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### Introduction

Telecommunications companies face significant issues when it comes to complying with federal, state, and local jurisdictions, agencies, and authorities. The total "tax" burden often exceeds 30%, making communications services one of the most heavily taxed industries.

Compliance for telecom and specifically VoIP service providers is one of the most



difficult to understand. There are various taxes and regulatory fees including communication services taxes, utility users' tax, E911 fees, Federal Excise Tax, right of way fees, USF, and more. With the progression of technology, VoIP services have taken center stage. Because the barriers to entry for delivering a VoIP service are very low, many businesses are diving in head-first without a solid understanding of their tax and regulatory obligations. Misinformation abounds regarding your obligations.

In this white paper, we will investigate many of these misconceptions and shed some light on the complexity of communications tax compliance.

## **Common Misconceptions**

Some of the more common misconceptions include the following:

**VoIP** is delivered over the internet and is therefore tax-free. Untrue.

The confusion lies with the sometimes controversial Internet Tax Freedom Act (ITFA), passed in 1998. ITFA does prohibit federal, state, and local governments from taxing internet access and from imposing discriminatory internet-only taxes. There were a few states that were "grandfathered" and allowed to charge tax on internet access; these grandfathered rules were revoked as of July 1, 2020.

ITFA has no application to the taxability of telecommunications services. Understanding that VoIP is not tax-free, each state (and, in some situations, local jurisdictions) are able to decide whether VoIP is taxable. For example, California at the state level does not tax VoIP but various cities in California do and they apply a local utility users tax to VoIP.

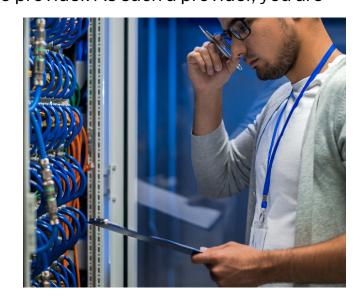
I'm not a telecommunications service provider, I'm a reseller. Untrue.

Many believe the major carriers are the service providers. But if you send an invoice to your customer for telecommunications service and the customer believes and recognizes that you are providing the service, then you are considered a telecommunications service provider. As such a provider, you are

responsible for collecting and remitting applicable taxes and regulatory fees.

I don't have nexus so I don't need to collect and remit any taxes. Untrue.

This comment often comes from someone experienced in the world of standard sales tax where nexus needs to be established before a company is obligated to adhere to the jurisdiction's sales tax rules.



In the non-telecom world, a company would have to have either a physical presence or an economic presence to be required to collect these various taxes. Nexus has historically been thought of as a physical presence, but within the last two years (ever since the Supreme Court's now-famous Wayfair decision) has expanded to include the economic presence, generally triggered by sales thresholds. If you are providing a telecom service, you could easily look to a customer in another state and conclude that you don't have either type of nexus in that other state and therefore are not responsible to collect and remit the taxes.

As a telecom service provider, you are utilizing infrastructure within a state to deliver your service: cell towers, fiber, switches, and so on. You may not own this infrastructure, but if it were not present you could not deliver your service. Multiple states have ruled that this infrastructure creates "attributional nexus" for the company, regardless of whether the company owns this infrastructure or not. As a result, the telecom service provider has the responsibility to the collect the applicable taxes.

Basically, where you have customers for your telecom service, you must collect the taxes.





My service provider handles my taxes for me. While there is an element of truth to this, it is not an effective strategy.

The main factor to consider is that by providing VoIP service, or any other communications service, you are now considered a telecom service provider. And as a service provider you have direct responsibilities related to taxes and regulatory fees. Your upstream carrier may be charging you these various taxes and fees, but that does not relieve your responsibility. Even if you are paying taxes to your carrier, these taxes are on the wholesale amount and not the retail. At the least, you are exposed for taxes on the mark-up – and in the worst case an auditor could assess you the full tax amount and you would have to work with your carrier for a refund.

Where this assumption is correct is related to your federal USF in certain situations. If you are considered a de minimis filer, it is correct for your carrier to assess the USF fee and pass-through to you. You then pay the USF fee as part of your invoice to your carrier. At the same time, you are not required to contribute directly to the USF fund.

Even this situation, though, does not relieve you of the responsibility of registering and filing a \$0 due report with the Universal Service Administrative Co. (USAC).



#### All communications services are taxed the same. Untrue.

One might think that VoIP, traditional landline service, and wireless are all taxed the same. After all, each essentially provides the same service – facilitating voice communication.

In fact, each type of service could be taxed differently in a state. Whether the service is provided to a residence or a business can also influence the taxability as does whether the service is prepaid or post-paid.

To determine the applicability of taxes, first look at your exact services. Are you a VoIP provider? A traditional landline provider of long distance? Do you provide a single service or multiple services? Do you invoice pre-paid or post-paid? Are the invoices recurring month to month or are they different every month?

# Other Taxes and Complex Calculations

Some states may appear to not apply sales tax to certain communications services; however, be aware these states could have a specialty telecom excise tax.

Florida, for example, has a communications service tax inclusive of the state sales tax and a communications-specific tax that applies to telecom. In California, sales tax doesn't apply to telecommunications services but there are numerous cities and counties that apply a municipal utility tax. Missouri has local license taxes in most cities.



Texas applies a Right of Way fee (ROW) to many communications services in almost 1,000 local jurisdictions. An E911 fee is also imposed by many local jurisdictions and some states (and it could result in a telecom service provider having thousands of filings across the country). Five states – among them Pennsylvania, Maryland, and New York – impose a gross receipts tax specifically on communications services: These are annual corporate-type taxes, often requiring an estimated payment like a corporate income tax.

Many of these taxes are "trust fund taxes" which means that the telecom service provider is a collection agent for the state with responsibility to collect and remit these taxes.

## **Tax-Exempt Services**

Many new telecom service providers are existing MSPs (managed service providers) with infrastructure in place to support the sales tax requirements of their existing business. An area where they frequently struggle is related to how to exempt their purchases with their carriers. Since the service providers purchase service from an upstream carrier and resell the service to their customers, there's an opportunity to exempt these purchases from taxes and fees for resale purposes.

The standard sales tax resale exemption is insufficient to achieve the exemption, though, primarily because the service provider needs to exempt different taxes – not just sales tax. They may need to exempt communications services tax, utility users tax, 911 fees – each potentially requiring a unique form to be completed and sent to the upstream carrier.

Exempting the regulatory charges and the USF fee can be more challenging. The USF has a de minimis category whereby a service provider is not required to contribute directly to the fund but rather the upstream carrier charges the fee and reports directly to USAC. Once the USF contributions of the service provider exceed \$10,000 in a 12-month period, then the service provider must contribute directly to the fund via USAC. In return, the service provider can now apply for a USF exemption with the carrier.

TaxConnex has worked to assist telecom companies alleviate the burden of tax for many years. We are experts when it comes to navigating the taxes associated with communication companies. Contact us to stay on top of this ever-changing environment.

## About TaxConnex™

TaxConnex ™ is how businesses finally get sales tax off their plate – no matter how many states they're in or how often regulations change. Sales tax is more complicated than ever, especially in a post-Wayfair world. Yet the providers who claim to simplify sales tax often still leave the hardest parts – and the liability – up to you. When you work with TaxConnex, it's all on us. This means you get all the know-how, all the backup, and none of the risk. It's only possible because of our proprietary platform and network of sales tax experts. That's why large to midsized corporations, including accounting firms, turn to TaxConnex.

Now it's all on us.™ TaxConnex.com





