

# Utility User Tax Facts

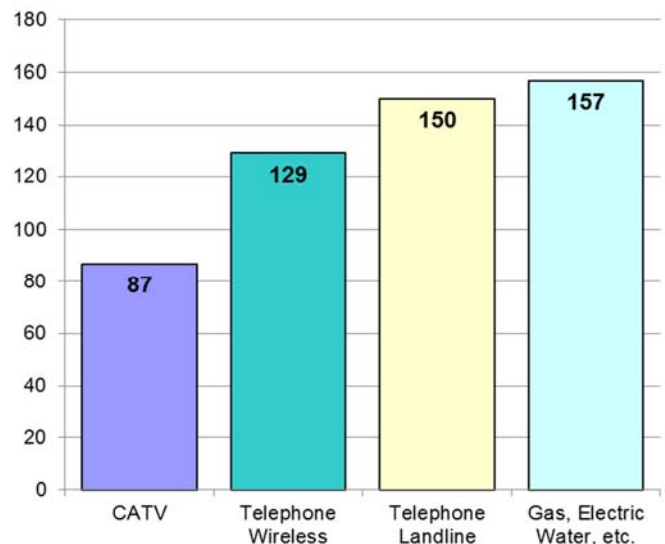
The Utility User Tax (UUT) may be imposed by a city on the consumption of utility services, including (but not limited to) electricity, gas, water, sewer, telephone (including cell phone and long distance), sanitation and cable television.<sup>1</sup> The rate of the tax and the use of its revenues are determined by the local agency. A UUT may be imposed as a special tax, earmarked for a specific purpose, or a general tax to be used for a variety of municipal service needs at the discretion of the city council. The tax is levied by the city, collected by the utility as a part of its regular billing procedure, and then remitted to the city. Statewide, city and county utility user taxes generate about \$2 billion per year.

<b>Cities and Counties With UUTs</b>				
	Cities <sup>2</sup>	Counties <sup>2</sup>	Total	State Population covered
Number with UUT	154	4	158	50%
Telephone UUTs	146	4	150	49%
Intrastate	146	4	150	49%
Interstate	114	4	118	41%
International	110	4	114	44%
Wireless	126	3	129	44%
Electricity	153	4	157	49%
Gas	153	4	157	49%
Cable TV	86	1	87	20%
Water	83	1	84	21%
Sewer	13	1	14	4%
Garbage	10	0	10	1%

## Voter Approval is Now Required to Levy a New or Increased UUT

Most of the 154 cities and 4 counties<sup>2</sup> with UUTs adopted the taxes by vote of the city council (or in the case of a county UUT, the County Board of Supervisors) prior to 1986. Generally, taxes imposed since then require voter approval. The Constitution (Article XIIC) requires 2/3 voter approval for any new or increased special tax. A special tax is dedicated to a specific purpose. A new or increased general tax requires majority voter approval.

Currently, all UUTs are general taxes except two. In June 2003, voters in the City of



<sup>1</sup> Authority: General law cities: Government Code § 37100.5; Calif Constitution Article XI § 5 (“municipal affairs”)

<sup>2</sup> The City/County of San Francisco is counted here as a county, not a city.

<sup>3</sup> No UUT on telecom in Azusa, Buena Park, Pacifica, Scotts Valley.

<sup>4</sup> Irvine charges commercial only.

<sup>5</sup> Irvine, Alhambra commercial only.

Desert Hot Springs approved a UUT which dedicates 50% of the proceeds to resolving the city’s bankruptcy related debt.<sup>6</sup> In June 2010, voters in the City of Mammoth Lakes approved the extension of the cities sun-setting UUT but earmarking it for “mobility, recreation, and arts and culture.” Ironically, that city later filed for bankruptcy facing a massive court judgment from a land use dispute.

**The UUT is Vital to Funding Essential Municipal Services**

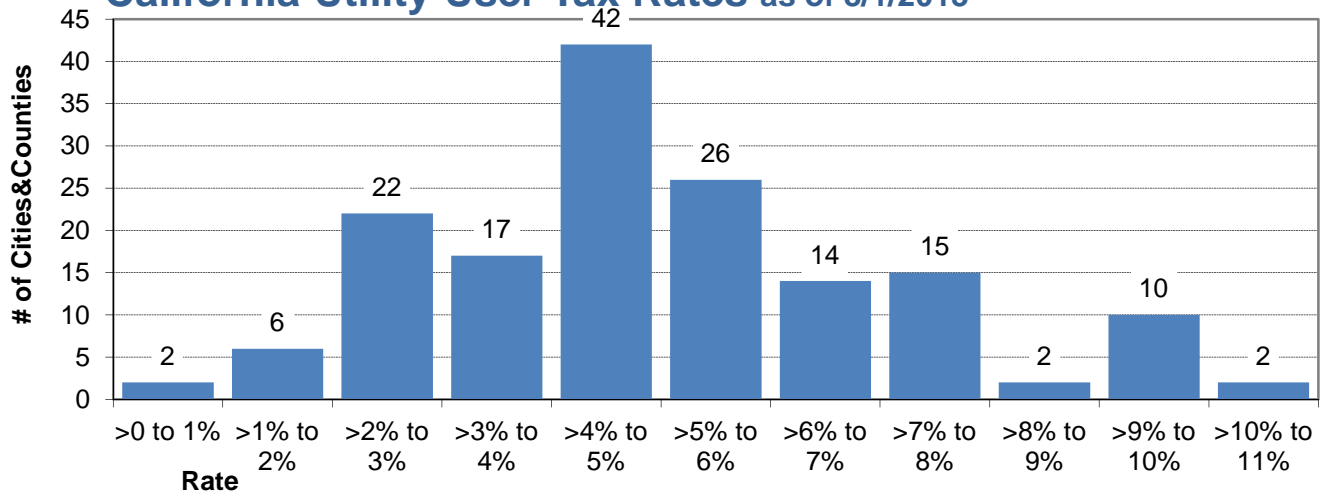
City Utility User Tax rates range from 1% to 11%. The particular utilities to which the tax is applied varies. In some cities different rates apply to residential versus commercial users. The most common rate (the mode) is 5%, applied broadly among many types of utilities. The average rate (mean) is 5.5% with a standard deviation of 2.1%. Because most large cities have UUTs, half of California residents and a majority of businesses pay a utility user tax.

The UUT is a vital element in the funding of critical city services. On average, the UUT provides 15% of general purpose (i.e. non-earmarked) revenue in cities that levy it. In some cities, the UUT provides as much as 1/3 of the general fund (Holtville, Compton, Richmond). UUT revenues most commonly fund police, fire, parks, library, and long-range land use planning services – and related support services (e.g. accounting, payroll, personnel, information systems, etc.).

**Counties Also Levy UUTs**

A county may levy a UUT on the consumption of electricity, gas, water, sewer, telephone, telegraph and cable television services in the unincorporated area.<sup>7</sup> Four (4) of the 58 counties levy a UUT (Alameda, Los Angeles, Sacramento, and San Francisco).

**California Utility User Tax Rates as of 8/1/2013**



<sup>6</sup> In 2009, those voters increased the tax to 7%.

<sup>7</sup> Revenue and Taxation Code Section 7284.2 et seq.

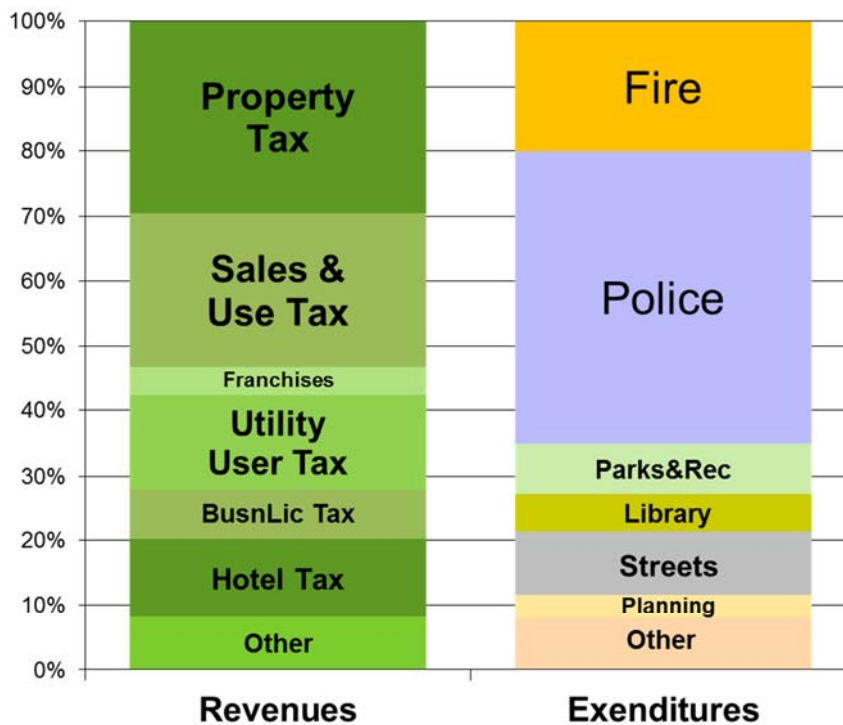
### Some UUTs Result From State Cuts to City Funds

Many city UUT levies and increases have resulted from cuts to city revenues by the state. In 1992, facing massive deficits in the state budget, the Legislature and Governor began the annual transfer of billions of dollars of property tax revenue from cities, counties and special districts to K-14 schools, allowing the state to reduce its general fund spending on education. Cities and counties, who depend substantially on sales tax and property tax revenues for discretionary income, were already experiencing the same recessionary effects as the state. These property tax shifts, using a mechanism called the “Educational Revenue Augmentation Fund” (ERAF), continue today. In FY 2008-09 the annual property tax shift totals \$7.5 billion including over \$1.2 billion from cities.<sup>8</sup>

City property tax revenue, a top source of general purpose revenue for most, was cut from at least 9% and 24% on average. Cities responded by cutting services, deferring infrastructure maintenance, relying more heavily on debt financing, paring down reserves, more aggressively pursuing sales tax generators, and raising taxes and assessments. Within a few years of the beginning of the ERAF property tax shifts, more than fifty (50+) cities increased an existing or levied a new UUT.

### Discretionary Revenues and Spending

Typical *Full Service City*



<sup>8</sup> For more information on ERAF, see <http://www.californiacityfinance.com/#ERAF>

## **UUTs on Telecommunications**

The application of utility user taxes to certain telephone services has been a topic of substantial legal and legislative turmoil due to changes in technology and federal law.

### **UUTs and the FET**

Many Utility User Taxes in California include reference to the Federal Excise Tax (“FET”)<sup>9</sup> commonly limiting the application of the utility user taxes to charges that are “subject to” the FET. Telephone calls which are not charged based on both time and distance — such as those paid by coin in phone booths — are exempt from the FET. By reference, these types of calls are also exempt from some local UUT ordinances. Many cell phone bills are based upon a package which provides a mix of local and long-distance calling for a flat rate.

In 2007, several federal courts and the IRS ruled that telephone service packages which provide a mix of local and long-distance calling for a flat rate or a fixed fee are based on neither time nor distance and are therefore not subject to the FET.<sup>10</sup> The IRS subsequently adopted a regulation incorporating these rulings.<sup>11</sup> That meant that if a city wished to continue to impose its UUT on cell phone or other telephone calls which are not charged on both time and distance, it must amend its ordinance to remove the reference to this exemption to the FET.

A number of cities have amended their UUT ordinances to clarify that they did not wish to adopt the IRS’ new practice, but rather wished to continue to impose their UUTs as they had historically been imposed (i.e. on charges based on time or distance). At the time of this writing, several localities are challenging the right of local taxing authorities to amend their ordinances without voter approval, or to continue to collect this revenue without amendment. The lawsuits argue that an amendment to an ordinance to bring it into conformity with the FET ruling is an “increase” subject to voter approval under Proposition 218.

### **UUTs and the MTSA**

Prior to the adoption of the Mobile Telecommunications Sourcing Act of 2000 (MTSA)<sup>12</sup> by Congress, cellular carriers had argued that the federal Constitution forbade the application of a utility user tax to telephone calls which neither originated nor terminated within the taxing agency. The MTSA expanded the permissible nexus for taxation to all cellular telephone charges for accounts with a primary place of use in the jurisdiction. However, carriers have argued in the courts that the California State

---

<sup>9</sup> 42 U.S.C. §§ 4251 et seq.

<sup>10</sup> IRS Notice 2006-50

<sup>11</sup> Revenue Bulletin 2007-5 Section 10

<sup>12</sup> 4 U.S.C. §§ 116 et seq.

Constitution Article XIIC prohibits cities and counties from applying the MTSA nexus rules without voter approval.<sup>13</sup>

As a result of these events, doubt has been cast over the application of some outdated local UUT ordinances to certain types of telephone service. Proposition 218 requires voter approval of any change in the “methodology” by which a tax is administered if the change increases the amount of the tax paid by the taxpayer.<sup>14</sup> Many agencies that rely on UUTs on telephony have successfully sought voter approval of an updated ordinance that reflects the realities of the modern telecommunications industry.

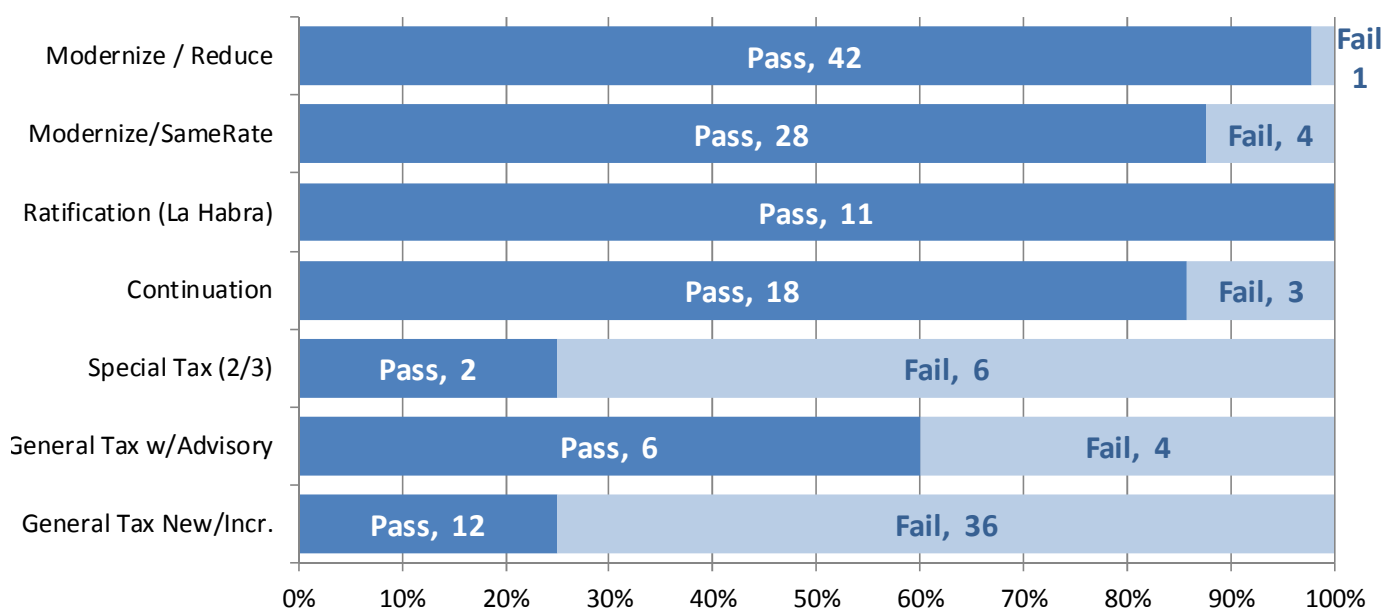
### Recent Voter Approval Record

From June 2002 through June 2013 there were 173 utility user tax measures placed before voters by cities and counties. Just three of these were county measures. Proposals for new or increased UUTs did not fare well: Just 20 of 66 proposals passed.

- Eight of these new/increase proposals were framed as two-thirds vote special taxes dedicated to police/fire (3) or streets (1); just two passed. Both were in Desert Hot Springs: June 2003 new 5% rate, May 2009 an increase to 7%.
- Ten attempted an “a/b” advisory vote strategy, proposing a majority-vote general tax with a second companion “advisory measure” regarding the specific use of the funds. Five of the ten passed. Of the 19 majority vote UUT general tax increase measures, just two passed (Rialto in June 2003, Menlo Park in November 2006).

### Utility User Tax Measures (increase or expand) June 2002 - June 2013

Cities and counties



<sup>13</sup> *Verizon Wireless v. Los Angeles*, No. B185373, *AB Cellular LA, LLC dba AT&T Wireless v. City of Los Angeles*, 150 Cal.App.4th 747 (2007)

<sup>14</sup> Gov. Code § 53750(h)

But voters were more accepting of UUTs already in place. Among the 21 measures to continue existing UUTs beyond a sunset date, 18 passed. All 11 measures which asked voters to ratify existing taxes following the 1991 La Habra decision upholding the validity of Proposition 62's majority vote requirement on general law cities passed.

Over the last decade, an increasing number of cities with UUTs have gone to their voters to modernize their ordinances to assure applicability to new technologies (e.g. wireless, internet-based, etc.) and billing methods (e.g. flat rate, etc.). In some cases, the measures have proposed small reductions in the UUT rate. All but five of the 75 measures passed.

During this period there were also 14 referenda placed on the ballot by citizens concerning UUTs. All seven measures to repeal a local UUT failed and four out of the five measures to reduce local UUTs failed. Voters in Greenfield (Monterey County) voted to reduce their UUT from 6% to 3% in November 2002. A referendum to restrict the use of UUT revenues to law enforcement services passed in Seaside (Monterey County) in November 2002, but a similar measure failed in Stockton in March 2003.

mc