

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 49 Tax on Substitute Communications Systems
SPONSOR(S): Stargel and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 818

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR |
|---|-----------|----------------|----------------|
| 1) Finance & Tax Committee | 7 Y, 0 N | Diez-Arguelles | Diez-Arguelles |
| 2) Utilities & Telecommunications Committee | 12 Y, 0 N | Cater | Holt |
| 3) Fiscal Council | | Diez-Arguelles | Kelly |
| 4) _____ | _____ | _____ | _____ |
| 5) _____ | _____ | _____ | _____ |

SUMMARY ANALYSIS

In 2000, the Florida Legislature enacted the Communications Services Tax Simplification Law (CST) which became effective October 1, 2001. Codified in chapter 202, F.S., the new tax structure combined 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).

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 the imposition of the CST on substitute communication systems. Also, the authorization to impose the gross receipts tax on the actual cost of operating a substitute communications system set forth in s. 203.01(1)(a)2, F.S., is repealed.

The bill's provisions apply retroactively to October 1, 2001. The retroactive application is remedial in nature and does not create a right to a refund or to require a refund by any governmental entity of tax payments made prior to the effective date of the act.

The Revenue Estimating Conference has determined that based on current collections, the negative revenue impact in FY 05-06 is estimated to be at least \$300,000 for state government and at least \$100,000 for local governments. However, the full negative impact of this bill if DOR were to enforce the substitute communications tax provisions is indeterminate.

The bill takes effect upon becoming law.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Lower Taxes – The bill repeals the imposition of the CST and the gross receipts tax on substitute communications systems.

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 service. The 1985 law (Ch. 85-174, Laws of Florida) stated:

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., Communications Services Tax Simplification Law (“CST”), was created and became effective October 1, 2001. 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 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 statute.

Since the rewrite was so substantial, many of the details were not discussed individually in committee or in floor debate. The language in chapter 202, F.S., 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 on telephone service purchased from a commercial provider. Today there is uncertainty as to the proper interpretation of what constitutes a “substitute communications system”.

Prior to 2002, communications services were subject to the following 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" was too broad. Of particular concern was an example in the proposed rule that found that a taxpayer operating a local area network (LAN) to connect multiple computers was operating a substitute communications system. The DOR also held workshops in June and September 2004.

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 a 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 that 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 is a substitute for any switched service or dedicated facility that a dealer would use to provide communications services." The system must be capable of providing communications services and may be operated on a "stand alone" basis or be interconnected to communications services or systems provided by a dealer. "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 businesses can have in-house systems, while small businesses must buy from others. Taxing substitute systems 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 tax provision related to substitute communications system has been in the statute since 1985, but has never been defined or examined. The DOR reports that less than five companies presently pay taxes on substitute communications systems. The DOR has had no previous rigorous enforcement

efforts. The DOR is now attempting to move forward and apply meaning to the statutes imposing a tax on substitute communications systems.

Proposed Changes

The bill repeals the communications services tax imposed by chapter 202, F.S., and the gross receipts tax imposed by chapter 203, F.S., on the actual cost of operating a substitute communications system.

The bill takes effect upon becoming law and applies retroactively to October 1, 2001.

B. SECTION DIRECTORY:

Section 1. Amends s. 202.11, F.S., to delete the definitions for “actual cost of operating a substitute communications system” and “substitute communications systems”.

Section 2. Amends s. 202.12, F.S., to delete the provision authorizing the imposition of the communications services tax on substitute communications systems.

Section 3. Amends s. 202.16, F.S., to delete unnecessary language.

Section 4. Amends s. 202.17, F.S., to delete unnecessary language.

Section 5. Amends s. 202.18, F.S., to delete unnecessary language.

Section 6. Amends s. 202.19, F.S., to delete 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. Amends s. 203.01, F.S., to delete the imposition of the gross receipt tax on users of substitute communications systems.

Section 8. Amends s. 624.105, F.S., to conform.

Section 9. Provides that the retroactive application for the provisions of the act are remedial and do not create a right to a refund or require a refund by any governmental entity.

Section 10. Repeals s. 202.15, F.S., to conform.

Section 11. Provides an effective date of upon becoming law, applying retroactively to October 1, 2001.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

| | FY 2005-2006 | FY 2006-2007 |
|--------------------|--------------|-----------------|
| G.R. | (.2m) | (indeterminate) |
| Gross Receipts Tax | (.1m) | (indeterminate) |
| Total | (.3m) | |

The Revenue Estimating Conference has determined that the provisions of this bill would have a negative impact on state revenues of at least \$300,000 in actual collections. However, the full negative impact of this bill if DOR were to enforce the substitute communications tax provisions is indeterminate.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

| <u>FY 2005-2006</u> | <u>FY 2006-2007</u> |
|---------------------|---------------------|
| (.1m) | (indeterminate) |

The Revenue Estimating Conference has determined that the provisions of this bill would have a negative impact on local revenues of at least \$100,000 in actual collections. However, the full negative impact of this bill if DOR were to enforce the substitute communications tax provisions is indeterminate.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Indeterminate. Taxpayers who are currently remitting the tax will no longer have to remit. Taxpayers who may be subject to tax, but who have never remitted the tax will be relieved of any past and future liability for the tax.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provision appears to apply because the bill reduces the authority of cities and counties to raise revenue. However, because the magnitude of the reduction cannot be determined, it is not possible to address whether the reduction is insignificant and therefore exempt from the mandates provision.

Because of this uncertainty, a 2/3 vote may be advisable.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES