HOUSE BILL REPORT
HB 1971

As Reported by House Committee On:
Finance
Appropriations

Title: An act relating to communications services reform.

Brief Description: Concerning communications services reform.

Sponsors: Representatives Carlyle and Nealey.

Brief History:
Committee Activity:
Finance: 3/15/13, 3/29/13 [DPS];
Appropriations: 4/5/13 [DP2S(w/o sub FIN)].

Brief Summary of Second Substitute Bill

- Requires retailers of prepaid wireless telephone service to collect and remit the Enhanced 911 tax.
- Repeals the taxes funding the Washington Telephone Assistance and Telecommunications Relay Service programs and requires the programs to be funded by State General Fund appropriations.
- Repeals the state and local sales and use tax exemption for local residential landline service.
- Establishes a temporary state universal communications services program.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 10 members: Representatives Carlyle, Chair; Tharinger, Vice Chair; Nealey, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Hansen, Lytton, Pollet, Reykdal, Springer and Wilcox.

Minority Report: Do not pass. Signed by 2 members: Representatives Condotta and Vick.

Staff: Jeff Mitchell (786-7139).

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Background:

Enhanced 911 Excise Tax on Prepaid Wireless.
Counties are currently authorized to impose a 70 cent per line tax on landline, cellular, and voice over internet protocol (VoIP) telephone services. The state is authorized to impose a 25 cent per line tax on these same services. The tax is referred to as the enhanced 911 (E911) excise tax, which is used to fund emergency communications systems. While prepaid wireless is not explicitly addressed in statute, in 2010 the State Supreme Court ruled that prepaid wireless is subject to the E911 excise tax. See *Tracfone Wireless, Inc., v. Washington Department of Revenue*, 170 Wn.2d 273 (2010).

Landline Telephone Sales and Use Tax Exemption.
In 1983 state and local retail sales tax was extended to telephone services. However, an exemption was provided for individuals "subscribing to a residential class of telephone service." The Department of Revenue (DOR) has interpreted this exemption to apply only to residential telephone service that is regulated by the Washington Utilities and Transportation Commission (UTC). The UTC regulates the rates and services of telephone companies providing landline telephone services in Washington. However, the UTC does not regulate cable services, cellular phone services, VoIP services, or internet service provider services.

In 2007 the DOR assessed Sprint Spectrum LP (Sprint) with retail sales tax on wireless telephone services sold to non-business customers for the audit period July 1, 1999, through December 31, 2002. (Several other taxes were also in dispute.) The Board of Tax Appeals (BTA) upheld the assessment. However, on April 8, 2011, a Washington superior court reversed the decision by the BTA by ruling that Sprint's sales of cellular telephone services to non-business customers qualifies for the residential telephone service exemption.

Washington Telephone Assistance Program and Telecommunications Relay Service.
Created in 1987, the Washington Telephone Assistance Program (WTAP), provides discounted wireline telephone services to low-income residents of the state. The program is operated by the Department of Social and Health Services (DSHS) and provides a reduced monthly charge for basic telephone service, discounts on connection fees, waivers of deposits for local service, and community voicemail. The program is currently funded by a monthly 14 cent excise tax on each switch telephone line in the state. The tax does not apply to companies providing wireless and VoIP telecommunications services. The DOR determines the tax rate necessary to fund the program, but the rate cannot exceed 14 cents per month for each switched telephone line. The fiscal year (FY) 2013 tax rate is 14 cents per switched line. Up to 8 percent of the receipts go to the Department of Commerce for costs of providing community service voice mail services.

The Telecommunications Relay Service (TRS) tax is used by the DSHS Office of Deaf and Hard of Hearing to provide telecommunications equipment and services to persons with a hearing or speech impairment. The TRS tax rate may be up to 19 cents per month for each switched line. The actual rate is computed annually by the DOR, based on budgetary information submitted by the DSHS Office of Deaf and Hard of Hearing. The FY 2013 tax rate is 17 cents per switched telephone line.

Universal Services Fund and Intercarrier Compensation.
Universal service is the long-standing policy of the United States and the State of Washington to enable every American, regardless of location, to have access to affordable high-quality telephone and, more recently, internet services. The federal government operates a universal service fund (FUSF) that supports the construction and maintenance of national telecommunications infrastructure. The FUSF was substantially expanded with the passage of the federal Telecommunications Act of 1996.

The FUSF program consists of four separate programs: (1) the High Cost Program; (2) the Low Income Program; (3) the School and Libraries Program; and (4) the Rural Health Care Program. The High Cost Program is by far the largest and most complex of the four programs. The net goal of this program is to keep telephone service affordable for customers in areas where, absent the subsidy, telephone service would be dramatically more expensive than the national average. The complex system of fees, surcharges, and subsidies supports telephone companies in rural and remote areas.

On October 27, 2011, the Federal Communication Commission (FCC) approved a six-year transfer process that would transition money from the FUSF High Cost Program to a new $4.5 billion a year Connect America Fund for broadband internet expansion, effectively putting an end to the FUSF High Cost Program by 2018.

Intercarrier compensation refers to the charges that one carrier pays to another carrier to originate, transport, and/or terminate telecommunications traffic. Intercarrier compensation payments are governed by a complex system of federal and state rules. There are two major forms of intercarrier compensation: access charges and reciprocal compensation.

Access charges generally apply to calls that begin and end in different local calling areas. Interstate access charges apply to calls that originate and terminate in different states, and intrastate access charges apply to calls that originate and terminate in different local calling areas within the same state. The FCC oversees interstate access charge rates, and the states oversee intrastate access charge rates. Reciprocal compensation generally applies to calls that begin and end within the same local calling area.

The FCC is substantially modifying intercarrier compensation by moving to a system in which almost no money will be exchanged between carriers that exchange traffic. At the end of the transition, carriers will be required to recover all of their costs from their own customers and will not be permitted to impose charges on originating carriers.

Summary of Substitute Bill:

Enhanced 911 Excise Tax on Prepaid Wireless.
The state and county E911 excise taxes must be collected by the seller of a prepaid wireless telecommunications service for each retail transaction occurring in this state at the point of sale. When practicable, the amount of the tax must be disclosed on an invoice, receipt, or other similar document. When a separate disclosure is not practicable, the seller may prominently display a sign notifying consumers of the tax. Sellers of prepaid wireless

telecommunications service are subject to the same administrative sales-tax provisions as companies providing wireline, wireless, and VoIP telecommunications services.

Landline Telephone Sales and Use Tax Exemption.
The state and local retail sales and use tax exemption for residential telephone services is eliminated. The state and local sales tax exemption for coin-operated telephone service is also repealed. The bill also provides an exemption for VoIP telephone services provided by a cable company prior to the effective date of the bill.

Washington Telephone Assistance Program and Telecommunications Relay Service.
The WTAP and TRS excise taxes are eliminated, and the programs are to be funded by biennial general fund appropriations.

The DSHS must enter into an agreement to provide operational support to the Washington Information Network 211 organization subject to legislative appropriation.

Universal Services Fund.
A state universal communications services program (Program) is established on July 1, 2014, and is set to expire on July 1, 2019.

The Program is funded by legislative appropriations to a new universal communications services account. The maximum amount appropriated each year cannot exceed $5 million. A communications provider is eligible to receive distributions from the account if: (1) the communications provider has fewer than 40,000 lines; (2) the customers of the provider are at risk of rate instability or service interruptions absent distributions to the provider; and (3) the provider meets any other criteria established by the UTC.

The UTC must report back to the Legislature by December 1, 2017, as to the adequacy of funding under the Program and the potential impacts on carriers and customers when the Program terminates.

Substitute Bill Compared to Original Bill:

The substitute bill eliminates the requirement that the state Program be implemented through a third-party administrator. It also requires the UTC to report back to the Legislature by December 1, 2017, as to the adequacy of funding under the Program and the potential impacts on carriers and customers when the Program terminates. The substitute bill specifies that state universal service funds can be used for broadband services. It also adds intent language related to the Program and makes a number of nonsubstantive, technical corrections.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: This bill takes effect 90 days after adjournment of the session in which the bill is passed, except for part I relating to communications services reform, which takes effect August 1, 2013, and sections 201 through 206, 208, 209, and 211 relating to a state universal services program, which take effect July 1, 2014.

Staff Summary of Public Testimony:

(In support) Rural phone companies have to cover huge geographic regions. Universal service began as a service contract between the companies and the federal government to maintain rates similar to those found in more urban areas. Universal service has been a longstanding policy of the state. This bill offsets reductions in carrier access charges that amount to about 20 percent of their revenue. Access revenues will go to zero by 2019. This will amount to about $8.8 million for the 14 companies that might qualify for state universal funds. This bill will help these companies provide the same level of service that they provide today. It will provide time and revenue for small companies to address the many significant changes in the industry. Customers in some areas are too few and spread out too far to be able to support telecommunications without support. These customers will see a $104 per month cost increase if this bill does not pass. With this bill, the cost increase will be 30 cents. Ninety percent of subscribers would leave if the rates went up by $104 per month; however, the service provider's fixed costs would remain relatively unchanged. It was known these changes were coming from the FCC, so cost-containment measures were implemented; however, the FCC changes were more significant than anticipated. There was a $65,000 cost to serve three customers. This bill will help to keep serving these customers. Customers must be served through the FCC mandate. Seventy percent of the E911 calls come from wireless phones. It is important for everyone who uses a wireless phone and who can call E911 to pay the E911 tax and contribute to the system. There has been confusion about how the E911 tax applies to prepaid wireless. This bill will help resolve the confusion. Seventy to 80 percent is sold by third-party retailers. Prepaid is growing faster than traditional wireless. It is important that everyone contributes to E911 funding. This bill will provide tax equity and parity. This bill will eliminate litigation risk for the state and eliminate potential prior sales tax liability for cable companies.

(Neutral) This bill will help provide tax equity and parity. This bill will help reduce the risk of significant litigation regarding the application of the residential telephone exemption. If the residential telephone exemption were extended to all telecommunications providers, it could cost the state $130 million per year.

(With concerns) There is concern about the elimination of the dedicated taxes for several programs for low-income and hard-of-hearing individuals and other telecommunication services. Funding for these programs should be reflected in statute. There is a risk that there may not be funding in the future. There was originally $2.5 million per year in funding. It has been reduced considerably. There is concern about transparency in the distribution of funds in this bill. The open public records act and open public meetings act must follow this process so the public knows how the money is used. There will be great public interest by those impacted by this bill.

(Opposed) The retailers will have problems reprogramming computers to collect the tax. It might not be a problem for large retailers, but smaller retailers could face a significant burden and cost. Retailers would like to retain a portion to offset the cost of collection.

Persons Testifying: (In support) Representative Carlyle, prime sponsor; Betty Buckley, Washington Independent Telecommunications Association; Dale Merten, ToledoTel; Dallas Filan, Pioneer Telephone Company; Marlys Davis, King County E911; Richard Kirton, Washington Chapter of APCO/NENA 911; Tom Walker, CenturyLink; Ron Main, Broadband Communications Association of Washington; Rhonda Weaver, Comcast; Anne Rendahl, Utilities and Transportation Commission; Bob Bass, AT&T; Jean Leonard, Sprint; Jim Blundell, T-Mobile; and Victoria Lincoln, Association of Washington Cities.

(Neutral) Drew Shirk, Department of Revenue.

(With concerns) Nick Federici, Washington Information Network 211; Kathleen Southwick, Crisis Clinic; Seth Dawson, Washington State Community Action Association; and Rowland Thompson, Allied Daily Newspapers.

(Opposed) Holly Chisa, Northwest Grocery Association; and T.K. Bentler, Washington Association of Neighborhood Stores.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Finance. Signed by 23 members: Representatives Hunter, Chair; Ormsby, Vice Chair; Alexander, Ranking Minority Member; Chandler, Assistant Ranking Minority Member; Wilcox, Assistant Ranking Minority Member; Carlyle, Cody, Dunshee, Fagan, Green, Haigh, Haler, Hudgins, Hunt, Jinkins, Kagi, Maxwell, Morrell, Pedersen, Schmick, Seaquist, Springer and Sullivan.

Minority Report: Do not pass. Signed by 7 members: Representatives Buys, Dahlquist, Harris, Parker, Pike, Ross and Taylor.

Staff: Jeff Olsen (786-7175).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Finance:

The Appropriations Committee amendment adds that the Department of Social and Health Services shall enter into an agreement to provide operational support to the Washington Information Network 211 (WIN 211) organization subject to legislative appropriation.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date of Second Substitute Bill: This bill takes effect 90 days after adjournment of the session in which the bill is passed, except for part I relating to communications services reform, which takes effect August 1, 2013, and sections 201 through 206, 208, 209, and 211 relating to a state universal services program, which take effect July 1, 2014.

Staff Summary of Public Testimony:

(In support) The purpose of the legislation is tax parity and to mitigate risks with lawsuits. There have been disputes about how the current taxes apply, and this bill resolves those issues. Without these changes, a significant amount of state and local tax revenue could be lost. The telecommunications industry has changed significantly since these taxes were enacted in the 1980s. Industry has met and worked out some contentious issues over the past year to come up with this proposal. With the federal government making changes to the High Cost program, the bill establishes a state level universal service fund. Prepaid wireless should contribute to the enhanced 911 (E911) system, and the bill establishes a fair system for collection. Small independent phone companies face challenges due to the loss of federal programs to provide affordable service in high costs areas.

(In support with amendment(s)) The legislation repeals dedicated fees that help low-income individuals, low-income seniors, homeless individuals, and blind, deaf, and hearing impaired individuals with access to telecommunication services. The bill should include an amendment to clarify that there are funds for the WIN 211 program. The bill creates new costs for retailers including reprogramming costs, tax collection, compliance, and reporting. Twenty-seven out of 29 states have a vendor fee to pay for the costs of collecting the E911 tax, and the fee would be scheduled to sunset.

(Opposed) Retailers request changes that recognize the costs to implement the bill for collecting and remitting taxes. Retailers are also working with stakeholders regarding time to implement the bill.

Persons Testifying: (In support) Representative Carlyle, prime sponsor; Drew Shirk, Department of Revenue; Ron Main, Broadband Communications Association; Tom Walker, CenturyLink; Bob Bass, AT&T; Betty Buckley, Washington Independent Telecommunications Association; and Victoria Lincoln, Association of Washington Cities.

(In support with amendment(s)) Holly Chisa, Northwest Grocery Association; Amy Brackenburg, Washington Food Industry Association; and Nick Federici, Washington Information Network 211.

(Opposed) Mark Johnson, Washington Retail Association.

Persons Signed In To Testify But Not Testifying: None.