure of the industry, and the historic amounts retained by providers as a collection allowance.

The presentation also provided data on historic phone service by type of service. Estimates of the number of wireless handsets, landlines, and voice-over-Internet protocol (VoIP) lines were provided for years 2001 through 2010. The annual growth rates for each of these services were provided graphically. There was an analysis of the implied number of prepaid wireless lines, based upon information from the Florida Public Services Commission and the Florida E911 Board.

Information on local rates for the CST was reviewed. The different rates available to municipalities and charter counties were compared to the rates available to non-charter counties. Maps were provided that presented the different rates across the various regions of the state. In total, there were 122 different local CST rates in 2012 in Florida.

The presentation provided information on the changes in state law since 2007 and the impact on CST revenue. During this time period, there were six changes in the law. The official Revenue Estimating Conference (REC) estimates of the fiscal impacts of those changes are as follows:

Chapter Law	REC Estimate
Chapter 2007-106, L.O.F.	<u>Emergency Rate Repeal</u> : Impact of law change determined to be indeterminate, while reducing potential revenues by \$86.9M on a recurring basis and \$572M in 2007-2008

Chapter 2010-83, L.O.F.	<u>Netting Bad Debt</u> : Estimated not to have a fiscal impact
Chapter 2010-149, L.O.F.	<u>Rate Swap</u> : Recurring impact estimated to state sales tax component of the CST as negative \$22.3M (-\$19.8M state impact and -\$2.5M local impact) and a positive \$22.3M to gross receipts tax
Chapter 2010-138, L.O.F.	<u>Transient Public Lodging</u> : Estimated not to have a fiscal impact
Chapter 2011-120, L.O.F.	<u>Rounding Rule</u> : Estimated not to have a fiscal impact
Chapter 2012-70, L.O.F.	<p><u>Change to Sales Price Definition</u>: Though the full scope of the impacts is indeterminate, the recurring annual impacts would be at least negative \$11.3M for gross receipts tax, negative \$2.9M for state sales and use tax, and negative \$21.3M for local government CST. The speed with which the minimum recurring impacts will be reached is unknown, so the cash impacts in FY 2012-13 are unknown.</p> <p><u>Local Siting</u>: Recurring impact of negative \$4.7M for the local component of the CST.</p> <p><u>Retroactive Application</u>: REC adopted a negative indeterminate impact along with the following statement regarding the retroactive application: The 2012-13 impact is expected to be at least negative \$6.0M (-\$2.5M GR sales tax, -\$0.3M local sales tax - \$1.0M gross receipts tax, and -\$2.2M local CST).</p>

C. Revenues Securing Bond Indebtedness

1. State Government

At the June 11, 2012, meeting, Amy Baker, Coordinator of the Florida Legislature's Office of Economic and Demographic Research, provided an overview of Florida's gross receipts tax and the bonding requirements for the tax. The gross receipts tax base is comprised of a tax on electricity, gas fuels, and on communications services, including telecommunication services, video services, and direct-to-home satellite service. The communications services portion represents approximately 40 percent, or about \$418 million, of the total for gross

receipts of approximately \$1 billion (FY 2011-12 estimate). It is anticipated that while gross receipts tax revenue growth rates are currently negative, the growth rates are expected to increase in the coming years, as the economy improves with most of the growth expected to come from the electricity component.

Section 11 of Article VII of the Florida Constitution authorizes the state to issue general obligation bonds or revenue bonds to finance or refinance fixed capital outlay projects. The general obligation bonds are secured by the full faith and credit of the state. Revenue bonds are payable solely from specified revenues. There is a difference in cost to the state, depending on whether a general obligation bond or a revenue bond is issued. Full faith and credit is considered to be less risky.

The Public Education Capital Outlay (PECO) bond is an education related bond that has a special feature, because the state is responsible for the liability even if local entities ultimately own the facilities. The state has undertaken the debt and purchased the facility, but when the state accounting is done, the facility is not listed as an asset of the state, but is attributed back to the local school district, state college, or university.

There is specific authorization to bond gross receipts tax revenues in Florida's Constitution, Article XII, section 9, which also provides that all of the proceeds from the revenues derived from the gross receipts taxes collected shall be placed in the Public Education and Capital Outlay Trust Fund. The PECO trust fund is handled by the State Board of Education and the issuance of bonds is handled by the Division of Bond Finance. Each year the Legislature decides how much to bond if there is capacity available.

The Constitution provides detail regarding PECO bonds. All bonds shall mature no later than 30 years after the date of issuance; no bonds shall be issued in an amount exceeding 90 percent of the amount which the state board determines can be serviced by the revenues; and it gives direction on the direct payment for the cost of any capital outlay project of the state system or the purchase or redemption of outstanding bonds.

The gross receipts tax revenue source has been declining. At present, the state is not able to issue any PECO bonds because there is not enough growth.³ The PECO program is the state's largest bond program. There is approximately \$11.3 billion in outstanding debt, which is 40.8 percent of total direct debt of the state that is outstanding.

Because the gross receipts tax has been under stress, the 2010 Legislature moved part of the revenues from the state portion of the CST to the gross receipts tax in order to take advantage of the constitutional ability to bond. Approximately \$19.8 million was shifted out of the state tax on communication services and was moved to gross receipts tax by reducing the state tax rate from 6.8 percent to 6.55 percent and increasing the gross receipts tax rate on communications services from 2.37 percent to 2.52 percent. The 2012 Legislature considered taking this step again but instead decided to turn to lottery bonding.

2. Local Government

At the July 25, 2012, meeting, Amber Hughes, Legislative Advocate with the Florida League of Cities, provided information concerning the bonding of the CST by local governments. There are three types of bonds that local governments in Florida are allowed to issue. General obligation bonds are secured by the full faith and credit of the issuer. Revenue bonds are secured by a specific source of revenue. Lastly, there are bonds in which the issuer promises to budget; and thereby, seek to have appropriated sufficient moneys to make lease, rental, or other required payments.

Various types of revenue sources are available to local governments in Florida. The CST is a revenue source that may be used for any public purpose, including any current or future pledge of indebtedness. The uses of many of the other revenue sources for local government are restricted to specific purposes. Examples of these restrictions include ad

³ The December 6, 2012, Public Education Capital Outlay Estimating Conference estimated there would not be sufficient revenues for bonded projects until 2015-16.

valorem taxes, which may only be pledged by the citizens via referendum and may only be used for capital outlay; and gas taxes, which generally must be used for transportation purposes.

There is no comprehensive list of local governments who have pledged CST for bond indebtedness and so several sources were investigated. There is a municipal security rule-making board that has a database of municipal bonds that is helpful when inquiring about a specific bond, but it is difficult to perform general searches, as not every bond is going to be called a CST bond in the database. To further complicate matters, the name or purpose of a local government may have been input in several different ways. An additional source of information is the Florida Division of Bond Finance where any local government bond issuance is to be recorded, but again, the information is input in different ways that may not be helpful for a search.

Another alternative that was used was a survey of members by the associations representing local governments. The Florida Association of Counties conducted a survey that asked if each county currently pledges or uses CST revenue to secure any form of debt. Of the 67 counties, 50 responses were received. Of the 50 responding counties, eight counties indicated that they had a specific pledge, seven counties responded with a “maybe” or non-specific pledge, and 35 counties responded “no.”

A survey of members of the Florida Government Finance Officers Association (FGFOA), which includes cities, counties, special districts, school boards, state and some private sector accountants, was also conducted. A total of 99 responses to the FGFOA survey were received. The first question asked was whether those surveyed used any form of municipal securities that required an annual appropriation to make lease payments, debt service payments, loan or other required payments. If the answer was “yes” to the first question, respondents were asked if the CST is a portion of the revenue budgeted to make such payments. Forty-six respondents answered “yes” to the first question and of those, 39 said that there was a specific pledge of CST revenues. Six respondents answered the first question as “maybe.” Forty-seven

respondents answered “no” to the first question with 7 answering “no” to the second question and 2 anticipating that CST revenues would be pledged in the next year.

The FGFOA members were also asked to provide information on the percentage of their jurisdiction’s general fund comprised of revenues from CST. Of the 95 respondents, 22 were in the 0-3.99 percent range; 43 were in the 4-6.99 percent range; 16 were in the 6-9.99 percent range and 14 were in the 10 percent range and above.

Information was provided regarding local government uses of bond proceeds. Projects included: capital improvements; equipment acquisition; water and sewer; convention center; land acquisition; community redevelopment agency purposes; and transportation improvements.

D. Fairness and Clarity of Laws for Industry, Government & the Public

1. Estimate of the Potential Impact of Repeal of the Residential Exemption

At the July 25, 2012, meeting, Bob McKee provided the Working Group with an estimate of the potential impact of the repeal of the exemption authorized in section 202.125(1), F.S., known as the residential exemption. This exemption applies to the 6.65 percent state portion of the CST and also applies to the .15 percent gross receipts tax levy authorized under section 203.01(1)(b)3., F.S. The information presented included a discussion of how the impact of the residential exemption should be measured by comparing the tax base for the state portion of the CST with the tax base for the gross receipts tax on communication services. Also discussed was how the impact of the residential exemption has been shrinking in recent years due to changes in consumer behavior.

The presentation also provided an estimate of the tax impact if the tax base was expanded, by eliminating the residential exemption, and the rate for the CST remained the same. Also provided was an estimate for possible rate reduction if the tax base was expanded, by eliminating the residential exemption, but the projected revenues were restricted to the current forecast amount.

2. Prepaid Communications Services

a. State Taxation

At the July 25, 2012, meeting, French Brown from the Department presented information that focused on the definitions of “prepaid calling arrangements,” as provided by Florida law (see sections 202.11(9) and 212.05(1)(e), F.S.). The presentation pointed out some of the operative phrases in the definition including, “consist[ing] exclusively of telephone calls” and “sold in predetermined units or dollars whose number declines with use in a known amount.”

Mr. Brown explained that the Department’s Tax Information Publication (TIP) #12ADM-02 provides that certain communications services labeled as prepaid service when sold do not fall under the statutory definition of “prepaid calling arrangements.” Examples of such services include, but are not limited to, services that provide services like voice, texting, and Internet access, unlimited calling plans, and services that are not sold in predetermined units or dollars. These services generally fall under the broader definition of communications services that are taxed under Chapter 202, F.S.

The presentation provided information on how the Streamlined Sales and Use Tax Agreement (SSUTA) defines both “prepaid calling service” and “prepaid wireless calling service.” The definitions in the Agreement apply to telecommunications services generally and are not tied exclusively to telephone calls like the definitions in Florida law. The Streamlined State and Local Advisory Council published a draft issue paper in August of 2011 (IP 11004) dealing with “unlimited plans” and the Agreement’s phrase “units or dollars of which the number declines with use in a known amount.” In the draft issue paper, the Council takes the position that plans which allow unlimited use for a time period, such as a week, month or longer, can be “prepaid” for purposes of the SSUTA when the customer is not entitled to further use of the service after the period. Florida is not a member state to the Streamlined Sales and Use Tax Agreement.

Of the 25 jurisdictions that answered the initial survey, 11 (44%) were full member states of the SSUTA and conformed to the Agreement's definition of prepaid. Of the four SSUTA member states that responded to the additional questions, one state (Georgia) did not follow IP11004.

The last portion of the presentation focused on how states characterize and treat communications services labeled as prepaid service when sold. The Department compiled the statutory definition of communications services labeled as prepaid services when sold provided by twenty-five (25) jurisdictions. The Department also sent these jurisdictions fifteen additional survey questions to clearly determine how each jurisdiction would treat a specific transaction. Questions distinguished between paying for a known unit or dollar amount versus an unlimited plan and between voice only versus talk, text, and web as examples.

Of the twenty-five jurisdictions, thirteen responded. The following are highlights from the survey. Ten jurisdictions tax prepaid local or long distance calling cards as prepaid; eight jurisdictions tax prepaid wireless voice as prepaid; and eight jurisdictions tax prepaid wireless voice and text, or wireless voice, text, and data as prepaid.

The survey also addressed data only services. Two jurisdictions treat data only services as prepaid; five jurisdictions do not tax data-only services; one jurisdiction taxes data only services under its sales and use and telecommunications tax; one jurisdiction taxes data only services as prepaid if bandwidth based; otherwise it is taxed as ways or means tax (use based) if unlimited; one jurisdiction taxes data only services under sales tax if it is a specified digital product; one jurisdiction taxes data only services under gross receipts tax; and one jurisdiction did not provide any guidance on this issue.

b. Estimate of Prepaid Wireless Service Tax Base

At the July 25, 2012, meeting, Bob McKee provided information related to prepaid cellular service labeled as prepaid when sold. Data was gathered from the Florida Public Service Commission, the Federal Communications Commission, and the Florida E911 Board

and used to develop an estimate of the number of wireless handsets labeled as prepaid services when sold that might be in service in Florida. An estimated tax base was provided based on high, middle, and low estimates of monthly service cost (\$55, \$45, and \$35, respectively). Market share of wireless service labeled as prepaid when sold was also estimated.

Estimates of tax revenues were presented using the above assumptions and assuming the tax rates for the state and local CST, and gross receipts tax remained the same. Also presented was an estimate of a possible rate reduction if the base is expanded to include prepaid service but the revenues are constrained to the official forecast in place at the time of the presentation.

c. Overview of Prepaid Plans

At the July 25, 2012, meeting, John Barnes, Senior Manager-Transaction Tax for MetroPCS, and Working Group member Kathleen Kittrick of Verizon, provided a joint presentation titled “31 Flavors of Pay Go, Pay-as-you-Go, Pay in Advance, Pay and go, Prepay...”. Several key qualities of wireless services labeled as prepaid when sold were provided. Among these qualities were: paid in advance before usage can occur; no credit extended, no credit checks, no overages; no long term contracts; higher retail selling price of handsets; and varieties of distribution.

Distribution of wireless services labeled as prepaid when sold happens in a variety of ways. National retail stores, convenience stores, direct remote via a company’s website or toll-free 800 number, indirect remote via an unaffiliated website or toll-free 800 number, direct retail in a company’s store, or indirect retail through unaffiliated retailers. Of these distribution systems, 72 percent of sales are through third parties (national retailers, convenience stores, etc.), 11 percent of sales are through direct retail and 17 percent are direct remote sales.

The history of wireless service labeled as prepaid when sold began in 1993. In 1995, more carriers began offering prepaid wireless plans to target the credit-challenged and budget

customer. The industry and services continued to grow in the late 1990s. In 1999, Leap/Cricket began providing “unlimited local” prepaid services without roaming charges, which offered an alternative to local wireline service. In 2002, MetroPCS began providing “unlimited local” services at a monthly rate, with long distance charged at \$.05/minute through a prepaid account and Virgin Mobile launched a model that could be recharged by phone or the Internet. In 2003, AT&T launched its Go Phone with a monthly plan that could be automatically replenished through a debit/credit card or a bank account.

A review of current MetroPCS prepaid products was provided. There are various types of plans that can include by-the-minute, by-the-week, or by-the-month payment options. Various types of features are available in the different types of plans from local and long distance, caller ID, voicemail, texting. A scenario was provided for a typical customer from the purchase of a handset, to selection of the rate plan and how the customer may use payment options and renewals.

Information on Verizon pay as you go plans was also provided. Types of plans included daily plans, by-the-minute or “unlimited” plans. A review of features available under these plans was provided to illustrate how the customer would use the services as well as make initial payments and renewals.

d. Retail Perspective

At the August 21, 2012, meeting, Mr. Warren Townsend, Specialty Tax Director at Wal-Mart, and Randy Miller, Executive Director of the Florida Retail Federation, provided insight as to the retail perspective of the sale of communications services labeled as prepaid when sold. Mr. Townsend expressed the view that retailers’ corporate structures are set up as retailers and not as providers of telecommunication services. If Florida were to classify retailers as telecommunication providers, the retailers would fall under requirements in several states. In addition, it would change their requirements on the federal level.

Understanding that Wal-Mart has a more sophisticated system for collecting fees than its competitors or small businesses, Mr. Townsend stated that he believed that retailers would be able to collect fees on a statewide flat fee basis at the point of sale. He added that fees or taxes collected on a percentage basis would be problematic, particularly for smaller businesses that may not be able to adapt their business equipment for collecting fees or taxes at different rates.

Mr. Miller expressed similar remarks that any fee imposed should be at the point of sale, like a sales tax that retailers have been collecting in Florida since 1949. The recommendation was that for whatever changes are made, it is important for the system to be simple to reduce errors that may happen if the system is complicated.

e. Industry Perspective

The Working Group received three written submissions from representatives of the telecommunications on the taxation of communications services labeled as prepaid when sold. One submission was received on behalf of AT&T, CenturyLink, Sprint, T-Mobile, and Verizon. The other submissions were received from MetroPCS and TracFone. All of the submissions support taxing communications services labeled as prepaid when sold as sales and use tax at the point of sale. At the December 7 meeting, John Barnes from MetroPCS testified concerning MetroPCS' written comments.

3. Unbundling of Communications Services

At the August 21, 2012, meeting, French Brown explained that the definition of "sales price" that was present in Chapter 202, F.S., before the enactment of Chapter 2012-70, Laws of Florida, included communication services and "any property or other services that are part of the sale." Changes made by Chapter 2012-70, Laws of Florida, allow charges for any goods or services that are not communications services, including Internet access, to be excluded from

the taxable sales price if such charges are separately itemized on a customer's bill, or can be reasonably identified in the selling dealer's books and records.⁴

The presentation also explained the difference between CST, which now allows unbundling, and sales and use tax, which does not generally allow unbundling. Examples were provided to show how a dealer's conscious decision to unbundle services can be hard for the Department or a customer to determine, based solely by looking at a customer's bill.

The twenty-five jurisdictions initially surveyed were asked additional questions related to unbundling. All allowed unbundling of transactions using the dealer's books and records except Connecticut, Louisiana, and Maryland. Massachusetts only allows unbundling for Internet access. New York allows unbundling of Internet access and it has guidance pending relating to the unbundling of other items and services.

4. Developments in Technology

At the August 21, 2012, meeting, Joy Spahr, Director of AT&T's Innovation Center, provided information on three main areas: the changing face of the Internet; the Internet as a value added platform that drives economic development; and the power of convergence. There was a discussion of how the public perceives the Internet as their favorite website, place to shop, place to download movies or games, or engage in activities such as email.

From the industry's perspective, the Internet is a series of hubs that interconnect. First, there are local access networks such as telephone, cable, satellite or even electric companies that provide access into the home. These local networks connect to regional backbone networks, which in turn connect to global backbone networks. Therefore, the Internet is a variety of interconnected networks using a common protocol by hundreds of thousands of

⁴ While there is no definition of "unbundling" in Florida law, "unbundling" is commonly understood to allow a seller of products or services that are sold for one non-itemized price to break apart and separately itemize for tax purposes distinct and identifiable products or services that are sold for the non-itemized price. When doing this, the seller is not required to provide the separate itemization of the products or services to the purchaser.

providers in the marketplace. In addition, there are over 200,000 private and semiprivate networks that are also interconnected using the Internet protocol.

To demonstrate the speed of change of technology, growth rates for usage of the Internet from 2007 to 2012 were provided. Electronic data generated has increased by 38 exabytes to 309 exabytes, or 713 percent. Internet users have increased from 1 billion to 2.26 billion, an increase of 126 percent. You Tube daily downloads have grown from 100 million to 4 billion, an increase of 3,900 percent. Facebook has grown from 50 million to 800 million users, an increase of 1,500 percent. Tweets per day have increased from 5 thousand to 250 million, an increase of 50,000 percent.

There has also been a growing trend of wireless substitution, the discontinuing of residential landlines in favor of wireless phones. As of 2010, nearly 30 percent of all United States households had discontinued their landline service, up from 25 percent the year before. It was estimated by the National Center for Health Statistics for the period of July 2009-June 2010, that 27.3 percent of individuals age 18 and over and 34.2 percent of individuals under age 18, live in homes that use cell phones as their primary home phone. Worldwide there were 6 billion mobile subscribers with most of the demand being for data.

The issue of the Internet as a value-added platform in order to stimulate growth is, from an industry perspective, a way to monetize the platform. An example of this is a platform such as iTunes that enhances the demand for Apple devices. Companies will be trying to create two-sided or value added platforms in order to generate economic development.

The power of this convergence has five major discontinuities: common protocol; broadband everywhere; wireless; multi-access interactive devices; and delayering and open IT platforms. In the past, there were multiple technological backbones for each access technology or services. Convergence allows for multiple access technologies and services on one Internet Protocol based backbone.

5. Audits

At the August 21, 2012, meeting, Peter Steffens of the Department's General Tax Administration Program provided information on the Department's experience auditing dealers for the CST. Since the creation of the CST, the Department has conducted 1,374 audits with collections totaling \$129,784,209 from 2003 to 2012. It took 121,336 hours to conduct these audits.

Major issues identified in audits include: situsing; surcharges and fees; improperly exempted sales; unsupported bad debts and credits; filing or accounting errors; and other records issues. All of these issues relate to the difficulty the Department has in obtaining access to historical or other supporting records. There have been many difficulties in auditing for compliance with CST situsing requirements. These difficulties include:

- Access to complete billing cycle or accounting data,
- Customer data that is not readily associated with billing systems,
- Multiple billing systems or third party billing systems,
- Difficulty in matching accounting records to returns filed, and
- The ability to isolate taxable from exempt customers.

Additional difficulties include incorrect addresses or incomplete databases, lack of a usable jurisdiction assignment in the database or accounting records, lack of customer service address information, and jurisdictions excluded from returns or default jurisdictional assignments.

Concerning surcharges and fees, there are difficulties with similarity in names and distinguishing if a purchase is taxable or exempt. As with situsing, it can be difficult to interpret a customer's bill with regard to tax base and rates that are used.

Improperly exempted sales have shown several areas of concern. At times, a dealer may be collecting sales and use tax for communication services. There have been problems

determining when the residential exemption has been applied or when a resale has occurred. As with the previous issues, access to historical or other support records can be problematic. There has been difficulty determining the situsing of improperly exempted sales or in isolating an exempt transaction. It can also be difficult to determine which portions of a transaction are exempt.

Statutory provisions concerning bad debts and credits can at times be confusing. It is difficult in audits to isolate when bad debts or credits are taken. There have also been difficulties in reconciling revenue and credits to accounting records and returns.

There are often differences between filing and accounting periods. This situation can be caused by using different period cut-off dates or late reporting of all or a part of each month filed. As a result, it is difficult to match records to returns or billing cycles, and customers to returns.

Other records issues that have occurred in audits include historical records that are not available or are in a format that the Department may not be able to use electronically. Generally, there is no history for the products or services that were offered and how they may have been bundled. There have been times when there are insufficient records to support reallocation of past amounts that have been reported. The fast pace at which the industry is changing can present difficulties, because there may be multiple entities comingled, the entity could change, or there could have been a change in area where the entity provides service.

VII. Options

A. Overview

At the conclusion of all of the presentations, the Chair asked Working Group members to submit options for the group's review. Members of the public and representatives of industry were also encouraged to submit options. The Working Group received submissions from: Charles Dudley, Sharon Fox, Gary Lindsey, Mayor Gary Resnick, Alan Rosenzweig, Davin

Suggs (Florida Association of Counties), Marshall Stranburg, the Florida Retail Federation, and the Telecommunications Industry (AT&T, CenturyLink, Sprint, T-Mobile, and Verizon). The Working Group also received submissions from MetroPCS on December 6, and TracFone on December 24.

At the October 16 and October 31 meetings, the Working Group discussed the merits of each of the proposed options. Through this deliberative process, the Working Group determined that the proposed options could be grouped into one of the following three categories:

- Holistic Replacement of the CST;
- Partial Replacement of the CST, and
- Fix the CST.

As will be discussed below, the Working Group concluded that the best approach to modernize the current tax structure, streamline the administrative system, and remove competitive advantages without reducing local government revenues, would be to adopt the Holistic Replacement option. This option would repeal the CST and bring all communications services under the sales and use tax of Chapter 212, Florida Statutes.

At the December 7 meeting, the Working Group continued to discuss the merits of the Holistic Replacement option. The Working Group also discussed implementation issues associated with the option.

B. Findings and Observations

The Working Group makes the following findings and observations based on the information and testimony provided at the six public meetings held to review the CST and develop options for improving the system. The Florida CST was enacted to simplify and reduce the number of state and local taxes on communications providers and consumers. State and local governments have relied upon CST revenues to support government services and to

secure bonded debt. While the CST worked as designed for several years, it is no longer a reliable source of funding for state and local governments. The CST revenue base for state and local governments is at risk due to changes in technology and the market, the sales of services by providers lacking nexus with Florida, and the increasing availability of applications that are being sold as substitutes for communications services. In addition, while the use of wireless services has increased significantly, prices have fallen, which also has negatively impacted CST revenues.

C. Holistic Replacement Option

The Working Group recommends repealing the CST and instead taxing communications services under the sales and use tax of Chapter 212, Florida Statutes. This option will allow the sales and use tax base to include a broad range of communications services that would be subject to the same state and local tax rates as other taxable goods and services. This proposal would solve many of the problems inherent with the current CST structure and position Florida to fairly capture revenue from a broad base of communications services today and in the future.

This proposal would significantly reduce or eliminate the tax differential between different types of communications services. It would bring taxation of contract wireless plans in line with the current taxation of prepaid calling arrangements under the sales and use tax, which taxes the sale of prepaid calling arrangements at the point-of-sale.

Additionally, should Congress pass the Main Street Fairness Act or other similar legislation to permit states to require remote sellers to collect sales and use taxes, Florida would be positioned to collect tax equitably. This would place all providers on a level playing field, an important benefit of replacing the CST with the sales and use tax. All of the bills currently being considered by Congress to grant state the power to enforce collection on remote sellers would only apply that power to the sales and use tax, not to other taxes like the Florida CST.

This proposal also would streamline the administrative system. Instead of an entire structure necessary to administer the CST as a stand-alone tax, this proposal would allow the Department to administer the tax under the existing sales and use tax administrative structure.

While a small increase in the state sales and use tax will be needed to offset the loss of revenues from the repeal of the CST, KSE Partners, LLP, estimates that the “typical” Florida taxpayer and the “typical” small business will pay less in overall taxes under this approach.⁵

This estimate was prepared at the request of the Working Group. An excerpt from the analysis provides as follows:

For the typical taxpayer, it is assumed that the household has one landline telephone, a wireless “family share” plan with 3 lines, and a typical Cable TV package. For the small business, it is assumed that the small business has 10 business landlines, 10 wireless lines, and a typical Cable TV package. For the small business, it is assumed that the small business has 10 business landlines, 10 wireless lines, and a typical Cable TV package.

The representative household pays just under \$400 per year in CST at an average assumed rate of 15.17%. If the CST were repealed, the tax on the same package of communications services would drop to about \$210 assuming that the current average state-local sales tax rate of 7.25% were increased to 7.55%. This household would need to make about \$62,000 in taxable purchases to pay more than the \$190 in net savings from repeal of the CST. If this household filed an itemized federal tax return, and Congress extends deductibility of sales taxes, the threshold in taxable purchases rises to \$86,000 in taxable purchases assuming that the taxpayer is in the 28 percent bracket.

[For the typical small business,] ... the business would need to make in excess of \$335,000 in taxable purchases to pay more in sales taxes than they would save in CST under the proposed reform.

D. Implementation of the Holistic Replacement Option

Because communications services are taxed at a rate much higher than the sales and use tax, a small increase in the state sales and use tax rate will be needed to replace the revenues that are currently generated by the CST. The Department’s Office of Tax Research estimated that the state sales and use tax rate would need to be adjusted from 6 percent to 6.34 percent,

⁵ See Appendix ____

based on the official revenue estimates for CST and sales and use tax in place at the time of the estimate.⁶

The Working Group recognizes that the CST is a significant part of local government funding. While local governments support this approach, they want to ensure that replacing the CST with sales and use tax will not have a negative impact on local government revenues. Based on these concerns, the Working Group submits the following policy statements to accompany its recommendation:

- Ensure a neutral fiscal impact on state and local governments;
- Ensure that each local government jurisdiction will be held harmless;
- Recognize that the sales and use tax revenue stream is a replacement for the communications services tax; and therefore, referendums by the cities or counties are not required;
- Provide that revenue streams for local governments will be unrestricted; and
- Ensure that distributions will be provided directly to municipalities and counties.

The Working Group also recognizes that this revenue stream will be used to secure existing and future state and local government bonds. Accordingly, this change to the tax structure must be implemented in a manner that ensures that state and local governments are able to bond the revenue stream, and that existing bonds are not impaired.

At the state level, PECO bonds are of particular note. PECO bonds are funded from the Public Education Capital Outlay and Debt Service Trust Fund. This is a constitutionally authorized trust fund that is referenced in Article XII, Section 9 of the State Constitution. The State Constitution provides that gross receipts collected under Chapter 203, Florida Statutes, are to be placed into that trust fund. With the elimination of the CST and Chapter 202, Florida Statutes, under which the gross receipts tax is administered and collected, sales and use tax

⁶ See Appendix III.A for detailed analysis.

revenue will need to replace the gross receipt tax revenue and revisions to laws to accomplish this result appear to be necessary.

There will also be technical issues that will need to be addressed with the adoption of this approach. Issues that should be reviewed include:

- The treatment of bundled services under the sales and use tax;
- Whether exemptions under the CST should be incorporated into the sales and use tax structure;
- Tax rounding, which differs in treatment under the sales and use tax;
- The treatment of direct-to-home satellite service since federal law prohibits imposition of the local option sales and use surtax; and
- The formula to be used to distribute replacement revenues to local governments.

The Working Group also suggested that the Legislature consider adopting national standards for defined terms. The Working Group generally viewed the definitions provided in the Streamlined Sales and Use Tax Agreement as a good model that is widely recognized and used by a number of states.

E. Partial Replacement Option

The Working Group also considered an option that would replace the local component of the CST with a uniform local option sales and use surtax. This approach would provide uniformity among the jurisdictions and simplify administration of the tax. The Working Group requested from the Department's Office of Tax Research an estimate of the necessary rate of local option sales and use surtax (also known as the local discretionary sales surtaxes) that would generate revenues sufficient to replace the local component of the CST. In calculating the rate, both current levies and unutilized CST capacity were considered.

The rate necessary to replace municipal and county local CST revenues was calculated. The highest replacement was 0.482 percent for Clay County and the lowest replacement rate was 0.101 percent for Walton County. To replace all revenue statewide would require a local option rate of 0.282 percent.

In calculating the replacement rate, only utilized and unutilized local CST and utilized local discretionary sales surtaxes were included. Unutilized local discretionary sales surtaxes levies were not included. The imposition of a local discretionary sales surtax results in an additional rate of local CST imposed countywide. Currently, there is \$57 million in utilized local discretionary sales surtaxes –local CST that was included in the analysis.

There is an additional \$225 million in unutilized local discretionary sales surtax that was not included in the analysis. Current law allows up to 4 percent discretionary sales surtax in certain counties. However, no county has ever imposed more than 1.5 percent. There is currently \$73 million in unutilized local discretionary sales surtax if all counties were to levy a local discretionary sales surtax at a rate of 1.5 percent.

While this option was considered, it was ranked behind the Holistic Replacement option.

F. Fix the Communications Services Tax

The other proposed options were grouped under the other category – Fix the CST. These options are contained in the appendix, along with an outline that groups the options by topic and identifies the person or entity providing the submission. While implementing one or more of the proposed options might mitigate some of the problems with the current system in the short term, the Working Group was of the opinion that a comprehensive long term solution, such as the one reflected in the Holistic Replacement option, is needed to modernize the taxation of communications services.

Appendices

- I. Section 12, Chapter 2012-70, Laws of Florida
- II. Options:
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 - b. Charles Dudley
 - c. Sharon Fox
 - d. Gary Lindsey
 - e. Mayor Gary Resnick
 - f. Alan Rosenzweig
 - g. Brian Smith
 - h. Marshall Stranburg
 - i. Florida Association of Counties
 - j. Florida Retail Federation
 - k. Telecommunications Industry (AT&T, CenturyLink, Sprint, T-Mobile, and Verizon)
 - l. MetroPCS
 - m. TracFone
- III. Data Related to Holistic and Partial Replacement Options
 - a. Holistic Replacement Option
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 - c. Memo from SE Partners Dated 1/3/13
- IV. Meeting Minutes
 - a. June 11, 2012
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- V. Meeting Materials
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 - e. October 31, 2012
 - f. December 7, 2012

Appendix II

Options

COMMUNICATIONS SERVICES TAX WORKING GROUP

INDEX TO WRITTEN OPTIONS SUBMITTED TO THE WORKING GROUP FOR CONSIDERATION

I. Options to Streamline the Administrative System

A. Rate Structure

1. Statewide Rate with Distribution Formula

- a. Eliminate CST and apply sales and use tax (Lindsey, Telecom Industry, TracFone)
- b. Create single statewide CST rate with distribution formula to local governments (Dudley, Lindsey)
- c. Create structure in which rates are uniform at state and local level regardless of technology (Smith)
- d. Create Local Statewide CST rate with distribution formula to local governments (DOR)
- e. Create Local CST rate at county level with distribution formula to local governments (DOR)

2. Other

- a. Substitute an alternative revenue-neutral revenue source (Fox)
- b. Revise tax structure to impose sales tax on internet retailers (Resnick)
- c. Maintain CST “as is” (Lindsey)
- d. Return to system prior to creation of CST (Lindsey)

B. Transparency

1. Require customer bills to indicate whether a tax or fee is government imposed (Resnick)
2. Specify the consequences that will result when customers are not provided with a breakdown of taxes (DOR)
3. Allow providers to further breakdown the Florida Communications Services Tax into state and gross receipts tax (DOR)
4. Create a requirement that, when requested by customers or DOR, providers must provide a breakdown of bundled services (DOR)
5. Create an incentive for providers to notify customers and DOR of the breakdown of bundled services (DOR)
6. Authorize additional information sharing for DOR to share provider information with customers (DOR)
7. Clarify use tax owed by customers on bundled services (DOR)

C. Records

1. Reverse 2012 law changes on books and records when determining “sales price” (Fox)
2. Clarify records that must be maintained (DOR)
3. Require searchable records for audit purposes (DOR)

D. Audits

1. Provide additional resources for DOR to increase audit capacity (Fox)
2. Mandate more audits and contract for external auditing services (Resnick)

E. Refunds

- Clarify statutes on distributions to local governments when there are large refunds (DOR)

II. Options to Remove Competitive Advantages within the Industry as it relates to the State's Tax Structure without Unduly Reducing Revenue to Local Government

A. Tax Base

1. Broaden the Base

- a. Tax like services the same regardless of technology or service provider (Fox, Smith)
- b. To extent base is expanded, reduce rates (Smith)
- c. Repeal CST and broaden sales and use tax base (Lindsey, Telecom Industry)
- d. Include digital goods in sales and use tax base for goods that have been sold in tangible form (DOR)
- e. Clarify definition of video service to include payments for licensure of content (DOR)

2. Residential Exemption

- a. Eliminate residential exemption (Dudley, Resnick, Fox)
- b. Clarify residential exemption only applies to landlines (DOR)

3. Franchise and Permit Fees

- a. Unbundle franchise and permit fees from CST for local administration (Fox)
- b. Restore local franchise and permit fees, without reducing CST, for local administration (Resnick)
- c. Consider whether localities should be entitled to payment for actual and direct use of rights of ways (Smith)

B. Prepaid Communication Service

1. Amend definition of prepaid wireless communication services

- If CST not eliminated, modernize the definition to encompass current offerings (Lindsey, Telecom Industry, MetroPCS and TracFone)

2. Alternative methods of taxation

- a. Create single statewide flat tax (Lindsey, DOR)
- b. Impose surcharge on prepaid wireless communication service at time of purchase (Resnick, Fox)
- c. If prepaid calling plans and arrangements cannot be taxed or surcharged at the point of sale, tax each minute using 9-1-1 location from which the minutes are sent to situs the tax (Fox)
- d. Apply sales and use tax and a gross receipts tax (DOR)
- e. Consider gross receipts tax on provider with offset if CST is collected (DOR)
- f. Clarify that CST applies to Communications Services (Lindsey)
- g. Exempt retailers from collecting CST and collect sales and use tax (Florida Retail Federation)

III. Other

- A. Convene a working group to draft legislation (Fox)
- B. Recommend the Legislature adopt a policy concerning local governments (Resnick)
- C. Adopt Guiding Principles for Changing the Tax Structure (Lindsey, Florida Association of Counties, Rosenzweig)

Communications Services Tax Working Group

Options for Consideration

Submitted by Working Group Member:

Charles Dudley

CST Task Force Options and Background
Submitted by Task Force Member Charles Dudley
September 14, 2012

- I. Findings - based on testimony and written materials presented to the Task Force. The following are my interpretation/observations for suggested Findings:
- A. CST state and local revenues have been and are projected to continue to decline. Several reasons for this were presented by DOR staff and others:
1. Substitution of "non-taxable" services, mostly delivered over the Internet (i.e., over the top services), for taxable services - video and voice examples were provided and demonstrated (*August 21, 2012 Agenda, Tabs 5 & 6*)
 2. While there is a "use tax" component of the CST, the same administrative and enforcement problems that DOR faces in regard to the sales and use tax on the on-line sale of goods and services negatively impacts CST receipts (*August 21, 2012 Agenda, Tabs 5 & 7*).
 3. The growth of "pre-paid" wireless, as a substitute for more traditional, post-pay plans, has impacted CST receipts. There is a dispute over the statutory interpretation of the application of the CST to pre-paid wireless, but the DOR has issued a formal opinion saying pre-paid is taxable under CST. Retailers testified that they are NOT dealers of communications services. Providers of pre-paid wireless services and retailers presented legal counter arguments to the DOR interpretation and several administrative issues that make collection/enforcement of the CST on pre-paid very difficult and some would say impossible, especially since 72% of these pre-paid services are sold by non-dealer third parties and 17% via remote sales (*July 25, 2012 Agenda, Tab 7, Slide 4*).
- According to the DOR survey, nearly every other state subjects pre-paid to sales tax only. (*June 11, 2012 Agenda, Tab 4, Slides 33 and 40*) The pre-paid/CST issue is one that may require more time, study and review - similar to the approach taken regarding the application of Florida's 911 fee to pre-paid wireless. Interestingly, the title of one of our pre-paid presentations—"31 Flavors of Pay Go, Pay-as-you-Go, Pay in Advance, Pay & 60, Pre-Pay..."-- illustrates many of the difficulties in defining and implementing changes to the taxation of pre-paid. (*July 25, 2012 Agenda, Tab 7*)
4. While the use of wireless services has clearly increased dramatically, prices have fallen, impacting CST receipts, while the growth of internet access services which are exempt under federal and state law from taxation has

resulted in reduced CST receipts. *(Several DOR presentations to date and EDR)*

- B. DOR audits over the last 12 years have resulted in the additional collection of revenues that represent **less than 1%** of total CST collections, while costing the DOR auditors over 60,000 hours (nearly 50% of total = 121,336). DOR testified and presented data that over 50% of its CST audit staff's time and energy was spent on "situsing" issues, but the resolution of those issues only resulted in "around 20%" of the total additional revenues collected. *(August 21, 2012 Agenda, Tab 7)*
- C. As wireless devices and services have grown exponentially, landline service has correspondingly decreased. *(June 11, 2012 Agenda, Tab 5, Slide 16)* All wireless accounts are determined to be "non-residential" under the CST and so customers who use their wireless phones as their primary phone or as a substitute for their former landline phone, do not receive the benefits of the partial residential exemption to the state sales tax component of the CST *(June 11, 2012 Agenda, Tab 8)*. The residential exemption in 2012-13 has a value of \$124m. If repealed, and the state sales tax component of the state CST was reduced in a revenue neutral manner, the current 6.65% sales tax rate component would become 5.95%, resulting in an overall rate of 8.47% on all communications services subject to the State CST. *(July 25, 2012 Agenda, Tab 6, Slide 11 and phone call with B. McKee)*
- D. Florida has the highest state CST taxes in the country and the second largest variance of local CST tax rates according to the DOR survey. *(June 11, 2012 Agenda, Tab 4, Slides 24 and 25)*
- E. Local governments rely on their CST revenues as a source of general operating revenue as well one of their more reliable sources of revenues to pledge in cases of bond financing. Any changes to the CST law that impact the amount of local CST revenues need to take into account these factors *(July 25, 2012 Agenda, Tab 5)*, and, according to our Mission, our options should not "unduly" reduce local CST revenues *(August 21, 2012 Agenda, Tab 1)*.
- F. The revenues generated by the State gross receipts portion of the CST have similarly decreased over the last several years - and when combined with falling utility gross receipts - has limited the state's ability to issue new bonds for school construction. There was no option or other ideas presented for how to address this issue in terms of changes to the CST, but any changes should take into account their impact on these receipts. *(June 25, 2012 Agenda, Tab 8)*

II. Options

At the July 25, 2012 Agenda, DOR put forth at Tab 4, Slide 6, Guiding Principles for how a tax structure would ideally function: Reliable, Simple, Neutral, Transparent,

Fair, and Modern. Clearly, Florida's CST needs significant reform in nearly every one of these areas, especially given the pace of technological change over the last 11 years since the CST's effective date.

In reviewing the materials and testimony presented to the Task Force to date, these suggested Guiding Principles, and the statutory "Mission" of the Task Force, I would offer the following options for consideration:

Option A - eliminate the partial residential exemption for voice services from the state sales tax component of the CST and suggest a corresponding revenue neutral reduction in that tax rate.

Option B - eliminate the situsing requirements for the local CST component and move to a single statewide CST rate as is currently done for DBS service, the rate of which is 13.17%. DOR and interested parties would work to develop a distribution mechanism similar to what is currently done with 4% of the DBS tax to cities/counties. There may need to be a phase-in moving to the 13.17% unified tax rate (or lower upon adoption of Option A and reduction of the state sales tax component of the state CST) in which the impact on each city and county could be minimized by guaranteeing certain revenue amounts; additional state CST revenues could be added to the distribution pool for sharing; or other methods consistent with the Guiding Principles and Mission.

While many details would remain for further review and discussion, I submit that these options would meet the criteria set out in the suggested Guiding Principles and the Mission of the Task Force.

Communications Services Tax Working Group

Options for Consideration

Submitted by Working Group Member:

Sharon Fox

Introduction:

The development of the CST was a consensus effort of the state, communications service providers, and local governments, intended to simplify the administrative burden of the seven different state and local taxes and fees for both the communications industry and local governments, by employing the Florida Department of Revenue (DOR) to receive, track, and distribute the resulting tax revenues and audit any discrepancies, as they already did for the state's sales and gross receipts taxes.

The CST was initially implemented to cover the broad spectrum of communications services, such that all communications services were taxed, giving no one service provider or communications service delivery method benefit over another, no matter the technology used. Additionally, the taxable base was broadened, such that the seven different state and local taxes and fees, when bundled into a single tax on the larger base, provided revenue neutrality and a stable, bondable revenue source to each of the governmental entities, a single entity for the communications industry to be accountable to for reporting and collection purposes, and a reduced cumulative tax rate on communication services for taxpayers.

Legislative and technological changes which have occurred over the past several years have resulted in a diminution of CST revenues to the state and to local governments, diminishing the reliability of this revenue stream for future bonding needs. These changes have additionally resulted in like services being taxed differently depending on the service provider or method of sale, causing the very discrimination that the Communications Services Tax Simplification Law was intended to prevent and confusing taxpayers in the process.

We have heard industry members' concerns regarding the difficulty in situsing services to the appropriate local jurisdiction, particularly regarding the taxable prepaid market; and the complexity and time-consuming nature of CST audits, given the number of jurisdictions involved, the available records, and the limited resources available to DOR.

In this light, municipal governments propose a number of options which, while individually not sufficient to address all noted concerns, when taken in combination with others may provide assistance in stabilizing the revenue stream for state and local governments, address concerns voiced by DOR regarding the complexity of administration, and provide the communications industry with relief regarding the prepaid service market and removing competitive advantages within the industry.

Option #1: Further broaden the taxable base, including all like services without exemption, no matter the technology or service provider used. (a) Eliminate the prepaid calling arrangement tax exemption in its entirety, and establish a methodology to assess a tiered surcharge, based upon the amount of the sale and sitused to the place of purchase. Industry presentations indicated that the bulk of the retail prepaid sales is repeat walk-in business, which leads one to conclude that the location of the sale is in the vicinity of its use. Given the lack of personal data collected, the place of a prepaid cash sale is a reasonable location for situsing for CST purposes. The retail presenters seemed to indicate that taxation in this situation was do-able through a surcharge at the point of sale, while they were averse to a different tax rate for prepaid sales, as vending machines and small retail establishments could accommodate a surcharge better than a varying tax rate. Tiering would prevent a customer from paying

the same amount of surcharge on a \$20 basic prepaid calling plan as would be paid on a \$120 enhanced prepaid calling plan, while further stabilizing the revenues currently being lost for lack of situsing ability.

(b) If prepaid calling plans and arrangements cannot be taxed or surcharged at the point of sale, tax each minute of use using the 9-1-1 location from which the minutes are sent to situs the tax.

(c) Eliminate the state residential tax exemption on communication services, which would make the administration and audit of the CST less burdensome, by further homogenizing the base for both the local and state components of the base.

Option #2: Unbundle franchise fees from the Communications Services Tax and return franchise fees and the administration of franchise agreements to local government. Franchise fees have traditionally been seen as license to do business within a specific jurisdiction for the privilege of providing services for profit for the company using the rights-of-way, and rent for the use of the jurisdiction's rights-of-way, in lieu of the need to contract with each parcel owner along the route where facilities have been placed (be they for electric, gas, communications, chilled water, etc.) Local franchise fees on gross revenues generated through the use of local rights-of-way is a nationwide method of providing a stable revenue stream for use for debt service or other local purpose, and most states other than Florida continue to allow franchise fees for use of rights-of-way by communications service providers, in addition to any other state and local taxes and fees. Franchise fees are simply another expense associated with a particular business model, i.e. the cost of renting rights-of-way for the physical placement of facilities. It is not a cost that satellite providers incur, but neither do cable operators have the same cost structure for technology that satellite providers have. Consequently, returning to the local collection of franchise fees is not violative of the goal of tax neutrality within the industry.

Option #3: Substitute an alternate, stable and revenue-neutral combination of revenue sources to replace the utility tax, franchise fee and permit fee components of the original CST bundle of seven taxes and fees. The alternate revenue stream should be able to be used for any public purpose, from continuing local government operations to public safety expenditures to debt service payments on infrastructure improvements, etc.

Option #4: Provide additional resources for DOR to increase audit capacity, given the complex and time-consuming nature of CST audits. (a) DOR currently has the authority to assess up to 1% of the total revenue generated for all taxing jurisdictions, and the total administrative costs must be prorated among those taxing jurisdictions on the basis of the amount collected for a particular jurisdiction to the total amount collected for all jurisdictions. However, the full assessment is not being spent to support audits for local government CST components. Municipal governments believe that adequate resources should be made available to the Department of Revenue such that they are able to perform the audit functions necessary to maximize revenues and minimize non-compliance. Additionally, if an increase in the 1% allowed by statute is necessary in order to justify additional audit coverage and audit manpower, then we support the 1% be increased.

(b) **Municipal government believes that the definition of "additional resources" should include financial sanctions (such as loss of collection allowance) for communications service dealers who do not comply with due diligence requirements in the assignment and maintenance of customers to local taxing jurisdictions.** Simplification should not mean that communications services providers are allowed to disregard the situsing provisions of Chapter 202, as such tactics merely punish the taxpayers who do not receive the benefit of their taxes, add additional burden to DOR to determine where the

communications service providers customers are located, and relieve service providers of the accountability for the task for which they are paid with collection allowances. Consequently, recent changes made to Chapter 202.22 (5) and (6) should be reversed.

Option #5: Reverse 2012 statutory changes to Chapter 202.11(13) allowing books and records to be used when determining sales price for other than internet access services when non-taxable property or other services are bundled as part of the sale and for which the charge is not separately itemized on a customer's bill. This provision is contrary to how Florida Sales and Use Tax is administered in Chapter 212, thereby increasing the complexity and administrative burden on the Department of Revenue, while adding yet another loophole to diminish the stability of the CST. Communications service providers previously had the option of separately stating charges for taxable and non-taxable items, and could revert back to that ability.

Option #6: Unbundle permit fees from the Communications Services Tax and return permit fees and the administration of permit fees to local government. If franchise fees are unbundled from the CST for local administration, then rights-of-way construction permit fees might also be considered to be unbundled for local administration. The local governments have the responsibility of making sure that construction in the local rights-of-way is done properly and that the construction site is restored to its original condition, for the safety of the traveling public. Permit fees cover the costs to review plans and inspect the work sites. Providers sometimes forget the purpose of construction permits when there is no direct cost associated with them.

Option #7: Municipal government recommends that a working group chaired by the Department of Revenue be convened to draft legislation to implement consensus recommendations. The options above are offered in the spirit of beginning a meaningful dialogue on the difficult issues before the CST Working Group. They are not meant to be exclusive and it is certain that additional new ideas will be identified as the Working Group continues its work. But we believe it is incumbent on all to begin to discuss solutions to the various problems that have been identified to date, and these options are offered to begin the discussion.

Discussion Re: CST Working Group Options
Sharon Fox, Working Group Member Representing Municipal Governments
December 7, 2012

The Communications Services Tax (CST) was implemented in 2001 as a replacement or swap for existing tax and fee revenues that were critical to the funding of municipal governments in Florida from their inception. The CST was not new-found money, but simply replaced funding that had been received through the separate revenue streams of negotiated franchise fees for private use of the public rights-of-way; locally imposed utility taxes, which appear to have been put in place in the 1940's to help fund local government; and permit fees for construction and inspections of work performed in local rights-of-way for the safety of the traveling public. Two of these revenues were, and continue to be in their rebirth as the CST, used to secure municipal bonds.

The design of the CST came about at the request of the communications industry, as a way to simplify the then current multi-tax and fee structure, which also included state and county taxes and fees. It taxed like services no matter what type of company was providing them, and eased the volume of reports required to be filed and the number of governmental entities to which industry was reporting. In return, local governments were promised a more stable revenue stream covering a broader tax base, to protect them from income erosion due to changes brought about by the type of company or method of service delivery utilized. Through consensus, the CST language was designed expansively, so that state and local governments would continue to receive bondable funding on communications services and participate in the benefits realized by growth in the market, no matter how the services were provided.

The CST functioned as designed for several years, but regulatory changes and technology developments have again blurred the lines between taxable and non-taxable services, diminishing the taxable base and eroding this vital local government revenue stream. The migration to provisioning services over the Internet, coupled with the federal moratorium on taxing Internet access, is taking an increasing toll on the CST taxable base. Without the elimination of the moratorium, the sustainability of even current levels of tax revenues is highly unlikely. Additionally, the communications industry expresses frustration regarding the difficulty in accounting for the taxes collected within the many Florida jurisdictions; the tax rates which, while lower than the individual rates paid prior to the CST, are higher than for other commodities in the state that do not use local rights-of-ways for provision to their customers; and the disparate treatment of like services depending upon the method of delivery or the company providing the services.

Solution Components:

Prepaid Services: Of immediate concern is the current treatment of prepaid wireless communications services, the bulk of which appear to be charged the regular sales tax rate at the point of sale, instead of being charged the Communications Services Tax, because of the misunderstanding of a limited prepaid calling arrangement tax exemption which has little bearing on current market offerings of prepaid services. In order to eliminate the misunderstanding, the tax exemption must be eliminated in its entirety. Retail vendors of/outlets for prepaid calling products indicate they are not equipped to charge a different tax rate other than the sales and use tax rate in their county, which causes disparate tax treatment, depending upon whether similar wireless services are sold postpaid or prepaid. The Working Group heard testimony indicating, however, that a surcharge at the point of sale on prepaid services could be

accommodated to address the tax disparity. Additional comments seemed to indicate that a tiered surcharge, based upon the amount of sale, was do-able, to prevent overcharging on minimum service offerings and undercharging on premium prepaid products.

We believe that this solution is within the realm of possibility for the immediate legislative session, both helping stem the erosion of CST revenues to both state and local government, and correcting, if only for the short term, the disparity of tax treatment for similar services.

Unbundling: Again of immediate concern, is the option to use books and records in the determination of sales price of taxable services in bundled offerings. HB 809, enacted in 2012, took a marked change in direction than has long been allowed under Florida tax policy and law. Chapter 202.105(13)(b)8, F.S. now allows books and records kept in the regular course of business anywhere in the dealer's entire service area, to be used to determine sales price for CST purposes on all charges for bundled services.

Florida's sales and use tax provisions at Chapter 212.02(16), F.S., continue to strictly limit the unbundling for sales tax purposes to "charges of Internet access services which are not itemized on the customer's bill," and only "to the extent required by federal law." Providers continue to have the ability to prevent customers from being taxed on "charges for property or other services that are not part of the sale of communications services, if such charges are stated separately from the charges for communications services" per Chapter 202.105(13)(b)7. The new ability for providers to pick and choose taxable sales prices from books and records anywhere in their nationwide service area or beyond has the potential for significant revenue loss to the State of Florida and local governments. It also makes the calculation of CST on a customer's bundled bill impossible for the customer to calculate, and time consuming for the Florida Department of Revenue to verify. Additionally, this new provision will cost more for DOR to audit, making the tax even more difficult to administer.

The impact of early adopters of this law allowing the reduction of the CST tax base when bundling is utilized is already proving that local government was justified in fears of the negative effect to the local government revenue stream. Since the CST revenues are bonded, a noticeable reduction in the amount received without an offsetting increase in revenues from another source may have the unintended consequence of impacting local government bond ratings. This situation can be addressed in the immediate legislative session by reversing the unbundling provision adopted in 2012 for purposes of CST. Should industry wish to address the taxation of non-taxable services which they also provide, they would continue to have the option of separately stating charges for those items on the bill, thereby preventing their customers from being taxed on them.

Elimination of the State Residential CST Exemption: This solution piece would make the administration and audit of the Communications Services Tax less burdensome for DOR, by further homogenizing the base for both the local and state components of the tax. It would also assist in reducing the current erosion of tax revenues for the state and local governments.

Alternate Sources of Revenues:

The nature of the industry seems to be gravitating to greater use of Internet access technologies in the provision of communications services, which, because of the current federal moratorium of Internet access taxation, appears to greatly impair the long-term viability of the CST for municipal funding purposes. To that end, we believe that the Legislature, the communications industry, the State of Florida, and local governments need to again address the bigger picture in a search for various other funding sources, whatever they might be. What

those other funding sources are remains to be seen, however, a few potential components that have been discussed during the working group meetings are addressed below:

Rights-of-Way Fees: While rights-of-way fees alone are not sufficient to address the fiscal replacement of the CST, the solution chosen should include a component consisting of payment for use of the rights-of-way to the jurisdictions in which rights-of-way are being used, by the communications companies that derive benefit from use of the public rights-of-way for their shareholders' benefit. The State of Virginia has a component of their communications services tax design that takes into consideration such use of public rights-of-way for private benefit. A monthly fee is assessed of each communications customer in order to provide the industry's share of the burden it places on each community through use of public rights-of-way.

A different methodology to consider for a rights-of-way component is that of allowing the return to the negotiated franchise fee agreement between every company that utilizes rights-of-way and the corresponding jurisdiction where that company has communications facilities in the rights-of-way, such as is done for users of the local rights-of-way for non-communications purposes.

State-imposed Local Option Sales Tax: An option that might be considered is the uniform sales and use tax for the state plus a guaranteed local option sales tax for the local jurisdictions. This local option component would initially be imposed by the state, as a substitution for the CST, with the rate for each county to be established by the state in a manner similar to that which was utilized upon the inception and implementation of the CST in 2001. Local municipalities have several concerns regarding a sales tax solution that must be addressed in order for this to be a viable replacement revenue source, as the CST is one of the few sources municipalities have that is a locally-assessed revenue stream with no prohibitions or strings attached as to how the funds can be utilized:

- 1) The initial rate for each individual county would be a composite calculated from the amounts of all jurisdictions received within the county, plus a percentage to cover lost revenues from prepaid services to date, in order to produce sufficient revenue to hold each local jurisdiction in the county harmless. Each jurisdiction must be guaranteed what it was getting prior to the date of the swap, in order to accommodate any bond stipulations for currently-pledged CST funds.
- 2) The Legislature must enact the replacement revenue stream as a direct substitution to the CST, without any required action by a city/county.
- 3) Any growth must be distributed amongst the cities and unincorporated county based upon the proportion of the guaranteed portion due each jurisdiction.
- 4) The replaced revenue must hold current bondholders of CST pledges secure, and there must be clear authority and express authorization for local governments to pledge the revenues (i.e. the revenue stream must be 100% accessible for local government bond pledging, if that is the will of the local government). This must include pledges on Utilities Tax Bonds, Communications Services Tax Bonds, Loans, Covenants to Budget and Appropriate (CB & A bond issues), etc., as CST funds are included in the funds municipalities currently receive to secure those methods of financing.
- 5) There must be some provision to accommodate unused CST capacity for jurisdictions within a county that does not harm other jurisdictions in that county, as well as an

accommodation for annexations and newly incorporated cities, and separate trust funds for cities and counties.

- 6) This option would continue to require a separate, state-imposed DBS rate. However, with the elimination of the prepaid exemption, it may not require a prepaid surcharge component, as the local option tax would be applied to prepaid sales the same as to postpaid sales, at the rate of the county in which the sale was made.

Statewide Sales Tax Replacement: Another source that has been discussed during the Working Group meetings has been the substitution of a uniform statewide sales tax increase for the Communications Services Tax, to provide full replacement to the state and local governments. This substitution of revenue stream for sales tax has been suggested to function similarly to the half-cent sales tax distribution currently received by local government. Again, local municipalities have concerns regarding a sales tax solution that must be addressed in order for this to be a viable replacement revenue source:

- 1) Local governments must have a guaranteed amount of replacement funds annually, to include a growth factor, as well as an accommodation for annexations and newly incorporated cities. The total replacement amount should hold each jurisdiction harmless, and should take into consideration the lost prepaid tax revenues which should have been collected.
- 2) The sales tax must be an increase to the statewide sales and use tax rate. The Legislature must enact the replacement revenue stream as a direct substitution to the CST, without any required action by a city/county.
- 3) Any distribution formula for cities/counties must provide, on a per jurisdiction basis, the greater of:
 - a) the guaranteed revenue replacement amount or
 - b) the amount produced by the distribution formula.
- 4) The replaced revenue must hold current bondholders of CST pledges secure, and there must be clear authority and express authorization for local governments to pledge the revenues (i.e. the revenue stream must be 100% accessible for local government bond pledging, if that is the will of the local government). This must include pledges on Utilities Tax Bonds, Communications Services Tax Bonds, Loans, Covenants to Budget and Appropriate (CB & A bond issues), etc., as CST funds are included in the funds municipalities currently receive to secure those methods of financing.
- 5) There must be some provision for unused CST capacity.
- 6) There should be separate trust funds for cities and counties.

These issues are vital to the continued financial health of local government. Currently outstanding bonds must not be impaired nor have the appearance of potential impairment. Favorable credit ratings save taxpayers money over the extended term of bonds used to finance local infrastructure repairs and improvements. It would be irresponsible to embody criteria in any statutory changes of the current CST laws that would create a failure to comply with covenants to existing bondholders or cause taxpayers to pay more for infrastructure financing for decades to come.

These options are suggestions of things to be considered, and are not intended to be all inclusive, but merely places to begin in the reinvention of a revenue stream that has been relied upon in one form or another by Florida municipalities for almost 80 years.

If the CST is to be reinvented, it is incumbent upon this working group to consider all options that might satisfy the direction provided by Section 12 of Chapter 2012-70, Laws of Florida, providing the removal of competitive advantages within the industry as it relates to the state's tax structure without unduly reducing revenue to local governments.

Communications Services Tax Working Group

Options for Consideration

Submitted by Working Group Member:

Gary Lindsey

Florida Communications Services Tax Working Group
Submittal of Options for Consideration
Gary S. Lindsey

Introduction

Florida law Section 12 of Chapter 2012-70 charges the Communications Services Tax (CST) Working Group with the responsibility to review data and information about the current Florida CST obtained from the Working Group meetings and material presented by stakeholders and to then identify options for 1) streamlining the administrative system and 2) to identify options that remove competitive advantages within the industry as it relates to the state's tax structure without unduly reducing revenue to local governments. It was decided in the August 21st Working Group meeting that each member of the Working Group would submit his/her own list of options to the Working Group Chair by September 14, 2012. I am therefore submitting my list of options by way of this document.

Summary of Options

I have compiled the following options based on information and ideas from the Working Group meetings, from industry input and from my knowledge and experience in the area of tax policy. These options are listed below and discussed briefly in my analysis that follows.

- Maintain CST "As Is"
- Eliminate CST and Go Back to Traditional State/Local Taxes and Fees
- Eliminate CST and Apply Florida Sales and Use Tax
- Develop a Statewide CST That Applies To All Communications Service
- Address Issue Regarding the Application of CST to Prepaid Communications Services

Communications Services Tax Background and Current Industry Perspective

The 2001 adoption of Florida's CST represented forward looking reform that considered the rapid technological changes, growth, and increased competition that was taking place in the communications arena. This reform removed a myriad of taxes and fees that were linked to the rate based monopoly era in which local governments assessed taxes and fees, and regulated providers were able to recover the cost of local fees that were assessed directly on them through the ratemaking process. As unregulated providers entered the marketplace and as the industry shifted to a competitive model, the monopoly era tax and fee structure that still applied to certain communications services and not to others became highly discriminatory and unfair to customers and providers.

The 2001 CST represented a significant step forward; however the new structure effectively spread the old monopoly era taxes and fees over a broader base of communications services including satellite and wireless. The CST provided a much simpler structure than before for most providers, however there are still many complexities including those related to administering the local component of the tax. The CST was designed to encompass a broader base of services, however many traditional revenue streams that were perhaps considered a given in 2001 are diminishing, while new types of services are introduced constantly that may not necessarily fit into the CST taxation model. The rapid technological changes, growth, and increased competition that was evident in 2001 has only accelerated since that time.

As I consider these issues and ongoing changes, I am hopeful that my submission and analysis will contribute to the Working Group effort to collectively generate new ideas that address these ongoing changes and that can lead to options that are administrable, that can generate adequate governmental revenues and that are fair to the Florida taxpayer.

FLORIDA CST WORKING GROUP

(Gary Lindsey – AT&T – 9/14/2012)

Methods of Analysis

It is my opinion that as the Working Group proceeds, each of the options submitted must be evaluated through application of certain assumptions and generally accepted benchmark measures which I list below. Many of these are complimentary to or overlap one another; therefore I am not suggesting a strict “checklist” but instead as items to consider holistically when the Working Group reviews each option.

Functionality – This is an understanding of the particular option’s working characteristics including but not limited to implementation, jurisdictional sourcing, ability to apply the tax to the array of communications services sold by CST providers, compliance (i.e., reporting and remittance by providers), and audit considerations.

Viability – This is an overall assessment of whether the option would have a reasonable chance of succeeding if adopted, including an assessment of attributes and potential problems for the particular option.

Tax Policy – the AICPA provides time-tested benchmarks to evaluate each option by reference to the AICPA’s “Ten Principles of Good Tax Policy” and the AICPA’s “Guiding Principles for Tax Equity and Fairness” Both of these references are listed below.

AICPA Ten Principles of Good Tax Policy:

(http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/Tax_Policy_Concept_Statement_No.1.doc)

1. Equity and Fairness - Similarly situated taxpayers should be taxed similarly.
2. Certainty - The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
3. Convenience of Payment - A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
4. Economy in Collection - The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
5. Simplicity - The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
6. Neutrality - The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
7. Economic Growth and Efficiency - The tax system should not impede or reduce the productive capacity of the economy.
8. Transparency and Visibility - Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
9. Minimum Tax Gap - A tax should be structured to minimize noncompliance.

FLORIDA CST WORKING GROUP

(Gary Lindsey – AT&T – 9/14/2012)

10. Appropriate Government Revenues - The tax system should enable the government to determine how much tax revenue will likely be collected and when.

Streamlining of the Administrative System – options for streamlining should be considered in light of the AICPA’s “Guiding Principles for Tax Simplification”.

AICPA Principles:

(<http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/TPCS%20-%20-%20principles%20for%20tax%20simplification.pdf>)

- Make Simplification a Priority
- Seek Simplest Approaches
- Minimize Compliance Burdens
- Reduce Frequency of Tax Law Change
- Use Consistent Concepts and Definitions
- Consider Administrative Burdens
- Avoid Limited Applicability

Competitive Advantage – I consider this to be any aspect of the taxation that would in and of itself influence or compel a consumer to make a particular purchasing decision. This could be related to the applicability of the tax itself or related to the ability of a provider to administer a characteristic of the tax structure.

Revenue Neutrality – The Working Group Study requires options that do not unduly reduce existing tax revenues to local governments. There may be some options that generate sufficient revenue on a stand-alone basis and there may be options that may require some additional means to hold each local government relatively harmless with regard to revenue impact.

Other Comments

There are certain issues that should also be considered and addressed in any of the options listed above. Some of these issues may be touched upon in my discussion of particular options or may reside within the tax policy benchmarks. I will list these issues below, at the risk of some redundancy, to help ensure that these are considered by the Working Group.

Sourcing/Audit issues - one of the primary challenges of the current CST is to correctly and consistently associate a customer’s address to the appropriate jurisdiction. Providers spend millions of dollars and human resources to have systems in place to accomplish this, and are yet still subjected to detailed audits that require further expenditure of dollars, time and effort of providers as well as the Department of Revenue. Providers are motivated by their taxpayer role and also of equal importance by the need to satisfy their customers by taxing them correctly. This task becomes increasingly complex with annexations, new subdivisions and the mobility of customers. A number of states have moved to a statewide tax in recognition of this growing complexity.

Nexus Issues – there are a growing number of entrants to the Florida marketplace that may have no physical presence in the state and are therefore not required to collect and remit the CST.

Internet Tax Freedom Act (“ITFA”) – may cause issues with taxing of package/bundled marketing plans that include internet service and other services. This may also cause limitations in the ability to tax certain new service offerings that are emerging in the marketplace.

List of CST Options and Comments

Maintain CST “As Is”

This option preserves the status quo. Growth in wireless may offset future landline cord cutting, and local governments may adopt some level of future rate increases to help preserve their tax revenue stream. This option does nothing to eliminate competitive issues or to enhance streamlining of administrative processes. This option also would do nothing with regard to considering the ability to address new and emerging services that may be offered by providers.

Eliminate CST and Go Back to Legacy Taxes and Fees

A question was raised during one of the recent meetings about the possibility of restoring right of way fees or other usage or licensing fees. I cannot envision the viability or the necessity of adding such fees to the existing CST. Such fees would theoretically be applied to services that have some presence in the right of way and would therefore apply to some providers and not others. Therefore I am assuming that this option would also entail disbanding the CST and reverting back to the old tax regime. This would be an unjustifiable step backward that would exacerbate competitive issues, would reintroduce the same complexities that existed prior to 2001, and would most likely not generate any additional tax or fee revenues but would likely result in declining revenues instead. I do not believe this would be a viable option that warrants much, if any consideration. Also, it is important - when reviewing other states that may have a sales tax and local franchise, right of way or other local fees - to note whether these fees apply in addition to the sales tax or in lieu of the sales tax (e.g., a state may apply sales or other communications tax to wireless, and may apply local franchise taxes to landline and/or video programming in lieu of the sales tax).

Eliminate CST and Apply Florida Sales and Use Tax

The 2011 CST is a discriminatory tax on communications services customers when compared to the sales tax that applies to the purchase of other goods and services in Florida. Therefore shifting from the higher CST to the sales tax would create a mathematical challenge to the requirement that local government revenues are not to be unduly impaired. Consideration would therefore have to be given to expanding the sales tax base to additional services outside of the communications services arena. Applying the state and local sales tax would still require local sourcing of communications services, and a statewide DBS tax would also still be required. Despite the challenges noted, this option presents a progressive and direct move from the legacy CST structure to one is fair to Florida taxpayers when compared to the tax that they pay on other goods and services, and that would meet the “Good Tax Policy” criteria presented earlier.

Develop a Statewide CST That Applies To All Communications Service

This option would adopt a statewide CST that would apply to all communications services. The key to this option would be the elimination of any requirement for local sourcing or any local reporting by communications providers when remitting the tax. This would greatly simplify administration and audits and may ultimately allow the Florida address database to be eliminated.

This option would require development of an appropriate state-wide tax that would maintain the existing total tax revenue. It could also include a “hold-harmless” distribution methodology so that local governments would continue to receive their proportionate share of the tax going forward. Consideration could also be given to developing another distribution methodology that would be acceptable to the local governments (e.g., based on population, etc) for further transition and streamlining in the future. This statewide CST platform would result in a uniform communications services tax that would be the same for all Florida communications services consumers. This option would still preserve a higher tax rate on Florida taxpayers than they pay on other goods and service in the state, however one that could be

FLORIDA CST WORKING GROUP

(Gary Lindsey – AT&T – 9/14/2012)

reviewed periodically by legislators should they want to consider a path to a more equitable tax rate for consumers of Florida communications services in the future.

Issue – Application of the CST to Prepaid Communications Services

The prepaid product is a retail product that has historically been subjected to the general sales tax in Florida. Failure to update the definition of prepaid communications service has generated an assertion that there is a perceived CST tax gap and therefore would not technically be defined as a tax increase. Florida taxpayers would however ultimately perceive this as a tax increase. The survey information that the DOR has provided to the Working Group indicated that all other states that tax prepaid communications service use the sales tax or other general tax (e.g., Hawaii, etc) that applies to general goods and services. Options for this area are as follows:

A - The option exists for Florida to be an outlier and to assert the CST and to develop further legislation that would explicitly apply the CST to prepaid communications services. Pursuit of this option would result in a higher tax burden on prepaid communications services customers than they currently pay. This burden would be particularly impactful on those prepaid communications services customers who are in lower income levels. This option would also explicitly require retailers to collect the tax, and the Working Group has already received input from the retail industry regarding the issues that they would have in trying to collect a separate tax at the retail point of sale.

B - Another option was mentioned that would create a single statewide flat tax that would apply to prepaid communications services in lieu of the CST, effectively placing the same level of higher tax on this service through the use of a flat dollar amount instead of a percentage. Comments received by the Working Group from retail representatives indicated that large retailers with robust systems might be able to administer such a fee structure however many other retailers may have difficulty in administering a separate fee of this nature. Consideration would have to be given to deciding on the appropriate amount of the fee to meet the objectives of the various stakeholders (e.g., state, local governments, taxpayers, etc). This option would also position Florida as a tax policy “outlier” throughout the U.S. for taxation of this service, and would also place a regressive burden on low income prepaid communications services consumers.

C - Another viable option is to recommend adoption of an updated definition of prepaid communications services (e.g., the Streamlined Sales Tax definition, etc) so that these services would continue to be subject to (only) the state and local sales tax. Consistent with comments that I made earlier with regard to the sales tax, this option would ensure that Florida communications services consumers are not burdened with a higher tax than they pay on other goods and services in Florida. This option requires no change in methodology for retailers or providers and it maintains the existing actual revenue stream that Florida receives through the state and local sales tax.

Conclusion/Summary

This completes my review and comments regarding options for this phase of the Working Group effort. I am hopeful that the options and guidelines that I have provided will be helpful to the overall effort as the Working Group considers all of the options submitted by Working Group members and other stakeholders.

Communications Services Tax Working Group

Options for Consideration

Submitted by Working Group Member:

Mayor Gary Resnick



City of Wilton Manors

2020 Wilton Drive • Wilton Manors, Florida 33305 • (954) 390-2100 • FAX (954) 390-2199

Gary Resnick
Mayor

Tom Green
Vice Mayor

Julie A. Carson
Commissioner

Ted Galatis
Commissioner

Scott Newton
Commissioner

Joseph L. Gallegos
City Manager

Kerry Ezrol
City Attorney

September 14, 2012

Via Electronic Mail

Andrea J. Moreland
Director, Legislative and Cabinet Services
Florida Department of Revenue
Post Office Box 5906
Tallahassee, Florida 32399-0100
morelanA@dor.state.fl.us

Re: Request for Options

Dear Ms. Moreland:

This is in response to Chair Stranburg's request that members of the Communications Services Tax (CST) Workgroup submit options for the Workgroup to include for Legislative consideration by September 14. The options listed below follow the Workgroup's tasks as set forth in the Statute.

Sections 12(4)(a) and (b) of the Statute provide for the Workgroup to review national and state policies relating to communications taxes and to review the effects of Florida law on the decline in CST revenues, respectively. As information provided to the Workgroup has revealed, every state other than Florida allows local governments to charge users of the rights-of-way reasonable fees to support local governments' costs associated with management of their public rights-of-way. The federal government also charges fees for using its rights-of-way. We have not had information presented to us as to whether the State of Florida charges fees for use of the State's rights-of-way. One of the replaced revenue sources that the local CST was supposed to be sufficient to cover was franchise fees for use of public rights-of-way by communications providers. As we learned, CST revenues to local governments have declined sharply. Accordingly, the Workgroup should include as one of the options for the Legislature to consider, reinstating local governments' ability to charge franchise fees to communications providers that use their public rights-of-way. Even states that have adopted state-wide franchising of cable services, similar to Florida, allow local governments to charge cable franchise fees and to collect such fees directly for use of their rights-of-way. Such fees would be easy to administer by providers as well as governments, easily understood by consumers and would not require any involvement of DOR or create further administrative issues. DOR should be able to estimate based on historic data the amount of revenue this would generate for local governments. Similarly, the Workgroup should also include

Andrea J. Moreland
Director, Legislative and Cabinet Services
Florida Department of Revenue
September 14, 2012
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that the Legislature should consider restoring local governments' ability to charge permit fees, without reducing CST rates, to communications providers that apply for permits to perform work in the rights-of-way. Permitting functions often involve complicated and costly reviews by local governments and the local CST structure, as it currently exists, is not sufficient to cover such permitting costs.

Section 12(4)(c) of the Statute provides for the Workgroup to review the extent local governments have bonded CST revenues. As presentations to the Workgroup have revealed, most local governments have bonded their CST revenues. Going forward, significant infrastructure and capital projects that will be vital for Florida's economic recovery require that local governments retain their full bonding capacity with CST revenues, which is one of very few unrestricted sources of revenues for any public purpose. According, the Workgroup should include as an option for the Legislature's consideration that it adopt a policy expressly preserving that local CST revenue may be used by local governments for any public purpose and that any revisions to the CST Statute must ensure that there are no negative financial impacts to local governments.

Section 12(4)(d) of the Statute provides for the Workgroup to review the fairness and administrative burdens of the CST, and the extent the CST is reasonably clear to stakeholders and (e) provides for the workgroup to provide options for streamlining administrative burdens. Based on the presentations to the Workgroup, it does not appear that the CST creates any unfairness or that providers, retailers, consumers, governments and DOR do not have a reasonably clear understanding of the CST. It may be helpful for the Legislature to consider requiring that certain charges by providers on various bills must be clarified as to whether they are a government-imposed fee or tax or not. Further, based on information presented to the Workgroup, the Workgroup should include as one of its options for the Legislature's consideration that the Legislature adopt more strict and definite laws regarding auditing of the CST. DOR presented information that it has the capability of auditing only a small percentage of communications providers, that it does not use contract auditors, and that the vast majority of audits – over 75% -- result in recovery of revenues. Further, DOR did not provide information to the Workgroup as to how it addresses communications providers that should be filing returns and paying CST but do not. Prior to the replaced revenue sources being centrally administered by DOR, local governments were very effective at conducting audits, often utilizing outside auditors with expertise in the industry, with the costs of such audits being borne by the provider if underpayments exceeded a certain percentage. Accordingly, the Workgroup should include that the Legislature should consider mandating

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Director, Legislative and Cabinet Services
Florida Department of Revenue
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more audits, requiring DOR to contract for external auditing services, allowing local governments to conduct and to contract for external audits, and requiring that providers pay for the cost of the audit if underpayments exceed a certain percentage. Such policies will not only lead to increased revenues for the State and local governments by ensuring more accurate reporting and collection of CST revenue, they will also reduce the burden and cost of administering the CST.

Section 12(4)(f) of the Statute provides for the Workgroup to identify options that remove competitive advantages within the industry as to the state's tax structure without unduly reducing revenue to local governments. We have had much discussion about the intent of this subsection without reaching any consensus. We discussed to some extent advantages that Internet retailers enjoy over brick and mortar retailers with respect to sales taxes. Consumers alter buying decisions and make purchases over the Internet solely to avoid state sales taxes. Accordingly, to address competitive advantages enjoyed by Internet retailers, the Workgroup should include as an option that the Legislature consider revising the state's tax structure and impose sales taxes on Internet retailers. We have had no presentations that particular segments of the communications industry enjoy a competitive advantage over others by virtue of the state's tax structure. Information provided to the Workgroup indicates that by far, the fastest growing segments of the industry are wireless services generally and in particular prepaid wireless services. The information provided to us indicates that consumers are abandoning landline telephones and utilizing wireless services. Accordingly, options the Workgroup should propose for the Legislature are: 1) eliminate the residential exception from CST and 2) impose a surcharge on prepaid wireless services to add to the state's tax structure. In addition, so as not to reduce unduly CST to local governments from such services, the Workgroup should include that the Legislature should consider requiring consumers of prepaid services, at the time of purchase, to identify the user and address where such services will be used to allow providers to properly and to determine easily the situs of such local CST. Given the importance of knowing who is utilizing communications services and where, there are numerous other public policy benefits of having such information apart from the state's tax policies.

In addition to the options for the Legislature's consideration as outlined above, it is important to note issues with our process for producing a report to the Legislature. It is troubling that after several meetings, the Workgroup has not established a process for producing a report to the Legislature. The Statute clearly provides for the Workgroup to prepare and to submit a report; it does not provide for DOR to do so. Further, the Statute clearly contemplates the Workgroup

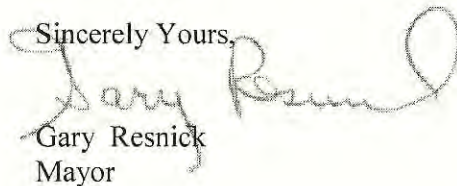
WILTON MANORS, *Island City*

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Director, Legislative and Cabinet Services
Florida Department of Revenue
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voting. Having every Workgroup member's options included in a report prepared by DOR would not be consistent with the Statute and may also be a violation of the Sunshine Law, particularly if members of the Workgroup engage in communications with DOR staff. For example, it would be a violation of the Sunshine Law for the Interim Executive Director of DOR to instruct DOR staff on how to prepare a report or what content to include in any report since, as a member of the Workgroup, such person is bound by the Sunshine Law, unless of course such communications occurred during one of our noticed meetings. The better process would be for the Workgroup to debate information to be included in a report, and ultimately to vote on how to prepare a report and what to include in a report to be issued by the Workgroup. A member of the Workgroup may volunteer to compile such report or alternatively, we could vote on what to instruct DOR to prepare. To do otherwise, would be a disservice to the State's taxpayers.

Thank you for providing this to members of the Workgroup. As always, I appreciate your assistance.

Sincerely Yours,



Gary Resnick
Mayor

Communications Services Tax Working Group

Options for Consideration

Submitted by Working Group Member:

Alan Rosenzweig



Leon County

Board of County Commissioners

301 South Monroe Street, Tallahassee, Florida 32301
(850) 606-5302 www.leoncountyfl.gov

Commissioners

October 24, 2012

BILL PROCTOR

District 1

Ms. Andrea J. Moreland
Director, Legislative and Cabinet Services
Florida Department of Revenue
Post Office Box 5906
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JANE G. SAULS

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JOHN DAILEY

District 3

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District 4

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District 5

AKIN AKINYEMI

At-Large

NICK MADDOX

At-Large

VINCENT S. LONG

County Administrator

HERBERT W.A. THIELE

County Attorney

Dear Ms. Moreland:

In response to Chairman Stranburg's request that members of the Communications Services Tax Workgroup submit input for consideration, I respectfully waited for the Board to approve their 2013 legislative priorities. Included in the Board's priorities is a policy statement on the Communications Services Tax (CST). This position is similar to the option presented by the Florida Association Counties for the Workgroup's consideration. In addition, Leon County fully supports the options provided by the Florida Association Counties, including "that this group, or similar group, be reconvened with the specific direction to provide consensus based recommended legislation."

On October 23, 2012, the Board approved the following legislative priority for the 2013 session:

"Support legislation that is revenue neutral; simplifies administration and collection of the current tax; enhances the stability and reliability as an important revenue source for local government; and provides for the opportunity for market-based growth."

This priority reflects the need to enhance the stability and reliability of the CST given that it is an important revenue source for local governments. The County has seen revenues from the CST decline by an average of 5.4% over the past six fiscal years. Curbing this decline to a more stable and reliable revenue source helps both the State and local governments.

I would also like to stress the importance of focusing our recommendations to not only guarantee that the CST is more stable revenue source in the future but that it eliminates the competitive advantages within the industry (such as the bundling of services and the exemption of prepaid wireless services). This is imperative to ensure the CST has a broad and equitable tax base and provides an opportunity for market-based growth.

I would appreciate you sharing Leon County's position with the members of the Communications Services Tax Workgroup. If you have any questions, please let me know. As always, thank you for your assistance.

Sincerely,

Alan Rosenzweig
Deputy County Administrator

Encl: 2013 Legislative Priority – Communications Service Tax

2013 State Legislative Session Legislative Proposal

Department / Division: Special Projects/Intergovernmental Affairs

Contact Person: Ken Morris/Cristina Paredes

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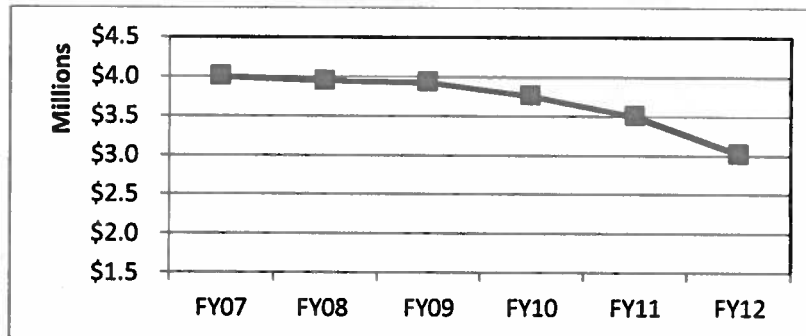
Topic: Communications Service Tax

Problem/Need:

The Communication Service Tax (CST) is a tax on the retail sales of communications services, which include voice, data, audio, video and any other information including cable (video) services. Internet access, as defined by the Internet Tax Freedom Act, email services, and prepaid calling arrangements (cards and cellphones) are not included and account for approximately 25% to 40% of all wireless phones. The proceeds from the tax are transferred to county and municipal governments, the Public Education Capital Outlay and Debt Service Trust Fund, and the state's General Revenue Fund.

A county or municipality may choose to levy the CST by ordinance. Currently, Leon County levies a CST 6.02% within the unincorporated areas of the County. The City of Tallahassee's rate is applied to those individuals who live within the city limits and is levied at 6.90%. Over the past six fiscal years, the revenues from the CST have declined by an average of 5.4%. The chart below illustrates the downward trend of this revenue source.

Graph #1: Leon County Communications Service Tax Revenue



Currently, the Florida Department of Revenue (DOR) administers the statewide collection of the state and local tax payments. Dealers/retailers who collect local communications services tax must notify the DOR of the method employed to accurately assign addresses to the appropriate taxing jurisdiction. The DOR maintains a database that provides the local taxing jurisdiction for all addresses in Florida. The database contains county and municipal names for every address and is based on information provided by the local taxing jurisdiction and updated at least once every six months. The amount of revenue collected is dependent on the jurisdiction's local CST rate. A county government's local CST is charged to those billable customers residing within the unincorporated area. A municipal government's local CST is charged to those billable customers residing within the incorporated area. There are currently 122 different local CST rates.

During the 2012 session, the Legislature passed a bill that made changes to definitions of the CST, and creates a workgroup to study the tax to make recommendations on future communications tax policies. The state levies a 6.65% communications services tax on items such as phone service and local governments apply a wide range of additional taxes that range from 0.1% to 7%. A key provision in HB 809 provided a broad CST exemption for certain services and hardware that are not separately stated on a customer's bill. For example, phone/cable service, in "bundles" with digital items such as cloud data storage or home security, would not have to pay communications taxes.

Furthermore, the legislation created the Communications Services Tax Working Group within the Department of Revenue to review a series of policies regarding the tax including: review of national and state tax policies relating to the communications industry; review the fairness of the state's communications tax laws and the administrative burdens it contains, including whether the applicability of the tax laws is reasonably clear to communications services providers, retailers, customers, local government entities and state administrators; identify options for streamlining the administrative system. The Workgroup consists of the following members:

- Marshall Stranburg, Chair Interim Executive Director, Florida Department of Revenue
- Charlie Dudley, General Counsel, Florida Cable Telecommunications Association
- Sharon R. Fox, Tax Revenue Coordinator, City of Tampa
- Kathleen Kittrick, Director of State Government Affairs, Verizon
- Gary S. Lindsey, Director of External Tax Policy, AT&T
- The Honorable Gary Resnick, Mayor, City of Wilton Manors
- Alan Rosenzweig, Deputy County Administrator, Leon County
- Brian D. Smith, Director of Transactional Taxes, the DirecTV GROUP, Inc.
- Davin J. Suggs, Senior Legislative Advocate, Florida Association of Counties

The two priorities of the Workgroup is to 1) identify options for streamlining the administrative system and 2) identify options that remove competitive advantages within the industry as it relates to the state's tax structure without unduly reducing revenue to local governments. The Workgroup's recommendations must be submitted to the Governor, the President of the Senate, and the Speaker of the House of Representatives by February 1, 2013.

Recommended County Position, Recommended Change in Florida Statutes:

Support legislation that is revenue neutral; simplifies administration and collection of the current tax; enhances the stability and reliability as an important revenue source for local government; and provides for the opportunity for market-based growth.

Communications Services Tax Working Group

Options for Consideration

Submitted by Working Group Member:

Brian Smith

DIRECTV's Comments to the Communications Services Tax Force

As you are aware, the task force's mission includes the following:

- a) review of national and state tax policies relating to the communications industry;
- b) review the historical amount of tax revenue that has been generated by the state and local communications services taxes imposed or administered pursuant to Chapter 202, Florida Statutes, for the purposes of determining the effect that laws passed in the past 5 years have had on declining revenues;
- c) review the extent to which this revenue has been relied on to secure bonded indebtedness;
- d) review the fairness of the state's communications tax laws and the administrative burdens it contains, including whether the applicability of the tax laws is reasonably clear to communications services providers, retailers, customers, local government entities and state administrators;
- e) identify options for streamlining the administrative system; and
- f) identify options that remove competitive advantages within the industry as it relates to the state's tax structure without unduly reducing revenue to local governments.

With this in mind, the goals of any reform should be revenue neutrality and creating a favorable business climate.

The current differences in taxation based on method of content delivery has resulted in uncertain revenues for the State. This uncertainty is due, in large part to;

- (1) changing customer patterns with respect to the consumption of media and the use of communications services, and
- (2) the increasing use of business strategies to minimize the tax burden.

Any reform should start with an expansion of the tax base and the creation of a level playing field for all communication providers. This will ensure that the tax burden imposed on the customer will remain the same regardless of the manner in which content is consumed. By way of example, a family in Gainesville should be subject to the same exact tax burden when it watches a TV show or movie on DIRECTV or DISH as a family in Jacksonville who watches the same TV show on Comcast, BrightHouse, or Cox. And both families should be subject to the same tax burden as a family who watches the same show or movie via the Internet, whether it's through Netflix, Amazon, or Apple TV. Similarly, an expansion of the tax base should result in no differentiation between bundled and unbundled services (separately stated movie rentals should be taxed the same as flat-fee rentals).

To the extent the tax base is expanded, there should be an offsetting reduction to the state tax rate in order to achieve revenue neutrality and restore competitive balance between cable and satellite TV providers. As an initial matter, the rates applicable to communications services should be uniform at the state and local level, regardless of technology. We recommend setting the local rate at the highest current local rate to address the needs of the local government for revenue. This would also promote simplicity in compliance since there would only be one local rate for all localities in the state. Furthermore, the Task Force should consider whether the localities should be entitled to payment for the actual and direct use of their right of ways. The uniform rates would provide simplification for retailers (selling prepaid and other taxable items), local governments estimating revenue streams, persons estimating revenue streams for bonding, certainty of collecting and remitting and ease of audit and administration for the Department.

These suggestions will have the additional impact of achieving a favorable business climate. Any uncertainty regarding the taxation of different types of communications services would be removed. Furthermore, a single tax base and single rate would ensure ease of administration and that the tax base was not subject to manipulation (creating competitive advantages amongst industry members).

Communications Services Tax Working Group

Options for Consideration

Submitted by Working Group Member:

Marshall Stranburg

Florida Department of Revenue

Options Submitted to Communications Services Tax Working Group

A. Options to Streamline the Administrative System

1. Rate Structure Changes
 - a. Create a statewide Local Communications Services Tax rate and distribute the tax to local governments via a formula. In addition, consideration may wish to be given to restructuring the collection allowance since administrative burdens will be reduced.
 - b. Create one Local Communications Services Tax rate per county and distribute the tax to the local governments via a formula. In addition, consideration may wish to be given to restructuring the collection allowance since administrative burdens will be reduced.
2. Records
 - a. Clarify the definition of records and which records must be kept by providers.
 - b. Facilitate the audit process for both providers and the Department by requiring that records be provided in a format that is capable of being exported to the Department as a searchable file.
3. Transparency
 - a. Specify the consequences that will result when customers are not provided with a breakdown of the Florida Communications Services Tax (combined state and gross receipts tax) and Local Communications Services Tax.
 - b. Allow providers to further breakdown the Florida Communications Services Tax into state and gross receipts tax, if desired, on customer bills.
 - c. Allow the Department to release the provider's contact person's name and contact information and/or managerial representative's name and contact information to its customers who have tax questions or complaints, including jurisdictional situsing issues.
 - d. Create a requirement that, when requested by customers or the Department, providers must provide a breakdown of bundled services including a description of the service, amount taxed, tax rate applied, and the period of time the rate applies. Provide a penalty for non-compliance.
 - e. If a breakdown of bundled services is not given to the customer, use tax on the entire amount will be due from the customer as provided by current law. Clarify use tax provision such that customers who request unbundling breakdown in writing from provider, but do not receive it within 30 days may use their own reasonable breakdown in order to calculate use tax.
 - f. Create an incentive for providers to notify customers and the Department of the breakdown of bundled services. For companies that provide advance notice of their unbundling practices to the Department, allow them to use a managed compliance agreement for an agreed upon time period.
4. Refunds
 - a. Amend the refund statute (s. 202.23, F.S.) to allow the local component of the Communications Services Tax that exceeds 90% of the local jurisdiction's average monthly distribution to be refunded to the dealer and recaptured from the local government on a pro-rated basis over a time period that equals the period covered by the refund.

B. Options to Remove Competitive Advantages within the Industry as it relates to the State's Tax Structure without Unduly Reducing Revenue to Local Governments

1. Tax Base
 - a. Revise the sales tax base to include a definition for digital goods. These goods and associated services have historically been sold in tangible form, but in recent years are increasingly migrating to electronic delivery. Examples of such products are music, videos, and books.
 - b. Clarify that the definition of video service includes payments for licensure of content.
 - c. Clarify that the residential exemption only applies to landline telephone service.

2. Prepaid Wireless Services
 - a. Create a flat Communications Services Tax rate and distribute to local governments via a formula.
 - b. Apply sales and use tax and a fee for gross receipts tax. The gross receipts tax fee could be a flat fee by dollar amount or a percentage, or a tiered amount based on dollars or time.
 - c. Consider a gross receipts tax on the provider of prepaid calling arrangements that can be offset with a dollar-for-dollar credit, if communications services tax is collected from the purchaser of the prepaid calling arrangement.

Communications Services Tax Working Group

Options for Consideration

Submitted by:

Florida Association of Counties

Florida Association of Counties

Options for Consideration by the Florida Communication Services Tax Working Group

- I. The CST working group should present an option that this group, or similar group, be reconvened with the specific direction/authority to provide consensus based recommended legislation.
- II. As a result of their September 2012 policy conference, the members of the Florida Association of Counties have tentatively adopted the following policy statement:

The Florida Association of Counties **SUPPORTS** amending and/or revising current law in a manner that is:

- 1) Revenue neutral with regards to current revenue levels and current existing capacity for revenue generation by local governments (unutilized rate);
- 2) Simplifies administration and collection of the current tax;
- 3) Provides for a broad and equitable tax base;
- 4) Provides for the enhanced stability and reliability as an important revenue source for local government; and
- 5) Provides for the opportunity for market-based growth

Communications Services Tax Working Group

Written Comments

Submitted by: Florida Retail Federation



September 17, 2012

Marshall Stranburg
Interim Executive Director
Florida Department of Revenue
5050 West Tennessee Street
Tallahassee, FL 32399-0100

Dear Mr. Stranburg:

On behalf of the 8,000 members of the Florida Retail Federation, we appreciate the opportunity to provide written comments to the Communications Service Tax Work Group regarding the imposition and collection of the Communications Service Tax on certain prepaid calling arrangements that the Department of Revenue has indicated may not be entitled to the exemption from the collection of Communications Service Tax contained in Sec. 202.11(9), FS.

As you are aware, prepaid calling arrangements are very popular with a large segment of the public at large and are sold at thousands of locations throughout Florida. Currently, retailers are collecting the state and local sales taxes on the sale of these products at the point of sale, as required by Chapter 212, FS. Any determination by the Department that certain prepaid calling arrangements are not included in the exemption referenced above will cause extreme confusion among retailers and result in possible disruption in the sales of these products in the future because the Communications Service Tax, with its complicated provisions, cannot be applied at the point of sale by any retailer in this state.

We encourage the work group to continue with its work and would hope that during the deliberations other collection methodologies would be discussed, since the "Point of Sale" methodology will not work with a tax that is as complicated as the Communications Service Tax. The Florida Retail Federation stands ready to assist in vetting any proposals that may evolve from the work of the work group.

Sincerely,

Randy Miller
Executive Vice President

RM/sw

Communications Services Tax Working Group

Written Comments

Submitted by:

AT&T, CenturyLink, Sprint, T-Mobile, and Verizon

Telecommunications Industry Proposal to the Florida Communications Services Tax Working Group

Submitted by: AT&T, CenturyLink, Sprint, T-Mobile, and Verizon

Overview

The average Florida Communications Services Tax (CST) rates on consumers are more than twice as high as the sales tax imposed on other taxable goods and services sold in Florida. At the same time, changes in technology are providing consumers with alternatives to traditional communications services that allow consumers to avoid paying the CST.

This system is not sustainable. Under the status quo, state and local governments will experience revenue declines as discriminatory tax policy, technological change, and consumer preferences continue to undermine the CST base by shifting consumer purchases to services not subject to the CST.

The telecommunications providers listed above recommend that the state repeal the CST and bring all communications services under the state and local sales tax. This proposal would promote competitive neutrality between communications providers, resolve the current dispute over the taxation of prepaid wireless service, and reduce excessive tax burdens on consumers.

The Problem

The Florida CST was enacted to simplify and reduce the number of state and local taxes on communications providers and consumers. However, technological changes and limitations imposed by federal law continue to undermine the CST base. As the presentation by AT&T at the August 21st commission meeting explained in great detail, many services are increasingly being provided as applications that “ride” over a high-speed Internet connection. As communications providers upgrade their landline and wireless networks to accommodate higher speeds and higher volumes of data, the capability to provide these enhanced communications services via Internet protocol will grow dramatically.

Instead of purchasing a monthly calling plan, consumers will purchase a fast Internet connection and install applications that provide voice, video, and other services. This will occur in both the wireless and wireline environment. Widespread availability of these “over the top” Internet-enabled services will undermine the CST base in two ways: 1) consumers will continue to drop services subject to CST altogether and install communications applications instead; and 2) competitive pressures from these Internet-based applications will force traditional

communications services providers to lower prices, reducing revenues from percentage-based taxes.

Additionally, federal law prohibits state and local governments from imposing taxes on charges for Internet access service. Therefore, state and local governments will not be able to capture revenues from this shift in technology and consumer preferences. Compounding this problem is the current CST rate structure. All else being equal, a customer switching to an Internet-protocol based communications application will save an average of 14% simply by avoiding services subject to the CST. The existence of the CST will reinforce and exacerbate market forces leading consumers to adopt new technology.

The Solution: Repeal the CST and Impose the Sales and Use Tax on Communications

The industry recommends that the CST be repealed and the sales and use tax base be broadened to include a broad range of communications services that would be subject to the same state and local tax rates as other taxable goods and services. This proposal would solve many of the problems inherent with the current CST structure and position Florida to fairly capture revenue from a broad base of communications services today and in the future.

First of all, this proposal would significantly reduce or eliminate the tax differential between different types of communications services. It would bring taxation of contract wireless plans in line with the current taxation of prepaid calling arrangements under the sales tax at the point-of-sale. Additionally, when Congress passes the Main Street Fairness Act or other similar legislation to permit states to require non-nexus providers to collect sales taxes, Florida would be positioned to collect sales tax equitably. This would place all providers on a level playing field, an important benefit of eliminating the CST in favor of the sales tax. All of the bills currently being considered by Congress to grant state the power to enforce collection on non-nexus sellers would only apply that power to the sales tax, not to other taxes like the Florida CST.

Second, this proposal would dramatically reduce administrative costs for the Florida Department of Revenue and local governments. Instead of an entire structure necessary to administer the CST as a stand-alone tax, our proposal would allow the department to administer the tax under the existing sales and use tax administrative structure.

Finally, the proposal brings fairness and relief to Florida consumers. Federal and state policies have long sought to make sure that all Americans are connected, first through basic telephone service and now through high speed Internet connections (wireline and wireless). Numerous studies show that low- and moderate-income Americans increasingly rely on their

Internet connections to successfully participate in the American economy, whether on the job or even to search for a job. Tax policies that impose excessive tax burdens on communications services work at cross purposes with federal, state, and local economic development goals. Repealing the regressive CST will most benefit low- and moderate-income Floridians.

Prepaid Wireless Telecommunications Services

The industry proposal to eliminate the CST would render moot the current effort by the Department of Revenue to assert that most current prepaid service offerings, including prepaid wireless service offerings, are subject to the CST. Regardless of what the Communications Services Tax Working Group recommends for long term changes to the CST, it is imperative that the current dispute over the status of prepaid wireless service be resolved immediately.

In excluding prepaid calling arrangements from the CST and making such services subject to the sales tax at the point of sale, the Legislature has long recognized that it is simply not feasible to impose the CST on services that are not billed to customers. There is no workable method to situs prepaid transactions to a customer address because address information is not collected in the majority of prepaid transactions. If the State were to require that retailers collect the CST at the point of sale, all Florida retailers that sell prepaid service would be required to collect customer address information and install a parallel CST point-of-sale tax system with hundreds of local CST tax rates alongside their current sales tax systems. This would be a significant expense for retailers and would require additional CST audits on thousands of retail establishments.

Thus, if CST is not eliminated, the industry recommends that the Legislature modernize the definition of "Prepaid Calling Arrangement" to accommodate technological changes that have occurred over the last decade, and encompass current prepaid service offerings. Such a change would conform the Florida Statutes to the original legislative intent of limiting the CST to billed services -- for which it is feasible to collect local CST based on customer addresses.

Communications Services Tax Working Group

Written Comments

Submitted by:

metroPCS

Prepaid Reform Proposal

Florida Communications Services Tax Working Group

December 6, 2012

We appreciate the opportunity to submit our proposal for reform of the Communications Services Tax (CST) and the Sales & Use Tax (SUT). This proposal is submitted on behalf of MetroPCS Florida, LLC (“MetroPCS”). MetroPCS and its affiliates represent the fifth largest facilities-based wireless communications provider in the United States and we have operated in the State of Florida since launching our service in 2002. MetroPCS provides mobile communications services to our customers on a no long-term contract, paid-in-advance basis. MetroPCS offers a variety of prepaid service plan options to our customers but are best known for our prepaid “monthly unlimited” plans. MetroPCS is exclusively a prepaid service provider and does not provide “postpaid” service.

We laud the Working Group’s efforts to explore all options in an effort to resolve this issue to the satisfaction of all impacted entities. We believe the Working Group should maintain a focus on proposing legislative solutions to address the disparity and administrative challenges currently facing prepaid wireless communications. Therefore, our comments and reform proposal specifically addresses prepaid wireless communications issues.

Specifically, we propose enacting a statutory amendment clarifying the definition of “prepaid calling arrangement” such that “prepaid calling arrangements” are subject to sales tax as originally intended by the Legislature when it first enacted the CST in 2001. The clarified definition should be broad enough to cover the current spectrum of prepaid communications services that are offered, leveraging definitions used by other states.

We have provided the reasons and support for why we believe this recommendation should be adopted by the Legislature.

Prepaid Challenges

Previous Working Group presentations have provided insight into the complexity of the prepaid wireless communications market. Wireless prepaid services cannot be easily categorized as they represent a broad spectrum of communications services that are sold through a broad variety of distribution models. Business practices and mode of distribution may vary among retailers and providers, but there are several fundamental differences that provide a strong contrast between prepaid and postpaid (contract customers).

For postpaid services, customers enter into a long-term service contract and must go through an extensive qualifying process, which includes a credit check, providing photo identification and a billing address. These customers are also subject to collections efforts if they

fail to pay for services rendered. For these reasons, apart from the need to establish a tax situs, it is vital that a postpaid carrier identify the customer's primary place of use and to be able to bill and collect for its services. This also provides a certain level of consistency and predictability to the CST revenue base.

A prepaid customer is highly mobile, many times anonymous, and can purchase or pay for prepaid services in a variety of manners and places that can differ for each purchase. Since it is unknown in advance how a prepaid customer will purchase each service period (or even if they will continue to purchase since they have no contractual obligation), it presents significant challenges to devise a CST methodology that can be uniformly applied across all distribution channels, from the Internet, to kiosks, to retail stores, to carrier operated stores, including card or cash based business models. In addition, prepaid service can be gifted or otherwise transferred making it even more difficult to know who the user is or where they are located.

These challenges are what led the vast majority of States in the 1990s to tax prepaid services as “tangible personal property” and expand point-of-sale Sales tax collection to prepaid communications services. In recent years, we've also seen many states adopt this same point-of-sale methodology for collection of 911 taxes—because it is simple, fair and leverages the existing administrative processes in place for sales taxes that retailers are already complying with.

However, these same characteristics make it clear that it is inequitable to apply a CST to prepaid customers because the CST does not provide for point-of-sale taxation. For instance, if one is to expect a retail establishment to collect CST, what local jurisdiction will receive the associated CST? What about rural locations that have no retail establishments, but have prepaid customers? Are they to receive no tax revenue?

Florida's Taxation of Prepaid is an Outlier

- a) Florida's attempt to impose a non-Sales tax on prepaid is inconsistent with the practical approach adopted by a majority of states*

The survey performed by the Department of Revenue (“Department”) and presented during the Working Group meetings make it very clear: Florida is unique in its tax policy regarding prepaid services:

Slide 40 of French Brown's June 11th presentation provided:

- Twenty-six states apply sales and use tax to prepaid communications.
- One state applies a communications services tax¹
- One state applies a gross receipts tax²

¹ New Hampshire does not have a sales and use tax.

² New Mexico levies a “gross receipts tax” in lieu of a sales and use tax

- Seven states apply a mix of sales and use tax and other taxes (see Note below)
- Four jurisdictions apply a mix of sales and use tax or prepaid is not subject to tax

Note, the Survey suggests that seven states impose sales and use tax *and* other taxes on prepaid service; however, we believe this misrepresents the general policy trend and warrants further analysis. Based on our analysis, these seven states all levy sales tax or an equivalent tax on the sale of prepaid. The survey incorrectly suggests that some states impose some other tax in addition to sales and use tax. For example, Texas which levies a sales tax and not a separate “communications tax” as suggested by the survey. In some limited cases, the states levy sales taxes *and* taxes on communications carriers that also provide prepaid services but the same non-sales taxes are not imposed on retailers (e.g. New York 186e or Kentucky Gross Receipts). The Washington B&O tax is a general tax that applies to all businesses and applies to prepaid in addition to the Sales Tax.

Therefore, after further analysis, of the states included, over 90% of the states impose sales and use tax or an equivalent tax on prepaid and no other taxes. Florida’s attempt to impose a separate communications tax in lieu of sales tax stand in stark contrast to the general taxation of prepaid across the United States.

b) Florida’s definition of “Prepaid” and current interpretation is inconsistent with all other states

In the recent Tax Information Publication (TIP) No. 12ADM-02 issued on March 27, 2012 and as described by representatives of the Department during the Working Group meetings, the Department recently adopted a very narrow interpretation of “prepaid calling arrangement.” This interpretation so narrowly defines prepaid, that many prepaid wireless offerings in existence in 2001 and nearly all today would not qualify under this new interpretation.

The Department’s interpretation essentially renders the tax provision essentially meaningless in effect, which would not seem to be the intent of the Legislature. In addition, the TIP represents a complete reversal in practice and administration. No other state has so narrowly construed its prepaid definition, and in fact, many states have reached quite the opposite conclusion based on same or similar provisions. This is evidenced by the second round of the survey results provided during the July 25, 2012 meeting. This is also evidenced by a ruling issued by the State of Virginia³ as well as the definition of “prepaid wireless calling service” adopted by the Streamlined Sales Tax Board.⁴

Dealers may be forced to determine whether a prepaid arrangement is subject to SUT or CST, and in some cases, this distinction may not be known until the customer actually uses the service, long after the point of tax collection. Further, requiring retailers to reprogram or replace

³ Virginia Public Document 10-192 (August 26, 2010)

⁴ Report of the 2011 Streamlined Sales and Use Tax Agreement (SSUTA) Amendments. Amending Rule 327.2

their registers to comply with the CST for a single product that they sell out of thousands is unnecessarily burdensome on business, and could lead to a reduction in the sales and distribution of prepaid wireless products. Prepaid wireless services represent an entry level service for many customers that cannot afford or cannot meet the credit requirements for postpaid or contract services. It is imperative that the legislature clarify the law and does not impose onerous requirements that could lead to a decline in these services.

Being an outlier may be considered a good quality for some things; however, for tax policy, consistency, uniformity and ease of administration are all hallmarks. In today's economy, companies operate in multiple state and local jurisdictions and tax policy outliers will drive a significant rate of failed compliance due to complexity. This confusion was hardly the legislative intent in originally passing the CST when the Florida Legislature wisely attempted to place the taxation of prepaid under the SUT.

CST Exemption for Residential is Anticompetitive

Many customers who purchase prepaid wireless services are those subscribers who use wireless phones as their only communications service (a wireline substitute). The provision of a residential exemption of 6.8% to wireline customers while the Department suggests, through its recently issued TIP, that significantly higher taxes (15%+) apply to prepaid wireless services is anti-competitive, and would strongly favor wireline services.

In addition, the Department's narrow definition of prepaid is contrary to legislative intent from when the CST was originally passed. It was stated during the original CST reform effort, that "although similar communications services may be provided by different means, the state seeks to treat dealers of communication services in a non-discriminatory and competitively neutral manner."⁵ Fla. Stat. §202.105, in stating the legislative findings and intent of the Communications Services Tax Simplification Law, states "this chapter promotes the increase competition that accompanies deregulation by embracing competitively neutral tax policy that will free consumers to choose a provider based on tax-neutral considerations." Affirming that prepaid services are subject to the SUT will remove the uncertainty and eliminate this disparity by applying similar rates to prepaid wireless and residential wireline services.

CST on Prepaid is Highly Regressive

Applying current CST to prepaid wireless services would incur cumulative CST tax rates as high as 15%+. Some of these prepaid customers do not qualify for contract services, cannot afford both a home phone line and a mobile phone, or simply need a mobile solution for personal and professional reasons. The imposition of CST to prepaid services is highly regressive and unduly burdens many Florida citizens that simply cannot afford an extra \$2 - \$4 per month.

⁵ The Florida House of Representatives in its Final Analysis to CS/CS/CS/SB 1338

A Flat or Tiered Surcharge on Prepaid is Unworkable

The Working Group has suggested the possibility of imposing a flat-rate (e.g., \$0.50 per transaction) surcharge or a tiered surcharge on prepaid services. These proposals are not a preferred remedy to CST issues because they add complexity and create more administrative burden.

First, a basic flat-rate surcharge may sound appealing on its face, except when you realize that this is severely regressive for those consumers who cannot afford the monthly prepaid plans and instead purchase prepaid weekly or prepaid minute programs that are recharged every few days. These consumers would see their taxes rise dramatically—and they can least afford it!

The tiered-surcharge is used to counter this regressive criticism. As previously mentioned, prepaid programs exist in a variety of options and denominations, such as \$10 for 100 voice minutes or \$80 for a bundle of voice, text and data that is good for one month. What are the tiers and how would they be applied to the variety of prepaid programs that are offered? This creates a significant challenge for determining a fair surcharge to apply to these transactions. How does this accommodate for new programs that have yet to be offered?

Further, this would require significant enhancement of systems to accommodate the complexity of the tiers. In addition, large retailers may be able to more readily accommodate a surcharge system (as communicated by Walmart), but smaller retailers will be challenged by this requirement, potentially leading to lower compliance, lower tax revenue and continued disparity. This system will also require the Department to create new systems to accommodate the different returns, create new audit procedures and train new auditors. Application of a sales tax is the most appropriate means to secure tax revenue from the sale of prepaid communications.

Situsing

Considering that revenue allocation is of critical importance to county and city governments, any legislative solution should maintain the current provisions in Fla. Stat. §212.05(1)(e)1.a(II) that provide for situsing prepaid transactions that do not occur in a traditional retail store scenario, e.g., activations or recharges that occur over the phone or internet (assuming nexus) or vending machines. We believe that all sales of prepaid communications that have situs in Florida, should have sales tax applied regardless of the manner in which the transaction occurs.

Our proposal for reform:

Florida should legislatively clarify the definition of “prepaid calling arrangements” through a statutory amendment clarifying the definition of “prepaid calling arrangement” such that “prepaid calling arrangements” are subject to sales tax. The clarified definition should be broad enough to cover the current spectrum of prepaid communications services that are offered, leveraging definitions used by other states.

These actions will:

- *Align the statutes with the original legislative intent to apply sales & use tax to prepaid service arrangements, and*
- *Bring Florida statutes in line with all other states in the United States that apply sales tax to prepaid services, and*
- *Remove the uncertainty and inconsistency in practice and enforcement, leveling the playing field for all forms of prepaid communications, and*
- *Eliminate the competitive advantage currently held by residential wireline services, and*
- *NOT have a significant negative fiscal impact since the substantial portion of prepaid services are already subjected to SUT today*
- *“Provide a fair, efficient and uniform method for taxing communications services sold in this state.” Fla. Stat. §212.105(1).*

Summary:

We believe our proposal creates uniform application among prepaid services, removes competitive inequities, and eases administration burdens since retail establishments are already permitted for sales/use tax collection. We recognize that there are additional opportunities to improve the CST beyond what we have suggested, but we believe our particular proposal merits independent consideration and addresses a problem in need of an urgent solution. We appreciate the efforts of the Working Group and welcome any input or questions regarding our reform proposal.

MetroPCS Florida, LLC
December 6, 2012

Communications Services Tax Working Group

Written Comments

Submitted by:

TracFone



**Comments and Proposal of TracFone Wireless, Inc.
To Florida Communications Services Tax Working Group
December 24, 2012**

TracFone Wireless, Inc. ("TracFone") respectfully requests that the Working Group consider this submission as it develops its recommendations for the Governor and legislature.

TracFone Wireless, Inc.

TracFone provides nationwide, prepaid access to the network facilities of cellular and landline service providers. TracFone sells handsets and prepaid "airtime cards"—either directly to end users over the internet, to third party distributors, or to third party retailers, who themselves sell prepaid handsets and airtime cards to end users. TracFone does not provide post-paid service and does not issue bills to its customers, nor does it own or operate any physical transmission facilities. Rather, the wireless telecommunications networks used to facilitate communications by end users are owned and operated by unrelated licensed commercial mobile radio service ("CMRS") providers with which TracFone contracts for service.

TracFone is headquartered in Miami-Dade County where it has over 680 employees.

Working Group Mission and Results to Date

The Working Group was charged with studying aspects of the CST, and identifying options for improving it from administrative and competitive standpoints without unduly reducing revenue to local governments. But during the course of its study the Working Group has reached the conclusion that the CST suffers from a fundamental problem which cannot be resolved by modifying the mechanics of administration or leveling the competitive playing field. For reasons that are well documented in the Working Group's record, the PECO and local government revenue base is at risk. Thus, the CST can no longer be relied upon to fulfill its purposes.

We encourage the Working Group to make its consensus on this point the primary thrust of its report to the Governor and legislative leadership. Although diverse interests are represented on the Working Group, the dysfunctional nature of the CST is an undisputed fact that demands the attention of Florida lawmakers. The suggestion that a modest increase in the sales tax rate could provide the revenues needed to replace the CST is an option that merits serious consideration, and there are presumably others. However, unlike the central finding of the Working Group that the CST must be replaced, the source of replacement revenues is potentially controversial. Therefore, it is important

that the Working Group's report clearly distinguish between the conclusion the panel has reached on the one hand, and its identification of possible solutions on the other.

As a seller of only prepaid services, TracFone has an interest in the efforts of the Working Group that differs from the interests of other industry participants. The evidence accumulated during this body's proceedings overwhelmingly supports retaining the longstanding system of applying the applicable sales and local surtaxes to prepaid services at the point of sale. All that is required is an update of the relevant definition presently labeled "prepaid calling arrangement" so that there are no further disputes about what transactions qualify for this treatment. This approach has worked in Florida and throughout the country. It would make no sense for a work group empanelled to identify options for improved administration, to select what may be the only aspect of Florida's system of taxing communications that has worked well, and recommend making it more complicated.

The prepaid issue is thus distinguishable from the many other issues associated with the CST that are described in the record of the Working Group. The primary distinctions are that : (1) the solution to the prepaid issue is simple and can be achieved with an update to a single definition; and (2) the present uncertainty occasioned by the Department's March 2012 Taxpayer Information Publication merits prompt attention. Although significant time and effort may be required to develop revenue sources to replace the CST, the solution to the prepaid problem can and should be implemented without delay during the next legislative session.¹

Suggested Findings

At a summary level, the record before the Working Group supports findings that: (1) continued government reliance on the CST is perilous as the revenues it will generate are at best uncertain; (2) nationally, the CST is unique in its complexity and difficulty in administration, and in the magnitude of the tax burden imposed on consumers; and (3) there is no workable model for the taxation of prepaid communications services other than at point of sale. Findings with the additional detail set forth below also merit consideration.

1. Florida state government has historically relied on the gross receipts tax, which is presently a component of the CST, to support the issuance of bonds for public education capital outlay. The issuance of additional bonds depends upon increases in tax collections.
2. Local governments have historically relied on the local CST (and its predecessors) to fund government services, including pledges of CST revenues to secure bonded debt.

¹ Needless to say, a reversal of the position announced in the TIP would also be welcome.

3. The CST revenue base for state and local governments is at risk due to changes in technology and the market, the sales of services by providers lacking nexus with Florida, and the increasing availability of applications that can substitute for communications services through the use of non-taxable Internet access.
4. Florida's transaction tax rate as applied to communications services is among the highest in the nation. No policy reason has been advanced for requiring consumers of communications services to contribute more to the cost of government than other consumers.
5. Florida's CST is also unusual in the disparity between the sales tax and communications tax rates, in the variation in rates across taxable services, and in the variation in local tax rates.
6. Prepaid communications services include a variety of business and distribution models that are distinguishable from other communications services. The seller in most consumer transactions is a retailer of merchandise with no communications facilities.
7. Like virtually all other states, Florida has historically applied the sales tax to prepaid services at the point of sale. There was no evidence that this system has proved unworkable, but ample evidence that alternatives would be difficult to implement.
8. In large part because of the requirement to source communications services to the municipal level, administration of the CST is complex and burdensome for industry and government, and engenders constant conflict. There was no evidence that the administrative burdens in other states remotely approach those imposed by the CST.

These facts, particularly #3, combine to create a strong indictment of the CST as a continued source of funding for government. The prudent course for Florida is to find an alternative. With respect to the prepaid issue, the straightforward solution of updating the relevant definition, so that it is clear the sales tax applies at the point of sale and the CST does not apply, should be implemented without delay.

We thank the Working Group for consideration of our comments.

Agenda Item #5 & 6

No materials