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Kara Rosenberg Cain
Pacific McGeorge School of Law

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Chapter 17 to the Rescue: California's Surcharge on Voice Over Internet Protocol to Aid the Health of the 911 Emergency Fund

Kara Rosenberg Cain

Code Sections Affected

Revenue and Taxation Code §§ 41016.5, 41019.5, 41152 (new), §§ 41007, 41009, 41011, 41016, 41020, 41025, 41030, 41031, 41046, 41050 (amended).
SB 1040 (Kehoe); 2008 STAT. Ch. 17.

I. INTRODUCTION

Ever since AT&T pioneered and employed the first system in Haleyville, Alabama forty years ago, Americans have been able to dial "9-1-1" to reach emergency services.¹ When a caller dials 911, switching and signaling equipment provided by the Local Exchange Carriers recognize the 911 code and relay the call to a Public Safety Answering Point (PSAP).² PSAP facilities are generally operated twenty-four hours a day by trained, professional operators who dispatch emergency response services or transfer calls to other public safety agencies.³ Although the operator traditionally gathers the emergency information from the caller, upgraded 911 systems now employ enhanced 911, which transmits both the caller's telephone number and address to the PSAP.⁴

As the public increasingly relies on this service, many people take for granted the cost and effort required to operate such a system.⁵ The telecommunications industry, state governments, and the Federal Communications Commission (FCC) work hard to ensure that 911 is available on traditional and wireless phones, but as telecommunications capabilities advance, access and funding of 911 services face

1. Peter P. Ten Eyck, Comment, *Dial 911 and Report a Congressional Empty Promise: The Wireless Communications and Public Safety Act of 1999*, 54 FED. COMM. L.J. 53, 55-56 (2001).

2. *Id.* at 56.

3. *See id.* at 56-57 ("[C]entrally located PSAPs [are] staffed by trained, professional operators who help callers in need of assistance and convey details of the caller's situation to the appropriate emergency personnel.").

4. *Id.* at 57.

5. *See* VOIP and 911 Services Background, <http://www.voip911.gov/> (last visited Oct. 15, 2008) (on file with the *McGeorge Law Review*) ("Since Americans were first able to dial '9-1-1' to reach emergency services in 1965, the public increasingly has come to depend on 911 in times of crisis.").

new challenges.⁶ The Legislature enacted Chapter 17 in an effort to maintain the health of the 911 system.

II. LEGAL BACKGROUND

A. 911 Funding

At both the federal and state level, 911 services are funded primarily through the imposition of a tax on the services used to access 911.⁷ In California, the Emergency Telephone Users Surcharge Act (Surcharge Act) imposes a surcharge on telephone service communications made within the state.⁸ The service supplier collects the tax and transfers it to the State Board of Equalization (BOE).⁹ The BOE then deposits the collected revenue to the State Treasury, where it is credited to the State Emergency Telephone Number Account.¹⁰ Existing law defines a “service supplier” as any person supplying intrastate telephone communication services.¹¹ Notably, this even includes the suppliers that the California Public Utilities Commission¹² exempts from having to file an intrastate tariff.¹³

The Department of General Service sets the tax rate annually at an amount estimated to fund the fiscal year’s 911 costs.¹⁴ The law mandates that the

6. *See id.* (“Most wireline 911 service has been enhanced (‘E911’) with the ability to provide caller identification and location information to the call answering center (‘E911’) and the FCC has established a program to require wireless telephone carriers to provide E911 capability.”).

7. ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF SB 1040, at 5-6 (Sept. 7, 2007) (explaining that the federal Internet Tax Freedom Act does not prevent taxing services used to access 911).

8. CAL. REV. & TAX. CODE § 41001 *et. seq.* (West 2004).

9. *See* STATE BD. OF EQUALIZATION, STAFF LEGISLATIVE BILL ANALYSIS OF AB 231, at 2 (May 2, 2007) (“The surcharge is paid to the Board of Equalization . . . and deposited in the State Treasury to the credit of the State Emergency Telephone Number Account in the General Fund.”). The BOE was created in 1879 and administers tax revenues, including sales and use taxes, property taxes, and other special taxes that support state and local government programs. Board of Equalization, About BOE, <http://www.boe.ca.gov/info/about.htm> (last visited Oct. 23, 2008) (on file with the *McGeorge Law Review*).

10. STATE BD. OF EQUALIZATION, STAFF LEGISLATIVE BILL ANALYSIS OF AB 231, at 2 (May 2, 2007).

11. CAL. REV. & TAX. CODE § 41007. Intrastate telephone communication services are defined as “all local or toll telephone services where the point or points of origin and the point or points of destination of the service are all located in this state.” *Id.* § 41010.

12. The California Public Utilities Commission (CPUC) was established in 1911 and regulates “natural gas, electric, telephone and water companies as well as railroads and marine transportation companies.” California Public Utilities Commission, PUC History and Structure, <http://www.cpuc.ca.gov/PUC/aboutus/puhistory.htm> (last visited Oct. 23, 2008) (on file with the *McGeorge Law Review*).

13. CAL. REV. & TAX. CODE § 41007; *see also* GTE Sprint Commc’ns Corp. v. State Bd. of Equalization, 1 Cal. App. 4th 827, 834-36, 2 Cal. Rptr. 2d 441, 445-46 (1st Dist. 1991) (“The . . . legislative history reveals that the Legislature intended to clarify the meaning of sections 41007 and 41019 of relieving [other common carriers] from surcharge liability for the relevant period, i.e., prior to imposition of California intrastate tariffs.”).

14. CAL. REV. & TAX. CODE § 41030 (West Supp. 2008); *see also* SENATE FLOOR, COMMITTEE ANALYSIS OF SB 1040, at 3 (Apr. 3, 2008) (noting that the estimated revenues for 2007-2008 were \$100 million).

surcharge be no greater than three-quarters of one percent and no less than one-half of one percent.¹⁵

B. Voice Over Internet Protocol

Before 2005, the law did not require Voice over Internet Protocol (VoIP) providers to supply access to 911.¹⁶ VoIP is a technology that converts vocal communications into digital signals that can travel over the internet.¹⁷ This technology allows users to make calls from a computer, a special VoIP phone, or a traditional phone connected to a special adapter, in addition to regular analog phone lines.¹⁸ The FCC's requirement that some types of VoIP providers grant access to 911 services, has shed light on another related problem: the law did not require any contribution to the 911 fund.¹⁹ As the use of VoIP increased, so did the concern for the stability of the 911 account.²⁰

III. CHAPTER 17

In enacting Chapter 17, the California Legislature declared that "[t]he furnishing of emergency telephone service is in the public interest and should be supported fairly and equitably by every telephone corporation and every provider of telephone quality communication in a way that is equitable, non-discriminatory, and competitively neutral."²¹ Chapter 17 ensures that telephone

15. CAL. REV. & TAX. CODE § 41030.

16. See Press Release, Att'y Gen. of Texas, Texas Attorney General Abbott Takes Legal Action to Protect Internet Phone Customers (Mar. 22, 2005), available at <http://www.oag.state.tx.us/oagnews/release.php?id=850> (on file with the *McGeorge Law Review*) ("Internet-based telephone providers are unregulated by state and federal communications authorities. Though some of the providers offer 9-1-1 access, they are not required to do so.").

17. Federal Communications Commission, VoIP Frequently Asked Questions, <http://www.fcc.gov/voip/> (last visited Oct. 15, 2008) [hereinafter FCC FAQ] (on file with the *McGeorge Law Review*); see also CAL. REV. & TAX. CODE § 41016.5(a) (enacted by Chapter 17). (To qualify as a VoIP service, it must "(A) [e]nable[] real-time, two-way voice communication that originates from and terminates to the user's location using Internet Protocol (IP) or any successor protocol. (B) Require[] a broadband connection from the user's location. (C) Permit[] users, generally, to receive calls that originate on the public switched telephone network and to terminate calls to the public switched telephone network.").

18. See FCC FAQ, *supra* note 17.

19. See ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF SB 1040, at 6 (Sept. 7, 2007) (noting that it is important for users to share the funding burden); see also VoIP and 911 Services Background, *supra* note 5 (noting the FCC's adoption of new rules requiring "interconnected" VoIP service providers that allow a user to receive calls to and from traditional telephone networks, to supply access to 911).

20. See ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF SB 1040, at 6 (Sept. 7, 2007) ("Supporters state . . . "911" services are obviously critical for the public safety, so it is important to make sure that . . . funding is adequate . . .").

21. CAL. REV. & TAX. CODE § 41152 (enacted by Chapter 17).

service providers—including the VoIP providers that connect to the 911 emergency system—help fund these services.²²

In enacting Chapter 17, the Legislature rewrote a number of definitions so as to incorporate VoIP.²³ First, it expanded the definition of a “service supplier” to include any person supplying VoIP and providing access to the 911 emergency system to any service user within California, in addition to any person supplying intrastate telecommunication services.²⁴ Second, it included in the term “service user” any person using VoIP service in California required to pay a surcharge under the “911” Surcharge Act.²⁵ Finally, the law defines a “toll telephone service” as a service providing telephonic-quality communication that (1) charges by either distance or time, or both, and is paid within the United States or (2) entitles the subscriber to a predetermined or unlimited amount of telephonic communications to or from persons having telephone or radiotelephone stations outside the local telephone system.²⁶

Chapter 17 does not apply the surcharge for VoIP services when the point of origin or destination is outside California.²⁷ A service supplier may calculate non-taxable charges based on books and records kept in the regular course of business.²⁸ The service supplier may also calculate the non-taxable portion of the interstate revenue based on several listed methods.²⁹ Any method chosen remains in effect for at least one calendar year.³⁰

The surcharge imposed on VoIP service commences January 1, 2009;³¹ all other amendments are operative immediately.³²

IV. ANALYSIS OF CHAPTER 17

Chapter 17 addresses two main concerns with prior law.³³ First, it remedies the growing inequity stemming from the fact that VoIP service providers are not required to contribute to the 911 fund, especially given the increased popularity of the technology.³⁴ In recent years, VoIP has gone from “a fringe product for geeks to a reliable, sophisticated, and often less expensive alternative to

22. *Id.* § 41019.5 (enacted by Chapter 17).

23. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 1040, at 2 (Apr. 3, 2008).

24. CAL. REV. & TAX. CODE § 41007(a) (amended by Chapter 17).

25. *Id.* § 41009 (amended by Chapter 17).

26. *Id.* § 41016 (amended by Chapter 17).

27. *Id.* § 41020(a) (amended by Chapter 17).

28. *Id.* § 41020(b)(1) (amended by Chapter 17).

29. *Id.* § 41020(b)(1)(A)-(C) (amended by Chapter 17).

30. *Id.* § 41020(b)(2) (amended by Chapter 17).

31. *Id.* § 41020(g) (amended by Chapter 17).

32. *Id.*

33. Telephone Interview with Randy Chin, Consultant for Cal. Energy Comm’n, in Sacramento, Cal. (Aug. 1, 2008) [hereinafter Chin Interview] (notes on file with the *McGeorge Law Review*).

34. *Id.*

traditional phone lines.”³⁵ Although some Legislators questioned the urgency of imposing a requirement on VoIP—as there is currently a \$132 million reserve in the State Emergency Telephone Number Account—public safety organizations and telephone companies supported legislative action.³⁶

When SB 1040—the corresponding bill that became Chapter 17—was first introduced, Legislators were confronted with the problem of how to assess the surcharge.³⁷ Because VoIP is a mobile service, service providers experience difficulty in distinguishing between intrastate and interstate calls.³⁸ Although Chapter 17 does not solve any of the technical issues,³⁹ it does resolve the assessment problem by allowing the service supplier to calculate the interstate revenue portion exempt from the surcharge based on the books and records kept in the regular course of business, or by another specified, reasonable, and verifiable method.⁴⁰ For example, one “safe harbor” method calculates the surcharge based on an FCC average percentage of intrastate calls, which is about 35.1 percent.⁴¹ Therefore, although the surcharge may not correspond exactly to the amount of intrastate calls made by VoIP service users, Chapter 17 devises a way to approximate the surcharge.⁴²

Second, Chapter 17 addresses potential liability stemming from the prior law’s definition of “toll telephone service.” Specifically, prior to Chapter 17’s enactment, California’s definition of “toll telephone service” aligned closely to that of the federal government,⁴³ which “could be interpreted [by the courts] as much more limiting than what was intended.”⁴⁴ The California definition of “toll telephone service” included charges for calls based on “time and distance.”⁴⁵ In

35. Nathan Halverson, *Hanging Up the Landline—Companies Going Digital: As Web-Based Voice Service Moves from Fringe to Mainstream, More Companies See Cost Savings in Cutting Traditional Lines*, SANTA ROSA PRESS DEMOCRAT, June 1, 2008, available at <http://www.pressdemocrat.com/article/20080601/NEWS07/806010343> (on file with the *McGeorge Law Review*).

36. See ASSEMBLY COMMITTEE ON REVENUE AND TAXATION, COMMITTEE ANALYSIS OF SB 1040, at 6-7 (Sept. 7, 2007) (listing supporters of Chapter 17).

37. See SENATE FLOOR, COMMITTEE ANALYSIS OF SB 1040, at 4 (Apr. 3, 2008) (“A problem with assessing this surcharge is that some VoIP providers are not able to accurately track exactly which calls are made entirely within California and are thus subject to the surcharge.”).

38. *Id.* For example, a person could have VoIP service through a laptop in California and could travel out of the state for business. If that person then makes a call to 911 while outside of California, the call may not be directed to the proper PSAP. Further, the physical address reported would be the address provided in California and the caller may not receive the proper assistance.

39. Section 41019.5 explicitly states that the intent of Chapter 17 is not to regulate VoIP. CAL. REV. & TAX. CODE § 41019.5 (enacted by Chapter 17).

40. *Id.* § 41020(b) (amended by Chapter 17).

41. *Id.* § 41020(b)(1)(C).

42. See SENATE FLOOR, COMMITTEE ANALYSIS OF SB 1040, at 4 (Apr. 3, 2008) (“This bill allows VoIP providers to use a ‘safe harbor’ method of paying the 911 surcharge based on an FCC analysis of the average percentage of telephone calls (35.1%) that are intrastate.”).

43. See I.R.C. § 4252(b)(1) (West 2008) (defining toll telephone service by “distance and elapsed transmission time”).

44. Chin Interview, *supra* note 33.

45. CAL. REV. & TAX. CODE § 41016 (amended by Chapter 17).

practice, the BOE assessed the surcharge on calls where the toll varied with time or distance.⁴⁶

In 2006, several cases recognized the distinction in language as a meaningful difference;⁴⁷ the IRS agreed to refund over thirteen billion dollars in excise taxes it levied on charges for long-distance calls based only on elapsed time.⁴⁸ Although the excise tax is unrelated to the 911 surcharge, if left unchanged, the “time and distance” language of the prior law could have exposed the State to similar legal challenges.⁴⁹ Therefore, Chapter 17 modifies the definition of toll telephone service to align with the BOE’s practices.⁵⁰

V. CONCLUSION

The 911 system saves many lives, and updating the 911 system “for today’s communications marketplace . . . requires changes in technology, governance, and funding strategies.”⁵¹ California recognizes that preservation and access to emergency telephone service remains a “longstanding goal.”⁵² Although future developments in communications technologies remain uncertain, Chapter 17 ensures that the providers of the latest advancement—VoIP—pay their fair share to support this important system.

46. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 1040, at 3 (Apr. 3, 2008).

47. See *Am. Bankers Ins. Group v. United States*, 408 F.3d 1328, 1338 (11th Cir. 2005) (“[W]e conclude that the services at issue are not taxable as ‘local’ telephone service under § 4242(a).”); *Nat’l R.R. Passenger Corp. v. United States*, 338 F. Supp. 2d 22, 30 (D.C.C. 2004) (“The Court declines to adopt the IRS’s liberal construction of § 4242(a).”); *Am. Online, Inc. v. United States*, 64 Fed. Cl. 571, 582-83 (Fed. Cl. 2005) (“The plain meaning of Section 4252(a) is that local telephone service is subject to the communications excise tax, whereas long-distance services like those obtained by AOL are not.”).

48. See Internal Revenue Service, <http://www.irstelephonetaxrefund.info/> (last visited Oct. 15, 2008) (on file with the *McGeorge Law Review*) (“[T]he IRS will issue a one-time payment that eligible taxpayers can request on their 2006 federal income tax returns. The refund gives back federal excise taxes paid in previous years.”).

49. SENATE FLOOR, COMMITTEE ANALYSIS OF SB 1040, at 3 (Apr. 3, 2008).

50. *Id.* at 2.

51. Philip J. Weiser, Dale Hatfield, & Brad Bernthal, *The Future of 9-1-1: New Technologies and the Need for Reform*, 6 J. TELECOMM. & HIGH TECH. L. 213, 215 (2008).

52. CAL. REV. & TAX. CODE § 41152(a) (enacted by Chapter 17).