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VoIP Taxation Primer

Debuting in 1995, Voice over Internet Protocol freed telecommunications from landlines and dedicated phones to the sky-high limits of satellites and WiFi. Commonly known as VoIP, usage grew steadily as individuals and companies embraced its cost effectiveness, accessibility, and flexibility. When the 2020 pandemic hit and any employee who could swing it abandoned their desk to work from home, demand for VoIP systems grew more than 10% year over year. But while the \$30 billion VoIP industry has made calls a breeze, its taxation can seem more like...a windstorm.

If your company provides VoIP services, it must be compliant with the corresponding regulatory laws. Here's a summary of the factors that drive VoIP communications taxation, and some strategies for mitigating the risk of non-compliance.

Unlike traditional landline and mobile networks, VoIP converts analog sounds into digital signals that are sent as data to recipients. You probably use VoIP more than you realize - it's

what you use when you Zoom, Skype, and FaceTime, and when you make a phone call over Wi-Fi rather than your cellular service.

With steadily growing demand and falling barriers to entry, VoIP services are an attractive addition to a company's product portfolio. Families and organizations around the world are throwing out wired phones and embracing the quality, security, and routing flexibility of VoIP systems. Consumers appreciate how VoIP services rarely add flat rate or marginal fees for long-distance calls (including international calls) or the time spent on a call. And services are easy to set up using organizations' existing broadband systems.

On the vendor side, VoIP systems are more cost-effective and scalable than traditional landline or cellular services. Together, these factors are driving market growth, with some projections estimating the VoIP market to reach \$55 billion by 2025.

While it's an attractive market, the taxes and regulatory fees VoIP providers are required to collect and submit are tricky. Let's start by reviewing the variables in play.

The basics of VoIP taxation

VoIP systems make it easy to send and receive calls using an internet connection.

Depending on the service provider, VoIP systems allow users to place calls to anywhere in the world through a computer, VoIP phone, landline phone with an adapter, or even a cell phone.

Applicable regulatory requirements and taxes and fees are formulated based on how the VoIP service is provided. In other words, the type of VoIP system you bring to the market

dictates the rules and taxes to which you'll need to adhere - and there can be a big difference.

The primary drivers of VoIP taxation are whether you provide *static or nomadic VoIP* and *interconnected or non-interconnected VoIP*.

Static vs Nomadic VoIP: Geographic Flexibility Complicates Taxation

Static VoIP calls are made from a fixed address, such as a private network. It's easy to identify the geographic origination point of the call when it's made from a static VoIP system, so it's easy to identify and calculate corresponding taxes.

Nomadic VoIP users can make calls using any broadband internet connection. And calls can theoretically originate from any location in the world. So it is challenging to identify and separate intrastate and interstate portions of VoIP services for compliance with applicable rules and regulations.

Nomadic VoIP services are more complex than static VoIP services operationally, and when it comes to regulatory data-gathering and fee calculation. Because the origination point of the calls is variable, the foundation for state and local regulatory fees is more difficult to identify. That said, many vendors find nomadic VoIP services create a stronger value proposition to consumers, and consumers' willingness to pay offsets additional costs and system complexity.

Interconnected vs Non-interconnected: The Broader the Services, the Broader the Regulations

Non-interconnected VoIP is often called “peer-to-peer” VoIP because users can contact other users of the same VoIP system. Think of how iPhone users can only perform certain functions, such as FaceTime, with other Apple devices but not Androids or other phones. Non-interconnected VoIP also doesn’t allow the user to make or receive calls from landline or cell phones.

Interconnected VoIP does allow the user to make and receive calls from landline or cell phones, and is commonly selected by organizations looking to upgrade their traditional desk phones. Interconnected VoIP uses the public switched telephone network (PSTN), which is the combination of all the infrastructure and services for telephone lines and cellular networks around the world.

Interconnected VoIP services are typically subject to significantly more taxes and fees than their non-interconnected counterparts. The Federal Communications Commission (FCC) requires Interconnected VoIP services to adhere to Local Number Portability rules and to contribute to the Federal Universal Service Fund (FUSF) and Telecommunications Relay Services Fund (TRSF). And because interconnected VoIP leverages the PSTN, vendors are often required to include 911 service, which is subject to local 911 fees.

Non-interconnected VoIP services are often subject to fewer state and local taxes, most commonly including a waiver from the FUSF and 911 service and fees.

Defining your organization's service methods and incorporating corresponding taxation [including how they evolve over time] is integral to avoiding censure due to non-compliance.

There are other complicating factors to VoIP services and taxes, on every level. For example, your company may be subject to submitting regulatory reports like FCC 499-A, a federal regulatory form that collects data from VoIP providers to determine several federal contribution obligations. States add an additional level of complexity. Each state is free to define its VoIP services and make its communications tax laws based on that definition. As you might surmise, this has resulted in VoIP taxation varying significantly from state to state.

Five Strategies for Minimizing VoIP Regulatory Risk

If your company is evaluating whether to become a VoIP service vendor, or is already in the business of doing so, be prepared to handle the regulations and taxes that come along with it. Here are some strategies to keep in mind:

1: Answer critical questions to procure the best fit VoIP system

Before you can begin to determine the applicable taxes and fees for your service, work with your product and engineering teams to define the service type:

1. Static or nomadic
2. Interconnected or non-interconnected
3. Can the service be associated with static IP addresses?
4. Should fees and taxes be sourced by call points of origin or customer billing addresses?

2: Identify federal, state, and local regulatory requirements

Like all telecommunication services, VoIP services are accompanied by a full spread of federal regulatory rules and fees. Both the FUSF and TRSF are calculated by applying a contribution factor to assessable revenue. State and local Public Service or Public Utility Commissions often enact additional rules and/or fees. We highly recommend retaining advisory guidance to ensure all requirements are identified and incorporated into tracking, billing, and submissions. Many vendors utilize a specialized tax software and billing application to manage this process.

3: Obtain applicable federal, state, and local regulatory licenses

On the federal level, you may be required to register with the Universal Service Administrative Company (USAC), the body overseen by the FCC that's responsible for the FCC 499-A form mentioned earlier. In addition, many states along with some localities require VoIP vendors to register or obtain a license from Public Utility or Service Commissions.

4: Correctly categorize revenue for easy reporting

Ensure that revenue will be categorized correctly by carefully designing systems and processes that deliver the output to make communications tax filings a breeze. Build in reporting requirements and formulas, applicable data points and measurements, how and where the data will be stored in your system, and how it will be rolled up by country, state, and locality. Tax filings forms are complex and time-consuming to create, but well-designed data gathering and manipulation will streamline the process and avoid unnecessary headaches. Again, specialized software can relieve the pain from this process.

5: Stay on top of it

It's easy to assume that once your organization's systems and processes are in place, you're safe and in compliance for the foreseeable future. Communications taxes and regulatory requirements are regularly updated, though, so it's important to ensure your organization reacts appropriately to changes. And as your company expands and grows, be aware that it may fall under additional tax and regulatory requirements.

From complete beginner to experienced provider, lack of guidance and understanding is never worth the ramifications of non-compliance. Be sure to keep your organization up to date with rates and requirements: even experienced businesses can misinterpret regulations or fail to notice a change in forms and fees. And if you're looking for help, reach out. It would be our pleasure to guide you through the storm of VoIP regulatory compliance.

Looking for personalized guidance on managing communications taxes for VoIP services? Visit our website at www.ceretax.com or [contact us](#) directly.