Today’s Instructors

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Agenda

• Introduction, History, Overview
• Telecom Networks & Technology
• Transaction Taxes – The Basics
• Regulatory Basics
• Today’s Communications Sector– Trends
• Taxation Issues for the Communications Industry
• Overview of Telecom Tax Billing Process
• Wrap-Up
Understanding Telecommunications Taxes
– Introduction, History, Overview

Jim Nason, Tax Managing Partner, Telecommunications
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Monopoly, AT&T, Telecom Act...

- Government “helped” competition/certain segments get started...
- Competition became fierce in some areas...
- Each “niche” began to get filled...
- Innovation was the order of the day...
- Explosion was expected...
- Maybe, too much too fast...
Incredible Technological Advancements in Communications…since 1984

- Wireless, Cable & Satellite
- Packet/IP Technology
- E-Mail, Texting, SMS, MMS
- PDAs, Smartphones, Tablets
- Cloud and on and on...
Spectrum shortage...
Tax Perspective - Basics

- Telecommunications is “regulated” and taxed differently from other industries.
- Monopoly/Luxury pedigree.
- Most heavily taxed service in the U.S.- only “sin”, rental cars & fuel taxes higher.
- Tax guidance is often dated & technologically obsolete.
What’s the Big Deal?

• Most heavily transaction taxed service in the US
  – Thought to be over 300 tax types applied to more than 685 potentially different tax bases.
  – Potentially over 48,000 filings due annually at the Fed, State, County, City, and District levels.

• Rate Differential:
  – General Business Sales (approx):  6.12%
  – Telecomn Services (approx):  14.17%
  
  Plus USF @ 17.4%

8.05%
What else…?

• Gross Receipts Taxes, Surcharge concept
• Unique Property Tax System
• Lots of tiny transactions…
• Regulatory impact
• Deemed “lifeline”, social treasury
• Security impact
Who’s behind it?

- **Who Imposes Telecom Transaction Taxes?**
  - Revenue Authority
    - Internal Revenue Service
      - Federal Excise Tax
    - State and Local Departments of Revenue
      - Sales and Use, Gross Receipts, and Occupation Taxes
      - Excise Taxes and License Taxes
  - Regulatory Authority
    - Federal Communications Commission
      - Federal USF
    - State Public Utility or Public Service Commissions
      - 911, USF, High Cost, TRS, DEAF, and Utility User’s Surcharges
      - Access and Utility Fees
Expansion of Constituency...

Both vertical and horizontal (and even 3rd dimensional) expansion of constituents...
Creates...

- Questions
- Competition, Aggressive postures
- Need for: Tools, Software, Services, Resources
- Noise, Awareness, Unrest…law?
Telecom Networks & Technology

Rick Heller
Deloitte Tax LLP
Original Voice Service

• Started out as Plain old telephone service ("POTS")

• POTS is the voice-grade telephone service that remains the basic form of residential and small business service connection to the telephone network in many parts of the world.

• In the US, the paired copper wires ("copper pair") from the central switch office to a subscriber's home is called a subscriber/local loop.
Original Voice Services

- The carrier wave is modulated or modified by the speaker’s voice.
- This wave is carried down the carrier’s local loop.
In the United States, the pair of wires from the central switch office to a subscriber's home is called a subscriber loop. It is typically powered by $-48\text{V}$ direct current (DC) and backed up by a large bank of batteries (connected in series) and in some cases, an additional electric generator in the local exchange, resulting in continuation of service during most commercial power outages. The subscriber loop typically carries a "load" of about 300 ohms, and does not pose a threat of electrocution to human beings (although shorting the loop can be felt as an unpleasant sensation).
Telecom – Evolution of switching

- Direct switched voice
- Direct Private Line
- Circuit switched voice
Now, Incredible Technological Advancements in Communications

- Wireless, Cable & Satellite
- Packet/IP Technology
- E-Mail, Texting, SMS, MMS, Video
- PDAs, Smartphones, Tablets

and on and on...
Multiplexing

• In circuit-switched networks such as the PSTN there exists the need to transmit multiple calls along the same transmission medium.

• Network designers make use of Multiplexing which allows switches to create channels, or tributaries, within a transmission stream.
Time-Division Multiplexing (TDM)

• To accomplish this, network designers make use of TDM. TDM allows switches to create channels, or tributaries, within a transmission stream. A standard DS0 voice signal has a data bit rate of 64 kbit/s.

• TDM takes frames of the voice signals and multiplexes them into a TDM frame which runs at a higher bandwidth usually 1.544 Mbit/s. This allows for 24 channels over a single connection.
Packet Technology

• A good analogy is to consider a packet to be like a letter: each packet has an address and the data is whatever the person puts inside the envelope.

• Common Telecom Packet Technology
  – Frame Relay or Frame
  – Asynchronous Transfer Mode or ATM
  – Internet Protocol or “IP”
  • Multi-protocol Label Switching or MPLS (used in connection with IP networks to carry various types of data traffic over one network)
Quick Refresher…Terms – “IP”

• Digital devices (i.e. computers) need a language to talk to one another on a network.

• “IP” is one such language.

• “IP” stands for “Internet Protocol.” - a universal language allowing devices / computers to communicate - the technique by which information [data, pictures, music, and voice] is digitized into a format suitable for transport on an IP-based network.

• IP - organized digital information that travels through a network in a sequence or grouping known as “packets”. IP based networks are often also called “packet networks”
How Does “IP” Lead to Vo“IP”?  

• “VoIP” – a description of the process for digitizing sound / voice message using IP.  
• VoIP in and of itself is not a “service” – it is a term used to describe the application of IP technology to transmit voice over an IP-based digital network.  
  – Note: the term “VoIP” does NOT include a requirement that the digitized voice travel over the public Internet. It is generally used broadly to describe any IP-based digital network but may be more narrowly defined for tax purposes to describe a telephony product that (1) facilitates voice communications available to broadband Internet subscribers; or (2) is purchased as an add-on service to a “managed” IP network.
Then, What is VoIP?

• Platform technology - can be used to simulate a traditional non-VoIP telephone call.
  
  – imitates traditional telephony: dialtone, ringing, busy tones, features, local, long distance calls, etc.

• Many public discussions have morphed the definition of VoIP to mean a telephone call that **must** traverse the public Internet. This is incorrect. Although some VoIP products do utilize the Internet; many are managed IP networks that do not use the Internet.
Fiber Optic Cable

- An optical fiber (or optical fibre) is a flexible, transparent fiber made of glass (silica) or plastic, slightly thicker than a human hair. It can function as a waveguide, or “light pipe”, to transmit light between the two ends of the fiber. The field of applied science and engineering concerned with the design and application of optical fibers is known as fiber optics. Optical fibers are widely used in fiber-optic communications, which permits transmission over longer distances and at higher bandwidths (data rates) than other forms of communication. Fibers are used instead of metal wires because signals travel along them with less loss and are also immune to electromagnetic interference. Fibers are also used for illumination, and are wrapped in bundles so that they may be used to carry images, thus allowing viewing in confined spaces. Specially designed fibers are used for a variety of other applications, including sensors and fiber lasers.
Cellular Telecom

- A cell site is a cellular telephone site where antennas and electronic communications equipment are placed, usually on a radio mast, tower or other high place, to create a cell (or adjacent cells) in a cellular network.

- The elevated structure typically supports antennas, and one or more sets of transmitter/receivers transceivers, digital signal processors, control electronics, a GPS receiver for timing, primary and backup electrical power sources, and sheltering.
Transaction Taxes
Overview

• State and local transaction taxes and surcharges
• Federal excise tax
• Wireless services
• Prepaid arrangements
• Equipment taxation
State and Local Transaction Taxes

“The Questions”

• What is the product/service…and who’s selling it?
• What types of taxes apply to sales of telecommunications services?
• What jurisdictions have the right to impose a tax?
• Where are the services performed?
State and Local Transaction Taxes
“The Questions”

• What is the tax base?
• What is and is not a nontaxable sale for resale?
• What are the rules governing exemptions?
State and Local Transaction Taxes
Defining the Product/Service

Is it a communications service or something else?
- Internet access
- Information service
- MPLS

If it is a communication service, what type?
- Local telephone service
- Intrastate v. interstate/international
- Mobile v. wireline service
- Voice v. data
- Private line
State and Local Transaction Taxes

Types of Taxes

• General sales tax
• Industry-specific gross receipts tax
• Regulatory tax, surcharge, or fee
State and Local Transaction Taxes

Types of Taxes

Sales tax:

- Types of telecommunications services subject to tax vary state-to-state.
  - Local only
  - Local and intrastate
  - Local, intrastate, and interstate

- Definitions of telecommunications also vary from broad to specific.
State and Local Transaction Taxes

Types of Taxes

• Texas
  – “Telecommunications services" generally defined as “the electronic or electrical transmission, conveyance, routing, or reception of sounds, signals, data, or information utilizing wires, cable, radio waves, microwaves, satellites, fiber optics, or any other method now in existence or that may be devised, including but not limited to long-distance telephone service.”

• Maryland
  – “Taxable services” include (1) cellular telephone or other mobile telecommunications service; (2) "900," "976," "915," and other "900"-type telecommunications service; (3) custom calling service provided in connection with basic telephone service; (4) telephone answering services; (5) pay per view television service; and (6) a prepaid telephone calling arrangement.
State and Local Transaction Taxes
Types of Taxes

Sales tax (cont’d):

• Taxability often depends on whether service is intrastate or interstate (is that readily determinable?).
  – Services sold on a basis other than call-by-call.

• Certain other non-telecommunications services may be subject to tax.
  – Data processing/information services
  – Installation
  – Repairs
State and Local Transaction Taxes

Types of Taxes

Regulatory taxes, surcharges, and fees:

- Access line charges
- 911 fees
- Deaf relay tax/surcharges
- PUC assessments
- USF contributions
  - State
  - Federal
- Utility user’s surcharges
Where is legal incidence of tax?

- Customer (collected by service provider);
- Service provider (may be passed through to customer); or
- Service provider (may not be passed through to customer).
State and Local Transaction Taxes
Nexus Considerations

• Generally, physical presence governs
• Impact of internet-type legislation
• Impact of Marketplace Fairness Act
• Other considerations:
  – Agency / affiliate nexus
  – FCC / PUC Regulation
  – Potential liability / exposure
  – Ability to present valid resale certificate
State and Local Transaction Taxes

Concept of “Sourcing”

  - Where is the service address?
- Private line services
  - How does Goldberg apply?
  - Sourcing based on proportion of channel points
- Flat rate or unlimited calling plans
  - Place of primary use
- Cloud-type services
  - Services performed or benefits received?
- M2M
State and Local Transaction Taxes

Tax Base

• Sales or Excise Taxes
  – Base varies by jurisdiction and service provided
    • Local, intrastate and interstate / international services
    • Features

• Gross Receipts Taxes
  – Generally, “gross receipts” is broadly defined

• Regulatory Taxes / Surcharges
  - Sales of products vs. services
State and Local Transaction Taxes

Tax Base

• Line taxes
  • Technology advances make it complicated
    • Single line vs. a pipe
    • Max capacity lines
  • Inbound dialing
State and Local Transaction Taxes

Tax Base

Potential deductions from a tax base
- Bad debts (often must be charged off for federal income tax purposes)
- Credits
- Installation charges
- Taxes v. regulatory charges
State and Local Transaction Taxes

Tax Base

• Traps for the unwary:
  – Minimum and maximum tax bases
  – Tax on “tax”
  – Line charges / fees
State and Local Transaction Taxes
Tax Base

• Bundling Concerns
  ✓ All or Nothing
  ✓ “One bad apple”
  ✓ Books and records
  ✓ “True object”
State and Local Transaction Taxes
Sale for Resale Exclusion

• Spirit of law is to tax product one time on sale to the end-user, presumably at highest value of transaction.

• Tax generally does not apply to sale of telecommunications services for resale.
  – Sale of telecommunications service to provider of information services or other enhanced services may not be excluded sales for resale
  – M2M & Telematics
State and Local Transaction Taxes
Sale for Resale Exclusion

• Sale for resale? “Prove it!”
  – Maintenance of resale certificates prerequisite for exclusion from tax.
  – Resale certificate requirements vary by jurisdiction and within jurisdictions.

• Indemnification agreements/tax clause
  – When was the last time you actually collected on an IA or tax clause?
State and Local Transaction Taxes
Exemptions

• Exemptions vary by jurisdictions and within jurisdictions by tax type

• Government and private nonprofit organization exemptions are most common
  – Don’t assume an exemption

• (Again) maintenance of exemption certificates is critical!
  – Pay attention to state specific requirements
Federal Excise Tax - Is it over yet?

• IRC Section 4251 is now imposed on:
  • Local telephone service;
  • **Toll telephone service**; and
  • Teletypewriter service.
Wireless Services
“Sourcing”

• Mobile Telecommunications Sourcing Act – enacted July 2000 by Congress

• Statute recognizes that Goldberg v. Sweet doesn’t easily translate to wireless environment.

• Generally provides that mobile telecom services are taxed in jurisdiction of customer’s “primary use”.
Wireless Services
“Sourcing”

• “Place of Primary Use” is defined as the street address representative of where the customer’s use of the service primarily occurs, which must be:
  - The residential street address or the primary business address of the customer, and
  - Within the licensed service area of the home service provider.

• Requirement to obtain & maintain
Wireless Services
Other Key Considerations

• Types of Taxes
  - Regulatory charges may differ
  - Specific wireless user taxes, fees, etc

• International Roaming

• Handset Promotions/Deep Discounts
Prepaid Arrangements
“The Issues”

What is it??

- Pay as you go
- Hybrid plans
Prepaid Arrangements
“The Issues”

• When prepaid arrangements are purchased, the use of the service cannot be determined. How is tax to be imposed?
  – Does it seem right to impose sales tax on a prepaid arrangement whereby a consumer uses it to purchase non-taxable services?

• How is the service/product sourced?

• How are 911s/line charges applied?
Prepaid Arrangements  
How is Tax Imposed?

• For sales tax purposes, most states deem prepaid arrangements to be taxed as sales of tangible personal property.

• For purposes of most gross receipts taxes and regulatory charges, tax applies on usage.
  – Need to ascertain type of usage (intrastate v. interstate v. information service v. whatever)
  – Who bears the economic burden?
Prepaid Arrangements
Sourcing

• “Two out of three” rule does not work easily

• MTSA may not apply (e.g., for wireline prepaid arrangements)

• Most common default – billing address
  • What if there is no address and the arrangement is purchased anonymously? As a practical solution, the place of sale may be deemed as the location where the customer makes the purchase.
Prepaid Arrangements
911s and Per-line charges

• How to collect?

• Trends we’re seeing
  - Collection of 911s at point of sale for prepaid wireless service. 911s imposed on prepaid wireless service may not necessarily be imposed on prepaid wireline service.

• Some taxes and fees are based on a monthly fee (i.e. $1/month). If prepaid services are based on number of minutes or $$ purchased, how is this calculated?
Equipment Taxation

• What type of exemption is it?
  – COE vs. Manufacturing vs. PUC
• Differences between wireline, wireless, and cable exemptions
• What equipment qualifies?
  – Mixed use equipment
• What about services (i.e., labor, installation, etc.)?
• Pre-qualification or refund claims?
• Review for other applicable exemptions
Equipment Taxation

• Applicability of manufacturing/processing exemptions:
  - *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763 (Mo. 2002)

• Broadened or new exemptions

• Customer premise equipment
Communications Regulatory Basics

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Brita D. Strandberg, Partner, Harris, Wiltshire & Grannis LLP
History and Context

In 1934 Congress passed the Communications Act, which abolished the Federal Radio Commission and transferred jurisdiction over radio licensing to a new FCC, including in it also the telecommunications jurisdiction previously handled by the Interstate Commerce Commission.

Title II of the Communications Act focused on telecommunications using many concepts borrowed from railroad legislation and Title III contained provisions very similar to the Radio Act of 1927.

The Telecommunications Act of 1996 was the first significant overhaul of United States telecommunications law. The Act’s goals were to foster deregulation and competition, and to set up definitions for telecommunications service and information service (non-regulated).
History and Context (cont.)

- The term 'telecommunications service' means the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.'

- On the other hand, the term 'information service' means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.

- The distinction comes into play when a carrier provides information services. A carrier providing information services is not a 'telecommunications carrier' under the Act. For example, until recently, a carrier was not a 'telecommunications carrier' when it is sold broadband Internet access. This distinction becomes particularly important because the Act enforces specific regulations against 'telecommunications carriers' but not against carriers providing information services.
History and Context (cont.)

• With the convergence of telephone, cable, and internet providers, this distinction has created much controversy.

• The FCC (in its Open Internet Order) has now classified broadband internet access as a telecommunications service.

• Regulatory classification has additional regulatory implications.
  ➢ Law enforcement access, customer privacy, state regulation, emergency calling, etc.
  ➢ For newly reclassified broadband internet access service, implications are not yet clear.
  ➢ For other services the new classification of broadband internet access service may call their regulatory classification into question.
History and Context (cont.)

- FCC had jurisdiction over Interstate services. Now, Wireless and VoIP.
- State PUCs had jurisdiction over Intrastate Services. Limited on Wireless and VoIP.
- Purpose of regulation was to regulate a monopoly industry and control pricing.
- Promote universal service (rural or underserved) for telephone and broadband
- Fund “pet” projects
  - The Connect America Fund, or CAF
  - Low Income/Lifeline
  - Schools and Libraries/E-Rate
  - Rural Health Care
History and Context (cont.)

• Taxes are levied to fund the general operations of a level of government. Usually applied to a broad base.
• Originally, regulatory fees only applied to specified classes of service. Usually applied to a narrower base.
• Tax ≠ Regulatory – Different sets of laws, regulations, rules and case law.

Regulatory Base ≠ Tax Base
Federal/State Jurisdiction – Guideposts

• Interstate/intrastate
  – Interstate – generally federal jurisdiction
  – Intrastate – generally state jurisdiction
  – Nature of “traffic” at end points of transmission
    o 10% polluted circuit rule
    o Internet traffic deemed to be Interstate in nature
Federal Universal Service Fund
“How It Works”

• All carriers providing **interstate** or **international** service to end users originating or terminating within the US must contribute.
  – “De minimis” exception may apply.

• Contribution based on projected interstate or international revenues as reported by carrier.
  – End of year true-up

• Remittance: The Administrator of the USF (e.g., USAC) invoices the taxpayer.
  – Separate State USF.
Enforcement

• The FCC may take enforcement action for failures to report revenue and contribute to the USF
• The FCC recently formed a USF Strike Force to focus on USF enforcement
• The FCC recently announced a 3x multiplier for contribution failures.
• The Department of Justice and whistleblowers sometimes pursue False Claims Act lawsuits for failures to report and contribute.
• Companies that receive subsidies may face additional scrutiny.
Selected Regulatory Reporting Issues

- Wireless services – safe harbor (37.1% Interstate) or traffic study
- VoIP services – safe harbor (64.9% Interstate) or traffic study
- Multiprotocol Label Switching (MPLS) “controversy”
- Text messaging – pending action
- Web conference and collaboration services
- State jurisdiction over VoIP services
Selected Regulatory Reporting Issues
Bundled Services

Many providers bundle information services and telecommunications services.

• Classic example: “Triple Play” of video, voice and broadband.
• Many offerings do not fit this model.

FCC has safe harbors to allocate bundled revenue, but the safe harbors are often a poor fit.

• 100% of revenue is assessable or
• Use stand-alone pricing to allocate

Providers may use other “reasonable” allocation methods.

• What is reasonable? Will the Universal Service Administrative Company (USAC), administrator of the USF, agree?
FUSF: Structural Reforms

• USF/ICC Transformation Order (10/2012)
  – Rebrands program as “Connect America Fund” (CAF)
  – Shifts subsidy support to broadband deployment
  – Reduces waste/Limits subsidy for individual lines
  – Additional Accountability/Oversight
Recent Reform: Resale Certifications

Contributions are due on end-user revenue, not resale revenue.

• In other words, USF should be due only once in the supply chain.

The FCC has imposed burdensome paperwork and compliance obligations on providers reporting resale revenue.

• Providers must collect and retain annual customer certifications to support their reporting.
• Providers must have “documented procedures” to ensure correct resale reporting.

Filers that do not comply are responsible for additional USF assessments if their customers are reclassified as end users.
Federal Universal Service Fund Reform (future)

• How should contributions be assessed?
  – Should the FCC continue a revenue-based system, but simplify compliance by clarifying rules?
    • Broadband and Wireless Data?
    • Apportioning bundles of assessable and non-assessable services
    • Identifying the jurisdiction of traffic (interstate, intrastate, international)
    • Distinguishing between wholesale (reseller) and retail revenue, including a potential “value-added” approach where providers in a chain would each contribute on their own incremental revenue
Federal Universal Service Fund Reform (future)

• Alternatives to a revenue-based approach
  – Connections
    • How to define and measure connections. Service or facilities-based approach? Service or capacity tiers?
    • How much should be assessed per connection?
  – Numbers
    • What numbers are assessable (with particular regard to issues such as free services and family plans)?
  – Hybrid number/connection approach?
Federal Universal Service Fund Reform (future)

• There is broad sentiment that reform is overdue.

• The recent decision to reclassify broadband internet access as a telecommunications service creates additional pressure for reform.

• The FCC has asked the Federal-State Joint Board on Universal Service for recommendations; those recommendations are expected some time this year.
Invoice Presentation

• Tax software may not be designed to track invoice presentation rules that apply to telecommunications taxes, fees and surcharges.

• Therefore, billing systems may have to be designed to address any federal or state-mandated (or taxpayer-preferred) invoice presentation requirements.
Invoice Presentation (cont.)

- Federal taxes should be grouped into two general categories: (1) taxes/fees imposed directly on the consumer or required to be passed on by the provider; and (2) surcharges/fees which a carrier is legally allowed to recover from its subscribers.

- State taxes should generally be separately itemized by tax type and by state or local components.
Understanding Telecommunications Taxes

Today’s Telecom Sector – Trends

Jim Nason, Deloitte Tax LLP
May 2015
Convergence in Action – Products/Services

Technology
- Semiconductor
- Software
- Hardware/infrastructure
- Systems integration

Media
- Electronic gaming
- Internet/Search
- Consumer high-tech devices
- Video/Cable
- Satellite
- Entertainment/music
- Advertising
- Print/publishing

Telecom
- Networking
- Telecom equipment manufacturing
- Mobile/
- Landline/
- Broadband
Convergence is all about redefining company boundaries:

1. New customers
2. New products
3. New partners
4. New business models
5. New competitors
6. New markets
7. New regulatory concerns
8. New industry power structures
9. Faster change
What does it mean…?

Convergence is all about redefining company boundaries:

1. New customers
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“Tenets” of Telecom Tax

• Telecommunications is generally taxable
• Internet access (and only access itself) is exempt by statute (w/ exception).
• Components/Segments of a service or transaction may be telecommunications.
• Regulatory issues can change everything.
• Pretty much, nothing else is certain.
What is Telecommunications?

Depends who you ask…

- IRS (FET)
- FCC (FUSF)
- State Regulatory Bodies (State fees, SUSF)
- State Revenue Departments (everything else)
Innovations and Forces Driving Change

• Developments in nanotechnology, artificial intelligence, cognitive computing
• Rapidly falling costs of computing power and data storage
• Ubiquitous access to lower cost bandwidth, increased mobility
• Democratization of data/information
• Connected global communities and machines
Innovations and Forces Driving Change (cont.)

- Reduction of entrepreneurial barrier to entry and newly enabled possibilities

- Cross-sector “invasion”
  - Internet companies continuing to disrupt the consumer product space
  - Interactive gaming companies impeding into the media/film world
  - Mega-media companies entering into the multichannel network space
  - Medical, supply chain, transportation…
## Significant Industry Trends – The Big 5

| Cloud          | Cloud Business Models are proliferating disrupting global tax structures  
|                | Margins are eroding on sales of tangible property as customers move to consumption based services models |
| Big Data       | Geometric volume increases in structured and unstructured data create issues and opportunities  
|                | Rapidly expanding sources of data including multiple ERP systems for acquisitive companies and unstructured data for cloud and other activities are giving rise to risk for tax |
| Mobility       | Mobility is creating new paradigms for where, how and when work is getting done  
|                | Challenges for tax exist in nexus, permanent establishment, and other areas |
| Social         | Social media is redefining the way people connect and consume information  
|                | Fundamental transformations of business models across multiple sectors are giving rise to tax issues |
| Analytics      | Cloud, Big Data, Mobility and Social are all opening the door to data analytics  
|                | From historical to predictive to prescriptive, enterprises are just scratching the surface in understanding the possibilities |
Next Big Battle: Utility v. Privacy…

• Location-based services can do amazing things – if you let them

• Coupons, advertising, information, emergency info… can all be tailored – if you let them
What is it?

- Information Services
- Enhanced Services
- Data Processing
- Software
- Computer Exchange Service

*Presentation on the invoice*
What you are and how you sell it…

Telecom - just voice

Voice & Entertainment & Data Service

Cable ISP
Entertainment Web Content

Differing Taxation

“Cloud” Provider

Telematics/M2M Provider

Hosted PBX / Collaborators
Current Trends & Developments in the Taxation Of Communications

Cathy Newport, Senior Manager, Deloitte Tax LLP
Robyn Staros, Senior Manager, Deloitte Tax LLP

with commentary from Kathy Saxton
State Updates
Handsets

California

Memorandum to the Board of Equalization (03/12/2015)

• The chief counsel to the California State Board of Equalization, in a memorandum to the board, said a petition seeking to repeal a regulation on the measure of tax on sales of wireless telecommunications devices in bundled transactions should be denied, finding no support for allegations of a conflict with the state’s definition of gross receipts.

BOE Publication 120 (07/01/2014)

• Explains that on purchases of mobile devices discounted contingent to the purchase of a service contract, the tax basis for the mobile device is the full undiscounted price.

• An exception exists when a mobile device is sold standalone at less than 50% of the cost to the retailer. In these circumstance the tax basis is the retailers cost of the phone, and the resulting tax cannot be passed on to the customer.
Data Center and Equipment Exemptions

• **Colorado FYI Sales 94 (03/01/2015)**: A broadband provider can claim a sales and use tax refund for equipment used in providing broadband service in a rural area. Claims for the 2014 calendar year must be received by April 1, 2015.

• **Missouri Mo Sec 144.810**: Effective August 28, 2015, a state and local sales and use tax exemption is provided for all machinery, equipment, computers, electrical energy, gas, water and other utilities, including telecommunication and Internet services, used in new or expanded data storage center facilities. An application is required.

• **North Dakota**: **H.B. 1089, Laws 2015, effective retroactively and applicable to taxable events occurring after December 31, 2014, and effective through December 31, 2020**: Enterprise information technology equipment and computer software purchased for use in a qualified data center are exempt from North Dakota sales tax. The exemption includes upgraded or replacement enterprise information technology equipment and computer software purchased for use in a qualified data center. An application is required.
Colorado: Messaging Services

• Private Letter Ruling 15-003 (02/04/2015)

• Colorado ruled that messaging services were not a taxable telecommunication service. Rather the company in this situation was considered the consumer of telecommunication services.

• The services included in the letter ruling were:
  1. Integrated Desktop Messaging (IDM)
  2. Electronic Data Exchange and Value Added Network Service
  3. Broadcast Fax
  4. Notification Email
Roaming Charges

Florida TAA 15A19-001 (1/7/2015) – Roaming into the US

• A mobile communications service provider's sales of roaming services to customers of associated foreign carriers are not subject to communications services tax if the roaming services are provided to customers whose places of primary use are outside Florida.
Dark Fiber

Florida - Technical Assistance Advisement,
No. 15A19-002 (03/18/2015)

• Dark fiber is not subject to the Communications Service Tax (CST)

• Although it may be subject to sales tax as the rental of real property

  • In the case, the dark fiber was considered a conduit, a fixture in effect real property.

  • If the lessee is (1) a utility or communications provider, and (2) the lease of the dark fiber is for utility, communications, or television purposes, then the lease would be exempt from sales tax.

  • If the lease does not meet (1) and (2) above, then the lease is subject to sales tax as the rental of real property.
Dark Fiber (cont.)


• Dark fiber falls within the definition of "competitive telephone service" (CTS) and is therefore subject to retail sales tax.

• The definition of CTS includes "providing by any person of telecommunications equipment or apparatus, or services related to the equipment or apparatus’’

• The seller has the option of sourcing the services to one location of first use or allocating each sale to the appropriate location of first use as described in the excise tax advisory. Retailing B&O tax is allocated to the same locations and in the same proportions as the sales tax
Record Retention

Illinois - Administrative Hearing TC-15-01 (01/06/2015)

- An ALJ for the Illinois Department of Revenue ruled that a telecommunications retailer's credit request for telecommunication excise tax and fees was properly denied, finding the department is precluded from issuing a credit or refund for erroneous payments made before January 1, 2003, under the general statute of limitations.
- As the taxpayer did not keep accurate records, they were not able to refute the state’s assertions.

Indiana - Letter of Findings Number: 04-2014095 (03/25/2015)

- Department of Revenue denied a wireless services and product retailer's sales tax protest, finding the taxpayer failed to maintain records documenting retail transactions or show that the auditor improperly assessed tax for payment transactions the retailer accepted from customers on behalf of wireless carriers.
Internet access

Virginia - P.D. 15-44 (03/18/2015)

The tax commissioner ruled that communications sales tax was correctly assessed on a high-speed Internet service provider's reactivation fees, finding state statutes do not exclude Internet access services from taxable communications services and define connection charges as taxable, and the Internet Tax Freedom Act does not bar the state from taxing connectivity charges.
Conference Bridging Services


- The tax commissioner ruled that fees for a conference bridging service allowing conference calling among persons who have been given an access code is not subject to Vermont sales tax.
  - Conference bridging service does not include the taxable telecommunications services used to reach the conference bridge.
- A meeting collaboration product providing additional web conferencing abilities during conference calls was also not subject to tax.
Cloud Computing
States with Rules or Guidance on Cloud Computing

- Colorado
- Florida
- Georgia
- Idaho
- Indiana
- Massachusetts
- Michigan
- Missouri
- New Jersey
- New York
- Ohio
- South Carolina
- Tennessee
- Utah
- Vermont
- Virginia
- Wyoming
Treatment of Cloud Related Items – Product or Service?

Depending upon the state, Cloud Computing may be considered:

1. Prewritten/licensed software
2. Data processing or data storage
3. Information Service
4. Computer Service
5. Digital automated service – any service transferred electronically that uses one or more software applications
6. Digital equivalent to tangible personal property (i.e. digital goods)
State Sales and Use Tax Treatment of Cloud

Not taxable because:

- The customer does not have physical possession of the item; therefore, it is not a sale or lease of software or tangible personal property.
- The vendor’s server is not in the state.
- The product is not canned or prewritten software and is not an enumerated taxable service.

Taxable because:

- The customer has “constructive possession” of the item; therefore, it represents a taxable sale or lease of software despite no physical transfer of the item.
- The server is a single-tenant server; therefore, it is a taxable lease of tangible personal property despite no physical possession.
- It is within the meaning of an enumerated taxable service.
- Customer receives benefit of a taxable service such as data processing or information service in the state.
Example of State Sales/Use Tax

Inconsistencies across the states can lead to interesting and frustrating situations with respect to the taxability as well as the proper sales tax sourcing of a transaction (e.g., location of a server v. location where service is performed v. location where benefit is derived)

Example: Assume a service provider sells Software as a Service ("Saas")
Service provider is located in State A (service is performed in State A)
Customer is located in State B (benefit is derived in State B)

Questions:

1. What are the tax implications if State A taxes the transaction based on where the service is performed and State B taxes the transaction based on where the benefit is received?
2. What are the tax implications if State A taxes the transaction based on the location where benefit is received and State B taxes the transaction based on where the service is performed.
State Updates
Cloud Computing
Software program (data processing program) used in Denver is subject to Denver sales/use tax regardless of where the software program resides. The delivery method for acquiring the software does not impact the taxability.

If the software program resides on a server outside of Denver, the software is subject to Denver sales/use tax based on the percentage of use attributable to Denver (e.g., based on the number or percentage of users located in Denver).

A mandatory service charge related to a software program is taxable, even if the charge is separately stated from the charge for the software.

An optional service charge related to a software program is not subject to Denver sales/use tax if the charge is separately stated from the charge for the software.

Charges that are not associated with a retail sale of software may fall into a category of non-taxable personal services or “work for hire” which may include:

- Installing software programs
- Writing code
- Designing and implementing computer systems, storage or data retrieval systems
- Consulting services, feasibility studies, training services
- Evaluation bids
- Providing technical help, analysts and programmers
- Maintenance of equipment
Indiana: Cloud computing

Indiana Commissioner’s Directive No. 41 – Taxability of products transferred electronically, December 2014

- Indiana sales/use tax is imposed on specified digital products that are transferred electronically along with the right of permanent use that is not conditioned on continued payment by the purchaser.

- Specified digital products include only:
  - Digital audio works (songs, spoken word recordings, ringtones)
  - Digital audiovisual works (movies)
  - Digital books

- Going forward, sales/use tax may only be imposed on products transferred electronically only if the products meet the definition of specified digital products, prewritten computer software, or telecommunication services; computer software and telecommunication services are not restricted to the phrase product transferred electronically.

- Directive No. 41, December 2014, is not retroactive; refund claims based on this Directive will be denied.
Michigan: Cloud computing

Michigan Court of Claims decision, March 20, 2014
- In a 2014 decision, the Michigan Court of Claims held that the taxpayer’s purchases of cloud computing services were exempt from use tax because the transactions involving remote access to a third-party provider’s cloud were purchases of nontaxable services—not the sale of taxable prewritten software
- Court determined transactions were not sales of prewritten software because the third-party provider did not deliver and did not surrender possession and control of the software to the taxpayer
- Even if the prewritten software was delivered to and used by the taxpayer, the use was merely incidental to the services rendered by the third-party providers

Michigan Court of Appeals Decision, May 13, 2014
- The Michigan Court of Appeals reversed a lower court decision and determined that the sale of an online research product is a non-taxable service, not taxable prewritten computer software
- Any transfer of tangible personal (i.e., taxable prewritten computer software) was incidental to the sale of non-taxable information service
Michigan: Cloud computing

  • At issue was whether an accounting firm’s subscription to an on-line research database was subject to use tax
  • Court ruled in favor of the taxpayer stating the software access did not involve delivery of software

- Proposed House Bills 4018 & 4019 and Senate Bills 82 & 83
  • Proposed legislation has been introduced which would amend the use tax law (HB 4019 and SB 82) and the sales tax law (HB 4018 and SB 83)
  • The bills proposes to include language in the definition of prewritten software, stating it does not include, “granting the right to use prewritten software installed on another person’s server”
New Jersey: Cloud Computing

NJ Adopted sales tax rules for software and related services
Effective December 1, 2014 through October 28, 2015

- Modification or clarification of various definitions (e.g., custom software, installation services, customer support services, modified software, servicing of software, software maintenance contracts)
- Tangible personal property (“TPP”) includes prewritten software regardless of delivery method.
- Downloaded or electronically delivered software is TPP and is taxable unless it qualifies for the business use exemption.
- Taxable: Servicing and installation of software is taxable
- Not Taxable: Modifying prewritten software, custom software, cloud computing and Software as a Service (“SaaS”)
South Carolina: Cloud Computing

SC Private Letter Ruling # 14-2 (08/26/2014)
Usage fees charged for uploading, downloading, or moving data to and from servers are not subject to sales tax in South Carolina.

SC Private Letter Ruling # 14-5 (12/10/2014)
Data processing services and use of a web-based application to manage insurance claim data and information. These services are deemed to be data processing services; data processing services are specifically excluded from taxable services in South Carolina.

SC Private Letter Ruling # 14-4, (11/04/2014)
Cloud-based services for processing and routing telephone calls within a customer’s phone system are deemed taxable as a communication service. The service provider provides cloud-based applications that support a customer’s telecommunication equipment including voice, video, messaging, audio, web conferencing and mobile capabilities. Charges for equipment used by the service provider to perform the communication service are also taxable and the service provider cannot purchase the equipment tax-free for resale.
NY Tax Bulletin TB-ST-128 (08/05/2014)

• When a purchaser remotely accesses software over the Internet, the seller has transferred possession of the software because the purchaser gains constructive possession of the software and the right to use or control the software.

• Accordingly, the sale to a purchaser in New York of a license to remotely access software is subject to state and local sales tax.

• The situs of the sale for purposes of determining the proper local tax rate and jurisdiction is the location from which the purchaser uses or directs the use of the software, not the location of the code embodying the software.

• If a purchaser has employees who use the software located both in and outside of New York State, the seller of the software should collect tax based on the portion of the receipt attributable to the users located in New York.
Prepaid Wireless & Prepaid 911 Fees
Alabama: Prepaid Wireless

Proposed Rule 810-6-5-.36.01

• The Department of Revenue has proposed a rule on the sales taxation of prepaid wireless services to reflect legislative changes affecting the taxation of prepaid calling cards.

• Prepaid telephone calling cards, prepaid authorization numbers, or both, constitute sales of tangible personal property subject to sales or use tax.
California: Prepaid Wireless

Assembly Bill 1717, signed into law as chapter 885 (09/30/2014)

• Establishes a prepaid mobile telephony services surcharge that is based on the sales price of prepaid mobile telephone services and includes the emergency telephone users surcharge, the state's public utilities commission surcharges, and any applicable local user utility tax.
Florida: Prepaid Wireless v. Postpaid

• Effective July 1, 2014, Florida House Bill 5601 clarified and updated what constitutes a “prepaid calling arrangement.

• Effective January 1, 2015, Florida House Bill 175 requires retail sellers of prepaid wireless services to begin collecting 40¢ for the E911 fee on the sale of each prepaid wireless service that allows a caller to connect to and interact with the Enhanced 911 (E911) System.

• For both sales and use tax and E911 fee purposes, the sale of prepaid calling arrangements are sourced to the point of sale or “ship to” address of the customer.
# Summary of Prepaid 911 Guidance

<table>
<thead>
<tr>
<th>State</th>
<th>Ruling</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kentucky</td>
<td>The 911 surcharge is imposed on all postpaid and prepaid wireless connections</td>
</tr>
<tr>
<td>Montana</td>
<td>911 fee currently does not apply to prepaid service</td>
</tr>
<tr>
<td>Oregon</td>
<td>$0.75 911 tax on the sale of prepaid telecommunications services</td>
</tr>
<tr>
<td>Tennessee</td>
<td>Monthly fee for unlimited service paid in advance not prepaid and most pay 911 service charge</td>
</tr>
<tr>
<td>Texas</td>
<td>Prepaid wireless services were subject to the monthly fee for prepaid 911 emergency services</td>
</tr>
</tbody>
</table>
Cases: Prepaid 911

Alabama - Beauty & More, Inc. v. Department of Revenue (06/10/2015)

- Sales tax does not apply to prepaid cellular telephone minutes and other services.
- Tax is limited to prepaid calling cards and authorization numbers.

Alabama HB 373 passed into law as Act 2014-336

- Prepaid wireless services are subject to sales tax whether or not a physical card is issued

Kentucky - Virgin Mobile USA v. Kentucky (06/29/2012)

- The 911 surcharge is imposed on all postpaid and prepaid wireless connections.
Cases: Prepaid 911 (cont.)

Maryland

- AG Letter of Advice to Emergency Number Systems Board (9/24/2013)
  - Monthly fee for unlimited service paid in advance not prepaid.
  - Must pay the higher postpaid fee.
  - Legislation planned to make fees the same.

- Montana
  - MT 911 fee currently does not apply to prepaid service.
Current Development Update - Prepaid 911

Oregon

- H.B. 4055 (03/14/2014)
  • Imposes a $0.75 tax on the sale of prepaid telecommunications services
  • E911 also imposed on fixed interconnected VoIP
  • Effective October 15, 2015
Current Development Update - Prepaid 911

Tennessee

- AG Opinion 2013-43
  - Monthly fee for unlimited service paid in advance not prepaid.
  - Must pay the higher postpaid fee.

Texas

- Tax Policy (4/9/2013)
  - Prepaid wireless services were not subject to the monthly fee for wireless telecommunications connections.
  - The services were subject to the monthly fee for prepaid 911 emergency services.
  - Two separate 911 fees could not be imposed on services because it would be “double taxation”.

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Appendix
SSTP Rule 327.2  I. Construction of prepaid definitions.

For purposes of the terms “prepaid calling service” and “prepaid wireless calling service,” the term “predetermined unit” includes but is not limited to units measured by dollars, events, time, or combinations thereof.

Units of time include minutes, hours, days, weeks, or months. One or more units measured by time will be considered to decline with use in a known amount if such unit or units declines according to a predetermined basis. The predetermined basis may be a combination of different units measured by time.

Units may also be measured by events, such as sending or receiving a text message, and the terms of the prepaid service may include such event-based units in addition to units measured by time.
SSTP Rule 327.2  I. Construction of prepaid definitions.

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Units may also be measured by events, such as sending or receiving a text message, and the terms of the prepaid service may include such event-based units in addition to units measured by time.
Streamlined Sales Tax Agreement-Telecom

Definition Provisions

• Mobile wireless service is defined as, “a “telecommunications service” that is transmitted, conveyed or routed regardless of the technology used, whereby the origination and/or termination points of the transmission, conveyance or routing are not fixed, including, by way of example only, “telecommunications services” that are provided by a commercial mobile radio service provider.

• Telecommunications services means, “the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points. The term “telecommunications service” includes such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code or protocol of the content for purposes of transmission, conveyance or routing without regard to whether such service is referred to as voice over Internet protocol services or is classified by the Federal Communications Commission as enhanced or value added.”
Streamlined Sales Tax Agreement-Prepaid Provisions

• Prepaid wireless calling service means “a telecommunications service that provides the right to utilize mobile wireless service as well as other non-telecommunications services, including the download of digital products delivered electronically, content and ancillary services, which must be paid for in advance that is sold in predetermined units or dollars of which the number declines with use in a known amount.”

• Post-paid Calling service is defined as “telecommunications service obtained by making a payment on a call-by-call basis either through the use of a credit card or payment mechanism such as a bank card, travel card, credit card, or debit card, or by charge made to a telephone number which is not associated with the origination or termination of the telecommunications service.”
Overview of the Telecom Tax Billing Process

May 2015
Identify the service type

- Local
- Interstate /intrastate
- Internet access
- Data
- Wireless
- Satellite
- Ancillary Services (Features, voice mail, bridging, etc.)
- TPP
- Dark Fiber
- Cloud or Hosted -SaaS, IaaS, PaaS
Product Coding

- At what level? How granular?
  - Too granular; lots of maintenance.
  - Too broad; potential misclassifications.

- Who decides? Tax Dept? Billing?
  - Tax Dept – better control; response time commitments.
  - Billing – requires training, periodic auditing.

- Default values?
  - GL
  - Product Hierarchy
Service Location

Geocoding
- NPA/NXX (approx. 70-80% accuracy)
- ZIP Code (approx. 75-85% accuracy)
- City name, State & ZIP (approx. 90-95% accuracy)
- ZIP+4 (approx. 99% accuracy)
- Address validation Software (100% ?)
- 50/50 circuit splits

Geocode Assignment
- Customer account
- Circuit
Customer Types & Exemptions

- Customer Type
  - Residential or Business
  - Resale
  - Government
  - Nonprofit / 501c3
  - Enterprise Zone

- Exemption Management
  - Tax types – surcharge or tax?
  - Image Scanning
  - 3rd party software
Telecom Tax Software

• Software Features
  – Multiple Tax types
  – Per line charges
  – Surcharges
  – Tax on tax calculations
  – Max & Tiered taxes
  – Customizations
  – Monthly Updates

• Other considerations
  – Does it handle Use tax on purchases?
  – Does it have a tax return module?
  – Does it have an exemption certificate module?
Telecom Tax Software (cont.)

• Other considerations
  – Does it have an existing interface with your current billing system?
  – Does it handle Use tax on purchases?
  – Does it have a tax return module?
  – Does it have an exemption certificate module?
Telecom Tax Software (cont.)

- Accounting & Audit considerations
  - How will you reconcile:
    - Tax detail to the general ledger?
    - Tax detail to the tax returns?
  - Audit support
    - What reporting is available?
  - Data retention
    - What is your company’s data retention policy?
    - Does your IT department adhere to the policy?
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