

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 735 Tax on Substitute Communications Systems  
**SPONSOR(S):** Stargel  
**TIED BILLS:** **IDEN./SIM. BILLS:** SB 2302

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Subcommittee on Telecommunications</u>	<u>10 Y, 0 N</u>	<u>Holt</u>	<u>Liepshutz</u>
2) <u>Business Regulation</u>	<u></u>	<u></u>	<u></u>
3) <u>Finance &amp; Tax</u>	<u></u>	<u></u>	<u></u>
4) <u>Subcommittee on Commerce &amp; Local Affairs</u>	<u></u>	<u></u>	<u></u>
5) <u>Appropriation</u>	<u></u>	<u></u>	<u></u>

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### SUMMARY ANALYSIS

In October 2001, the Florida Legislature enacted the Communications Services Tax Simplification (CST) law, Fla. Laws 2000 chapter 260 and Fla. Laws 2001 chapter 140. Codified in chapter 202, F.S., the new tax structure combined seven different state taxes, local taxes, and fees into a two-tiered tax composed of a State Communications Services Tax and a Local Communications Service Tax. The CST broadened, among other things, the taxable base of communications services by restructuring separate taxes and fees into a revenue-neutral communications services tax centrally administered by the Department of Revenue (DOR). Among the legislative findings and intent, chapter 202 is to "ensure that the growth of the industry is unimpaired by excessive governmental regulation. The tax imposed pursuant to this chapter is a replacement for taxes and fees previously imposed and is not a new tax."

The CST applies to communications services including telecommunications, cable, direct-to-home satellite, and related services. This application encompasses voice, data, audio, video, or any other information or signals, including cable services that are transmitted by any medium. Included in these taxable services are substitute communications systems. A substitute communications system is generally characterized as a stand-alone system capable of providing its own exclusive switched communications services in lieu of having those services provided by a communications services dealer. Although the system may be interconnected with a communications services dealer, its services are not for hire, resale, or provided to any third party.

The bill amends chapter 202, F.S., to repeal substitute communication systems from the communications services subject to the CST.

The bill takes effect upon becoming law.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

**STORAGE NAME:** h0735a.br.doc  
**DATE:** March 11, 2004

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. DOES THE BILL:

- |                                      |                              |                             |   |
|--------------------------------------|------------------------------|-----------------------------|---|
| 1. Reduce government?                | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. Lower taxes?                      | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. Expand individual freedom?        | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. Increase personal responsibility? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. Empower families?                 | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a “no” above, please explain:

#### B. EFFECT OF PROPOSED CHANGES:

##### BACKGROUND:

##### History

In 1985 the Legislature added a “substitute telephone or telecommunications system” to the list of services subject to gross receipts and sales tax. In 1985 most of the communications services available today were not yet in existence. “Land-line” telephone was the most common communications services. The 1985 law (Ch. 85-174, Laws of Florida) states:

Any person who purchases, installs, rents, or leases a telephone system or telecommunications system for his own use to provide himself with telephone service or telecommunication service which is wholly or partially independent of any local telephone system or any intrastate or interstate interexchange network or which is a substitute for any telephone company switched service or a substitute for any dedicated facility by which a telephone company provides a communications path is exercising a taxable privilege . . . .

In the 2000 Regular Session, the Legislature substantially rewrote Florida’s communications tax law. The new chapter 202, F.S., the Communications Services Tax Simplification Law (“CST”), was created and became effective January 1, 2002. Communications services are now subject to a uniform statewide tax rate and a local tax administered by the Department of Revenue.

The 2000 rewrite of Florida’s communications services tax law was a complex undertaking. Numerous individuals from both business, and state and local government, assisted the Legislature in formulating policy and drafting language. The new CST was meant to replace the old tax structure with a simplified and revenue-neutral new tax code.

Since the rewrite was so substantial, many of the details were not discussed individually in committee or in floor debate. The language in Ch. 202 concerning substitute communications services was among the details not discussed. The present definition of a “substitute communications system” reads:

“Substitute communications system” means any telephone system, or other system capable of providing communications services, which a person purchases, installs, rents, or leases for his or her own use to provide himself or herself with services used as a substitute for any switched service or dedicated facility by which a dealer of communications services provides a communication path. s. 202.11(16), F.S.

The original intent of taxing substitute communications systems was to provide equal tax treatment on an in house telephone system and telephone service purchased from a commercial provider. Today there is great uncertainty as to the proper interpretation of a “substitute communications system.”

Prior to 2002, communications services were subject to the following various taxes: gross receipts tax, state sales and use tax, local sales and use tax, and municipal utility tax. Each of these taxes had a different base, and the revenue raised by each tax was used for different purposes.

#### Proposed Rule

The DOR has issued a proposed rule, 12A-19.036 on substitute communications systems. A proposed rule is a “first draft” and may be subject to significant revisions. A public workshop was held on the proposed rule on August 1, 2003. At the workshop, many members of the business community expressed concern that the DOR’s interpretation of a “substitute communications system” is too broad. Of particular concern was an example in the proposed rule that found a taxpayer operating a local area network (LAN) to connect multiple computers was operating a substitute communications system.

The following are examples from the DOR’s draft rule of taxable substitute communications services.

- A telephone system with switching and routing capabilities allowing for intercom and other self-contained communications at the taxpayer’s facility.
- A computer local area network (LAN) system that uses a router to provide switching capabilities necessary to connect the multiple computers used by the taxpayer’s employees.
- A wireless dispatch system that transmits and switches voice or data signals to provide a communications path between and among remote receivers and a central base station.
- A taxpayer buys telephone transmission and receiving equipment located at various sites where the taxpayer does business and acquires and installs a tower for the purpose of providing communications services between those sites in lieu of using a local exchange provider and long distance provider.
- A system to transmit, route, and switch data to permit monitoring the activities and operations of manufacturing equipment, pipelines, rail systems, or utilities.
- A small business has five computers, each connected to a central router that allows the computers to share printers, files and documents, and other business related activities.
- A two-way mobile radio system that includes a base station, a central tower used for signal switching, and several mobile radio units and for which the company does not buy airtime or switching services from a provider.

The DOR provided these examples because the proposed rule defines a substitute communications system as “any system capable of providing communications services that are a substitute for any switched service or dedicated facility that a dealer would use to provide communications services.” The system must be capable itself of providing and may be operated on a “stand alone” basis or be interconnected to communications services or systems provided by a dealer. A “switched service” is defined as any service that uses a mechanical, electrical, optical, or other device that opens or closes circuits, completes or breaks an electrical or other path along which signals travel, or selects paths or circuits to allow for the transmission, conveyance, or routing of communications signals between and among points.

#### The Problem

Both the sales tax and the CST attempt to create an equal tax situation between the business that buys its goods or services from another and the business that creates the goods or services in-house. Large business can have in-house systems, while small business must buy from others. Taxing substitutes is generally viewed as a tax fairness issue rather than just a way to raise more revenue. However, defining and valuing a substitute is more difficult than defining and valuing a service that is purchased from another.

The substitute communications system has long been in the statute, but never been defined or examined. The DOR reports approximately 10 companies presently pay taxes for substitute communications systems. The DOR has had no previous rigorous enforcement efforts. The DOR is now attempting to move forward and apply meaning to taxation of substitute communications systems.

The bill repeals the two-tiered communications services tax imposed by ch. 202, F.S., on the actual cost of operating a substitute communications system.

The bill takes effect upon becoming law.

#### C. SECTION DIRECTORY:

Section 1. Deletes the definitions for "actual cost of operating a substitute communications system" and "substitute communications systems" from the definitions in s. 202.11, F.S.

Section 2. Delete the reference to the tax rate to be used in calculating communications services tax on the actual cost of operating a substitute communications system.

Section 3. Deletes the exception reference for the collection and remittance of communications services tax for substitute communications systems.

Section 4. Deletes the exception reference for the issuance of annual communications services tax resale certificates by DOR to persons registered as users of substitute communications systems.

Section 5. Deletes the requirement to the distribution of communications services tax proceeds collected from substitute communications systems.

Section 6. Deletes the authorization for the imposition of the local communications services tax by a local government on the actual cost of operating a substitute communications system.

Section 7. Repeals s. 202.15, F.S. Special rule for users of substitute communications systems.

Section 8. The act shall take effect upon becoming law.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

#### 1. Revenues:

Indeterminate. A Revenue Estimating Conference has not yet been scheduled.

#### 2. Expenditures:

Indeterminate. A Revenue Estimating Conference has not yet been scheduled.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

#### 1. Revenues:

Indeterminate. A Revenue Estimating Conference has not yet been scheduled.

#### 2. Expenditures:

Indeterminate. A Revenue Estimating Conference has not yet been scheduled.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Indeterminate. A Revenue Estimating Conference has not yet been scheduled.

D. FISCAL COMMENTS:

None. A Revenue Estimating Conference has not yet been scheduled.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Indeterminate. A Revenue Estimating Conference has not yet been scheduled.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

According to DOR, Section 203.01(1)(a)2., F.S., imposes a gross receipts tax on the retail sale of communications services in Florida and on the actual cost of operating a substitute communications system in Florida. This bill did not delete the authorization to impose the gross receipts tax on the actual cost of operating a substitute communications system.

Moreover, administering communications services taxes imposed on the actual cost of operating a substitute communications system in Florida has been problematic. The DOR prepared a draft rule on substitute communications systems, proposed Rule 12A-19.036, F.A.C., and held a public workshop on August 1, 2003. The intent of the proposed rule and public workshop was to gather information from industry and local government in an attempt to identify actual substitute communications systems and the actual costs of operating such systems that would be subject to tax. After numerous public comments and various meetings with industry and local government representatives, the DOR is not sure at this time exactly what constitutes a substitute communications system. The DOR is also not sure at this time the specific costs that a user of a substitute communications system would incur that would be subject to tax. Without specific legislative guidance on these issues, the DOR is not confident that it can properly administer this tax. Any attempts to enforce this tax against taxpayers who are audited for the period between October 1, 2001, and the effective date of this bill could result in litigation that would be costly and time-consuming for both the DOR and taxpayers, even though any resolution of the issues would have no prospective meaning.

The bill proposes that the act shall take effect upon becoming law. This means that the DOR would need to administer and enforce this tax for the period October 1, 2001, through the effective date of the act becoming law. Noting the problems identified above, the DOR would like to propose a retroactive repeal of this tax effective October 1, 2001, and that any such repeal would not create a right to a refund of any previously paid tax on substitute communications systems.

### IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

