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) Be revenue neutral for the governmental entities;

~~4)~~6) Will reduce the tax burden for the “typical” Florida taxpayer and “typical” small business, and

~~5)~~7) 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 intent is to maintain revenue neutrality for the collecting governmental entities.

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.

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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.

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In the late 1990s, a gubernatorial task force produced a report calling for Florida to modify its taxes on communications services and adopt a "unified tax" with an additional unified statewide "privilege fee" for local governments. Several years later, legislative leaders convened a working group of interested parties including representatives of local governments, the communications industry, and legislative and Department of Revenue staff to review and develop a new state and local tax scheme for communications services~~.~~ ~~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

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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. Of course, no legislative enactment can guarantee an increase in government revenues when price and service competition leads to lower prices in the market.

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~~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 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.~~

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 now competing against "over the top" providers who offer similar services (voice and video) as internet application which may not be monetized in the same way as traditional communications services. These new services are often free for the customer or offered at a much lower cost than traditional voice and video services and as a result, the tax base is eroding. Coupled with the federal moratorium on taxing Interest access, it is clear that the sustainability of even current levels of tax revenues is highly unlikely.

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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 threatening 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 portion of the charge is being assigned to the transmission of these services as required under state and federal law, both of which exempt "Internet access services" from any and all state and local taxes. In 2014, the federal moratorium on taxing Internet access expires, and there is uncertainty as to future CST revenue streams as Internet access services evolve.

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Additionally, the communications industry expresses frustration regarding the difficulty in identifying and accounting for the taxes collected within the ~~many~~ 481 Florida jurisdictions~~;~~ at 122 differing CST 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.

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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)

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

Charles 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 S. 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

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. This rate was initially established by the Legislature to hold each local jurisdiction harmless, based upon the amounts received from the replaced revenue streams given up in exchange for the new taxing system. If the rate established did not prove to hold the jurisdiction harmless, or was not at the maximum rate established by law, the jurisdiction has the authority to increase the 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. When

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combined with the state CST tax rate of 9.17 percent, the average Florida customer pays an overall CST tax of 14.21 percent on communications services. The local component of the CST does not apply to direct-to-home satellite services. In counties that have a local option sales tax, the local CST rate consists of both the local option sales tax for the county, as well as the local jurisdiction's assessed communications services tax rate.

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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 arrangement[1]. 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. The application of books and records to determine taxability for non-Internet bundled charges was added during the 2012 Legislative session, and represents a departure from how Florida Sales and Use Tax treats non-Internet bundled charges.

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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 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

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

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.

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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:

[2] See Appendix ___ for complete survey results

- 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).

During the presentation, it came to light that the questions asked of the other states only addressed taxes and did not include questions regarding local communications franchise fees or rights-of-way construction permit fees, which are uniquely included in Florida's Communications Services Tax. Since it is not uncommon for local jurisdictions nationwide to additionally charge franchise fees and/or construction permit fees, the above responses cannot be considered to provide a one to one comparison with regard to rates.

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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.	Emergency Rate Repeal: 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.	Netting Bad Debt: Estimated not to have a fiscal impact
Chapter 2010-149, L.O.F.	Rate Swap: 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.	Transient Public Lodging: Estimated not to have a fiscal impact

Chapter 2011-120, L.O.F.	Rounding Rule: Estimated not to have a fiscal impact
Chapter 2012-70, L.O.F.	Change to Sales Price Definition: 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. Local Situsing: Recurring impact of negative $4.7M for the local component of the CST. Retroactive Application: 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 (-$2.5M GR sales tax, -$.3M local sales tax - $1.0M gross receipts tax, and -$2.2M local CST).

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

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

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.

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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~~ appropriate sufficient moneys to make lease, rental, capital improvement, debt service or other required payments.

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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 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 rulemaking 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 compromised 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.

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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, primarily the very low penetration of "landline only" telephone customers who do not subscribe to any wireless, video or other communications service.

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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.

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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.

Comment [JP26]: See attachment for Mayor Resnick's comments

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 customers' bill, or can be reasonably identified in the selling dealer's books and records.[4] The dealer may support the allocation of changes with books and records kept in the regular course of business covering the dealer's entire service area, including territories outside Florida.

Comment [JP27]: FOX

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

[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.

variety of interconnected networks using a common protocol by hundreds of thousands of 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. The Department audits over the last 12 years have resulted in the additional collection of revenues that represent **less than 1 percent** of total CST collections, while costing the Department auditors over 60,000 hours (nearly 50 percent of total = 121,336). The Department testified and presented data that over 50 percent 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 percent" of the total additional revenues collected.

Comment [JP28]: DUDLEY

Comment [JP29]: See attachment for Mayor Resnick's comments

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 ~~of~~ 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.

Comment [JP30]: FOX

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.

Comment [JP31]: See attachment for Mayor Resnick's comments

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.

Comment [JP32]: See attachment for Mayor Resnick's comments

This proposal would significantly reduce or eliminate the tax differential between different types of communications services. For example, ~~I~~it would bring taxation of contract wireless plans in line with the current taxation of prepaid calling arrangements under the sales and use

Comment [JP33]: DUDLEY

tax, which taxes the sale of prepaid calling arrangements at the point-of-sale. Another example would be the proliferation of Internet or other online video products and services which may or may not be currently subject to any tax in Florida, but should be subject to the same level of taxation as traditional cable or video providers and satellite television providers.

Comment [JP34]: DUDLEY

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.

Comment [JP35]: See attachment for Mayor Resnick's comments

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

Comment [JP36]: FOX

[5] See Appendix ___

> 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.

Comment [JP37]: See attachment for Mayor Resnick's comments

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, 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:

Comment [JP38]: See attachment for Mayor Resnick's comments

- 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~~ votes by the cities or counties are not required;
- Provide that revenue streams for local governments will be unrestricted for purposes of bond financing; and

Comment [GC39]: First and second bullet points are redundant DUDLEY

Comment [JP40]: FOX

Comment [JP41]: DUDLEY

[6] See Appendix III.A for detailed analysis.

- Ensure that distributions will be provided directly to municipalities and counties as currently done under the revenue distribution provisions in chapter 202 and in similar fashions under chapter 212, F.S.

Comment [JP42]: DUDLEY

Comment [JP43]: See attachment for Mayor Resnick's comments

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 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.

Comment [JP44]: See attachment for Mayor Resnick's comments

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. Additionally because the federal government limits local jurisdictions from assessing communications tax upon satellite communications providers, the state would have to continue an additional tax assessment upon satellite communications providers at the statewide level in order to ensure that all like services were taxed in a like manner.

Comment [JP45]: FOX

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.

Comment [JP46]: See attachment for Mayor Resnick's comments

Appendices

I. Section 12, Chapter 2012-70, Laws of Florida

II. Options:
   a. Index
   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
   b. Partial Replacement Option
   c. Memo from KSE Partners Dated 1/3/13

IV. Meeting Minutes
   a. June 11, 2012
   b. July 25, 2012
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V. Meeting Materials
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VI. Transcripts
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January 16, 2013

Via Electronic Mail

Andrea J. Moreland
Director, Legislative and Cabinet Services
Florida Department of Revenue
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morelanA@dor.state.fl.us

Re: DOR Draft CST Working Group Report

Dear Ms. Moreland:

As a preliminary matter, I want to commend the Department of Revenue staff for preparing the draft report of the Communications Services Tax ("CST") Working Group. Obviously, a tremendous amount of work went into this draft report. Below please find my comments and questions concerning the draft, listed by relevant sections.

Executive Summary

There are a few revisions that I would suggest. First, it needs to be emphasized in the third paragraph, when we first mention the repeal of the CST and bringing communications services under the sales and use tax that this would be an **increased** sales and use tax. We certainly do not support merely repealing the CST and using the current sales tax. In addition, the draft should emphasize that such a major shift must ensure that each jurisdiction that currently receives CST revenue must continue to receive the same or greater revenue under a sales tax distribution mechanism, necessary for bonding and operational capabilities. In addition, the Executive Summary fails to mention expressly that the increased sales and use tax would not only replace CST but also the gross receipt tax on communications services. Further, I would suggest removing the qualifying terms in the first paragraph of page 2 that communications services are taxed at a "much" higher rate than goods and services under the sales and use tax, or that we support a "small" increase in the sales and use tax. Such matters are relative and in some jurisdictions, the CST on communications services may be very close to the sales tax or possibly lower, particularly in non-charter counties or cities that have not imposed a CST. In addition, there is no mention in the Executive Summary of discussions concerning charges for use of public rights-of-ways and permit fees to review construction applications. My further comments with respect to these items are contained below. In the last paragraph of the Executive Summary, there is a specific reference to the two members representing municipalities also supporting this approach but conditioning their support upon certain principles. That is not correct. I have not voted to support this approach. Rather, in an informal survey at one of our meetings I indicated that based on the limited three approaches we were discussing, this was probably the best but I would not support it unless it included insuring that each local government's revenue was at least equal to what each government was currently receiving under the CST. It is my understanding that this was also the position of the Association of Counties. In addition, my support for this approach also includes the caveat that communications providers no longer received special treatment and free use of public rights-of-way or exemption from permit fees. Accordingly, I do not agree with the characterization of my support or non-support of the holistic approach.

I. Introduction. My only suggested addition in the first paragraph is that we should explain that prior to the CST, rights-of-way inspections were not for merely the safety of the traveling public but all user of the rights-of-way including other utilities and commercial entities.

II. Creation and Charge of the Working Group. No comments.

III. Members. No comments.

IV. Florida's Communications Services Tax. It is helpful to provide a summary of current law and practice regarding the CST. There are a few suggested revisions to this discussion. In subsection A2, Local Portion, we should merely add that while there are 481 separate jurisdictions that could imppose a local CST rate, 359 adopted the same rate, pursuant to the statute (this information is contained on page 12 of the draft). In subsection A4, services not subject to the tax, I would suggest adding digital goods, which were made exempt from the CST in 2012. Further, we should point out that the federal government is considering legislation for determining the nexus for digital goods to allow states to tax such digital services. In subsection A7, collection allowance, there should be discussion of the administrative fee maintained by the Department. In addition, I would suggest adding a new subsection A8, addressing the current law and practice with respect to public rights-of-way and permit fees. While the draft mentions in the Introduction that prior to the CST, local governments charged franchise fees and permit fees, it is important to point out that with the enactment of the CST, local governments are not allowed to charge communications providers that pay the local CST a fee for use of the public rights-of-way. Similarly, permit fees became very restricted and would not cover the cost of reviewing construction applications, and thus, under the CST, local governments opted to receive a small increase in the CST of .12% in exchange for not charging permit fees to communications providers seeking to perform construction in the public rights-of-ways. Further, that Florida is the only state that does not allow local governments to charge communications providers for use of the rights-of-ways, or that provides such limits on permit fees.

V. Meetings. No comments.

VI. Review of Issues. At the end of subsection A (page 11), National and State Tax Policies Relating to the Communications Industry, there should be added an explanation that the survey of other states' communications taxes did not reveal an "apples to apples" comparison with Florida because, as was pointed out in the Working Group meetings, other states either charge or allow local governments to charge fees for use of the public rights-of-way by communications/cable providers, while Florida does not allow such charges. While the Working Group attempted to determine the amounts of such charges in other states, it was too difficult to obtain exact information. However, best estimates from national organizations indicate that most local governments charge cable television providers a 5% franchise fee, the maximum allowed under federal law, for use of the rights-of-way, and percentages vary for other communications providers, which fees are passed through to consumers on their bills. In addition, permit fees vary based on the scope of the permit application. Accordingly, *total* taxes and fees paid by consumers for communications services in other states were not accurately reflected in the survey and may be lower than Florida's when you add in such franchise fees.

At the end of subsection C(1) (page 15), State Government, there should be a conclusion that statutory amendments that repeal or alter the gross receipts tax on communications services must ensure that the State is held harmless because of such bonding and Constitutional concerns. Similarly, at the end of subsection C(2)(page 17), there should be a similar conclusion that statutory amendments that repeal or alter the revenues received by local governments under the CST must ensure that each local government is held harmless because of such bonding and operational considerations.

In subsection D (page 17), Fairness and Clarity of Laws for Industry, Government & the Public, we did not include in the draft a discussion about the clarity of the CST to the public, which should be added since it was part of our charge. We should include a discussion that we did not have presentations from any organization representing the interests of consumers, but that members of the Working Group pointed out that there is significant confusion among consumers as to what services are subject to the CST, and the amounts of such tax. Further, such confusion increases when bills contain one charge for bundled services. It was also pointed out that under Florida law, no government entity in Florida has the ability to regulate consumer billing to ensure transparency and accuracy of taxes and fees on bills for communications services. One option the Legislature may want to consider is to provide such jurisdiction to the Public Services Commission.

In subsection D(2)(d) (page 21), Retail Perspective, please eliminate the last line as to the effect of Florida classifying retailers as telecommunications providers. We did not discuss this.

In subsection D(5), Audits, (page 25) in the initial paragraph, it would be helpful if the Department gave a brief history that prior to the CST, audits were performed by cities and counties (and the State, if that is correct), but that after the CST was enacted, except in very limited exceptions, only the Department may conduct audits. In addition, it would be helpful if the Department included a statement as to the number of returns or amount of revenue over such period, to give a perspective as to whether 1,374 audits represent a high or low percentage of returns. We discussed this in one of our meetings.

VII. Options.

As stated earlier, we should insert the words "an increased" where the draft first mentions the repeal of the CST and bringing all communications services under the sales and use tax (page 27, 3rd paragraph). We should state expressly that no one on the Working Group supported repealing the CST and bringing communications services under the existing sales and use tax rates. In addition, the requirements for such repeal of CST that were presented by Ms. Fox at our December meeting were accepted by the Working Group and should be included in this discussion of the Holistic Replacement option. These are as follows:

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.

Similarly, to the extent the Workgroup has such information, we should reference requirements for replacement of the gross receipts tax for the State's protection.

In subsection C (page 28), in the first paragraph we must also state "an increased" sales and use tax. In addition, the Working Group's holistic option included replacing not only the CST, but also gross receipts taxes on communications services. In the last paragraph on page 28, we may want to also mention Congress's effort to create a nexus for taxation of digital goods (this information was provided to the Workgroup on December 17, and should be included in the Report's backup materials).

In the second paragraph on page 29, we should avoid characterizing the increase as "small" or large. While .34% may seem small, cities debate for extended periods when considering whether to increase milage rates by .34% or even less. In addition, I object to including the comments from KSE Partners. First, the Working Group did not request this, only one member did. Second, state economists are better positioned to determine the effect on residents and businesses of an increase in the sales and use tax. In addition, at first blush, many finance persons with cities questioned how a .34% increase in sales tax could cover the revenue lost by a 15.17% CST. Accordingly, there should be a general, high level discussion that the .34% increase in the sales and use tax would make up the revenue of the CST, even though the CST is on average 15.17%, because 1) the sales and use tax includes a much larger base of taxable goods and services, and 2) the universe of payers of the sales and use tax is much larger than consumers of communications services, and includes not only Florida's residents and businesses, but also tourists and out of state businesses that pay such sales taxes. State economists will also be able to quantify the impacts of a sales tax increase to such important stakeholders in our economic development, which is not included in the KSE comments.

In the second paragraph on page 30, first line, CST and gross receipts taxes are a significant part of local *and* state government funding. As to the requirements listed on page 30, we should refer to such "requirements" as part of the holistic option, from Ms. Fox's submission identified above, as opposed to "policy statements" listed in the second paragraph. These requirements should be linked to any discussion of repeal of CST and gross receipts.

In addition, we should add to our discussion of the holistic approach, the re-instatement of direct rights-of-ways and permit fees, on the basis of fairness and equity, so that private, for-profit entities are not given special treatment and allowed to use such public resources for free and to ensure that local governments received sufficient revenue to cover the costs of maintaining the rights-of-ways for all users, and to review construction applications submitted by communications providers.

With respect to subsection F, Fix the Communications Services Tax, we should identify that while we would favor the holistic replacement approach, we recognize that it may take substantial time and effort to perform the work necessary to determine the appropriate mechanism to satisfy the requirements that accompany this option. Accordingly, there are various short term fixes that may be considered. For example, in the short term, the residential exemption and exemption of digital goods could be repealed. Similarly, the CST could be repealed as to prepaid services and replaced with a flat fee surcharge, along with sales and use tax, as discussed above. However, the Working Group would not recommend an option of merely repealing the CST on any particular services and having such services subject to the existing sales and use tax.

I look forward to discussing the draft with the Working Group during our call. While I will be able to join at 1:30, I will need to leave at approximately 2:30 pm, and have placed on my calendar our last call scheduled for January 28. Thanks again for the Department's work on the Draft Report.

Sincerely Yours,

Gary Resnick
Mayor

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