

EDUCATIONAL ADVISORY

FORM 499 REVENUE REPORTING PRIMER SERIES Reporting Revenue from Interconnected VoIP Bundles and Corollary/Peripheral Services Sold in Conjunction With I-VoIP

Issues, Options, Risks and Considerations for Enhancing Your Company's Confidence in Its Revenue Reporting Decisions

Through the years, both our law firm and its affiliated consulting arm, [The Compliance Group](#), have represented hundreds of telecommunications and VoIP service providers with an assortment of legal and regulatory compliance matters on a nationwide basis. More than any other area of communications regulation, the one that has confounded our clients and the industry at large has been, and continues to be, the Federal Communications Commission's ("FCC" or "the Commission") Universal Service Fund ("USF") program, and the administration/enforcement of the program by the Universal Service Administrative Company ("USAC").

In the interests of sharing knowledge and educating clients about the FCC Form 499 revenue reporting, USAC audits, and FCC appeals processes, we occasionally memorialize our experiences and circulate educational information to our entire client base in the hopes of highlighting issues (and opportunities) which may otherwise be overlooked. We hope you find the following information both useful and informative.

INTRODUCTION

Through our organization's experience advising clients on FCC Form 499 revenue reporting requirements,¹ we have witnessed the considerable confusion surrounding the proper approaches to reporting revenue derived from Interconnected VoIP ("I-VoIP") bundles and certain common features, functionalities and corollary services which are frequently offered in conjunction with I-VoIP services. To remedy this confusion, The *Compliance Group*, Inc. ("TCG"), filed a Petition with the Federal Communications Commission ("FCC" or "Commission") seeking a Declaratory Ruling to remedy and obtain clarity around certain revenue reporting issues that have plagued I-VoIP service providers. One question, in particular, necessitated clarification – whether the FCC's precedent related to "adjunct-to-basic" telecommunications services applied in the I-VoIP context.

¹ Through both our law firm, Marashlian & Donahue, LLC, The *CommLaw* Group, and consulting firm, The *Compliance Group*, our professional services organization has advised clients on FCC Form 499 (and multi-state and local regulatory and tax) revenue reporting requirements and "Best Practices" since 2001.

Soon after filing, we discussed the Petition and its contents with the staff of the FCC's Wireline Competition Bureau. Through these discussions we confirmed staff's view that the FCC's adjunct-to-basic precedent does not apply to I-VoIP. Having obtained the guidance we sought through informal channels, the Petition was withdrawn.

While the adjunct-to-basic concept may not yet apply to features offered in conjunction with an I-VoIP service, there is very little guidance from the FCC as to how to treat services, such as SIP trunking, Direct Inward Dialing numbers ("DIDs") or toll-free services, that are commonly sold in conjunction with I-VoIP. Nonetheless, I-VoIP providers must determine how to treat these peripheral services, whether they are offered as part of a bundle or on a stand-alone basis. Consequently, I-VoIP providers must weigh the benefits and risks of available options, and their ability to support a particular classification, in determining how to treat these offerings.

After reflecting on the clarification obtained from FCC staff and upon consideration of certain additional complex I-VoIP service provider FCC Form 499 revenue reporting challenges frequently encountered by our clients, we decided to prepare this Memorandum to address a few common and critically important revenue reporting issues. These fall into two, discrete areas: (1) classification and revenue reporting related to "vertical call features" and other non-telecom components of an I-VoIP "bundle" and (2) classification and revenue reporting related to "peripheral" services commonly sold in conjunction with I-VoIP services. Clients with specific questions regarding the regulatory treatment of their products and services should contact the attorney assigned to their account.

I. SERVICES "BUNDLED" WITH VOIP: *Avoiding Exposure of Revenue from Non-Telecom, Unregulated Services "Bundled" with Basic VoIP Service Package to USF and other Regulatory Fees*

a. Effect (or lack thereof) of "Adjunct-to-Basic" Precedent

The degree to which a particular communications service is subject to federal regulation depends upon the FCC's classification of the service. Services that meet the definition of "telecommunications service" are subject to FCC jurisdiction and the accompanying panoply of federal regulations pursuant to Title II of the Communications Act of 1934, as amended ("the Act"). In contrast, services that meet the definition of an "information service" (also referred to as "enhanced" services) are largely unregulated, and the FCC generally does not require providers of such services to register with USAC or make USF contributions.²

Over the years, the line between "telecommunications" and "information" services has required some interpretation at the margin. For example, the FCC has ruled that certain services that otherwise might meet the literal definition of an information service are nevertheless treated as regulated "adjunct-to-basic" services, if they are "incidental" to underlying basic communications services and do

² See *Amendment of Section 64.702 of the Commission's Rules and Regs.*, 77 FCC 2d 384 (1980); *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1932, as Amended*, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd. 21905 (1996) ("*Non-Accounting Safeguards Order*"); *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd. 11501 (1998) ("*Stevens Report*").

not “alter [...]their] fundamental character.”³ Services that qualify as adjunct-to-basic services are regulated in the same manner as the underlying basic telecommunications service; thus, they are subject to USF and other FCC regulatory fee contribution obligations. Adjunct-to-basic services include, for example, call forwarding, call waiting, caller ID or a recorded message provided with a calling card service.⁴

While the FCC has used its Title I ancillary authority to extend many Title II regulatory obligations to I-VoIP services,⁵ to date the FCC has not addressed formally whether its adjunct-to-basic precedent extends to I-VoIP. And our informal discussions with FCC staff confirm that, at this time,

³ See, *AT&T Corp. Petition for Declaratory Ruling Regarding Enhanced Prepaid Calling Card Services, Regulation of Prepaid Calling Card Services*, WC Docket No. 03-133, 05-68, Order and Notice of Proposed Rulemaking, 20 FCC Rcd. 4826 at ¶ 16 (2005) (“*Enhanced PPCC Order*”), *aff’d sub nom. American Tel. & Tel. Co. v. FCC*, 454 F.3d 329 (D.C. Cir. 2006).

⁴ *In the matter of Federal-State Joint Board on Universal Service Appeal of Administrator’s Decision, Radiant Telecom, Inc.*, DA 07-2922, Order ¶ 7 (2007) (“*Radiant Order*”); see also *AT&T Corp. Petition for Declaratory Ruling Regarding Enhanced Prepaid Calling Card Services, Regulation of Prepaid Calling Card Services*, WC Docket No. 03-133, 05-68, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 4826 (2005) (“*Calling Card Order and NPRM*”).

⁵ Specifically, in 2005, the Commission required I-VoIP providers to supply 911 emergency calling capabilities to their customers, and determined that providers of I-VoIP services are subject to the Communications Assistance for Law Enforcement Act (“CALEA”). *E911 Requirements for IP-Enabled Service Providers*, First Report and Order and Notice of Proposed Rulemaking, FCC 05-116, 20 FCC Rcd 10245 at para. 24 (2005) (“*E911 Order*”), *aff’d sub nom. Nuvio Corp. v. FCC*, 473 F.3d 302 (D.C. Cir. 2006); 47 C.F.R. § 9.3. In 2006, the Commission required I-VoIP providers to contribute to the support of the Federal Universal Service Fund. See *Universal Service Contribution Methodology*, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518, paras. 38-49 (2006) (*2006 Interim Contribution Methodology Order*), *aff’d in part, vacated in part sub nom. Vonage Holdings Corp. v. FCC*, 489 F.3d 1232, 1244 (D.C. Cir. 2007). In 2007, the Commission extended the customer privacy requirements of section 222 and the Commission’s Customer Proprietary Network Information (“CPNI”) rules to I-VoIP providers. See *Implementation of the Telecommunications Act of 1996: Telecommunications Carriers’ Use of Customer Proprietary Network Information and Other Customer Information; IP-Enabled Services*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 6927, paras. 54-59 (2007). In 2007, the Commission also extended section 255 disability access obligations to I-VoIP providers, required I-VoIP providers to contribute to the Interstate Telecommunications Relay Service Fund, and required I-VoIP providers to offer 711 abbreviated dialing for access to relay services. See *IP-Enabled Services*, Report and Order, 22 FCC Rcd 11275, paras. 17-43 (2007). Also in 2007, the Commission extended local number portability (“LNP”) obligations, LNP contribution obligations, and numbering administration contribution obligations to I-VoIP providers, and required I-VoIP providers to pay regulatory fees at the same rate as interstate telecommunications service providers. See *Telephone Number Requirements for IP-Enabled Services Providers; Local Number Portability Porting Interval and Validation Requirements; IP-Enabled Services; Telephone Number Portability; Numbering Resource Optimization*, Declaratory Ruling, Order on Remand, and Notice of Proposed Rulemaking, 22 FCC Rcd 19531 (2007). See *Assessment and Collection of Regulatory Fees for Fiscal Year 2007*, MD Docket No. 07-81, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 15712, paras. 11-13 (2007). In 2009, the Commission extended domestic Section 214 discontinuance obligations to I-VoIP providers. See *IP-Enabled Services*, Report and Order, FCC 09-40, 24 FCC Rcd 6039 (2009). Finally, in 2012, the Commission required I-VoIP providers to comply with the Commission’s network outage reporting requirements. *The Proposed Extension of Part 4 of the Commission’s Rules Regarding Outage Reporting To Interconnected Voice Over Internet Protocol Service Providers and Broadband Internet Service Providers*, Report and Order, 27 FCC Rcd 2650 (2012).

staff would not interpret the Commission's adjunct-to-basic precedent as being applicable to I-VoIP, which ameliorates concerns that USAC may overreach its authority and do so unilaterally.

b. Confirmation That Non-Telecom, Unregulated Services Remain Outside Purview of USF and Other Regulatory Fees When Sold on a Stand-Alone Basis

The informal guidance we received from the Wireline Competition Bureau has important consequences for I-VoIP providers. Based this guidance, I-VoIP providers offering services that would be classified as adjunct-to-basic services if offered with a telecommunications service (i.e., vertical call features, such as call waiting, call forward, etc.), can appropriately classify these services as unregulated information services when they are sold on a stand-alone basis. As information services, these services are not subject to USF or other FCC regulatory fees. As a result, I-VoIP providers should report revenue from these services as "other, non-telecommunications revenue" on Line 418.3 of FCC Form 499-A.

c. Confirms Non-Telecom, Unregulated Services Remain Outside Purview of USF and Other Regulatory Fees When Bundled With I-VoIP Services, are Subject to Bundling "Safe Harbor" Rules

When services that would be classified as adjunct-to-basic services if offered with a telecommunications service are offered as part of a bundled VoIP service offering, VoIP providers should consider carefully the FCC's bundling rules. The FCC has adopted a bundling "safe harbor" that allows service providers to "pull out" from the federal regulatory fee contribution base all revenue from unregulated services that are offered as part of a bundled service offering. By implementing the bundling safe harbor, I-VoIP providers can continue offering bundled services and include in the bundle any non-telecom, unregulated service that might otherwise be treated as an adjunct-to-basic service if offered with a traditional telecommunications service. This permits VoIP providers an opportunity to avoid exposing the non-telecom, unregulated portion of the VoIP bundle to federal (and likely also state) regulatory fees.

That said, if VoIP providers do wish to take advantage of the opportunity to avoid subjecting non-telecom, unregulated services sold in a VoIP bundle, they must do so in conformance with the 499-A Instructions and the FCC's unbundling rules. And while there are technically two unbundling safe harbors, the first is really not much of an opportunity. Under the first FCC safe harbor, I-VoIP providers can simply treat all bundled service revenues as assessable I-VoIP service revenues.⁶

Under the second, more relevant unbundling safe harbor, I-VoIP providers can report revenues from bundled service offerings based on the unbundled service offering prices, with no discount from the bundled offering being allocated to assessable I-VoIP services.⁷ This approach requires service providers to maintain the unbundled service offering prices in their books and records and also maintain internal price lists detailing each unbundled service offering and its associated stand-alone

⁶ See 2015 499-A Instructions at page 22. See also *1998 Biennial Regulatory Review – Review of Customer Premises Equipment and Enhanced Services Unbundling Rules in the Interexchange, Exchange Access and Local Exchange Markets*, CC Docket Nos. 96-61 and 98-183, Report and Order, 16 FCC Rcd. 7418, 7446-48 at ¶ 51 (2001) ("1998 Biennial Regulatory Review").

⁷ *Id.*; *1998 Biennial Regulatory Review* at ¶ 50.

price. It is worth noting, that this approach may not be acceptable under state tax requirements for unbundling taxable and non-taxable elements in a bundle.

Under the second safe harbor approach, I-VoIP providers would determine a price for each of the non-regulated features, functionalities and software intelligence associated with the VoIP service, as if each of these “non-regulated” features were offered on a stand-alone basis. I-VoIP providers would then allocate the total value for these services away from the contribution-eligible services revenue that forms the company’s regulatory fee contribution base.

In the event a contributor does not offer certain non-regulated features on a stand-alone basis, we recommend implementing one of two different approaches for revenue allocation, depending on a company’s willingness and ability to defend a more aggressive position:

- The more “conservative” approach is to review the prices charged for the stand-alone service components by competitive providers in your company’s service area and charge a similar rate.
- A “moderately aggressive” approach would be to determine the underlying costs for the stand-alone service component, plus the retail markup.

We describe the latter approach as moderately aggressive due to the complexities often involved in determining the individualized costs of service components, and associated challenges confronted when defending the “cost plus” markup model in the context of a USAC audit. In short, while equally viable, the conservative approach may be easier to defend and support, barring exceptional efforts by the company to easily reproduce reliable evidence documenting their “cost plus” markup model.

The FCC will afford companies that employ a safe harbor the presumption of reasonableness in an audit or enforcement context.⁸ Companies are free to choose an alternate method; however, other allocation methods may or may not be considered reasonable by the FCC and USAC and will be evaluated on a case-by-case basis.⁹

II. PERIPHERAL SERVICES SOLD WITH VOIP: Determining Jurisdictional Nature of “Traditional” Telecommunications or Telecommunications Services Sold in Conjunction with I-VoIP

In addition to navigating the FCC’s unbundling rules, I-VoIP providers must also grapple with addressing the appropriate methodology to use when it comes to jurisdictional allocations. The 499-A Instructions provide three alternatives for jurisdictionalizing revenue from I-VoIP services: use of the FCC’s safe harbor presumption, use of actual books and records, and use of a traffic study. Determining the proper revenue jurisdictional allocation is particularly challenging for I-VoIP providers

⁸ *Id.* at ¶ 52.

⁹ In any audit or enforcement proceeding, a company using an alternative allocation method must demonstrate that its selected allocation methodology produces a reasonable approximation of the actual interstate telecommunications revenue the company receives and provide evidence that the amount of reported telecommunications revenues complies with the company’s actual contribution obligations. *Id.* at ¶ 53.

offering “peripheral” services in conjunction with an I-VoIP service, such as toll free services, SIP trunking services, and the provision of DIDs, that would normally be considered to be “telecommunications” or “telecommunications services” when offered by a telecommunications service provider. When these services are offered by an I-VoIP provider in conjunction with an I-VoIP service, it is highly likely USAC would expect the revenue from these services to be assessable. What is less clear is how USAC would treat a revenue allocation of this revenue as between the federal and state jurisdiction revenue buckets.

One approach would be to treat the revenue from these services as 100% interstate, provided there is a reasonable and factually supportable basis to support the allocation. While this approach is more straight-forward from an administrative standpoint, the downside is that it creates higher exposure to USF, which can negatively impact a company’s competitive positioning.¹⁰ Further, there is no guarantee USAC would even accept reporting 100% of the revenue as interstate if this cannot be supported by a company’s books and records. Lastly, there is also the risk that states would oppose a revenue allocation that eliminates any recovery of state USF and other regulatory fees.

While state utility commissions have remained generally silent when it comes to asserting their authority over the intrastate revenue allocation of peripheral services sold in conjunction with I-VoIP services, we do not anticipate this silence continuing forever. Eventually, we do expect states that are feeling shortchanged by VoIP service providers whose revenue allocations are tilted too heavily in favor of the interstate jurisdiction to become more active.

One option to hedge against this eventuality would be to allocate revenue from these “peripheral” services consistent with the allocation methodology (and associated percentages) used to jurisdictionalize revenue associated with the I-VoIP service (*i.e.*, safe harbor or traffic study). However, doing so could result in exposure to federal USF and other fees in the event of a USAC audit, as this approach is currently untested.

Therefore, the most conservative approach, but also the most burdensome (depending on the type, nature and accuracy of a company’s records), would be to support any revenue allocations associated with the provision of DIDs, SIP trunking, and toll free service through a company’s actual books and records, *i.e.*, use call detail records or other defensible evidence to support revenue allocation among Interstate and Intrastate jurisdictions.

Each of these options comes with certain advantages, but none are without some risk, especially if not supported by the facts. Ultimately, it is an inescapable truth that, given the uncertainties in the FCC’s rules and lack of clear guidance from USAC (and state PUCs), all service providers must make risk-based judgment decisions on how to report their revenue. We encourage clients to confer with counsel about the risks and benefits of each option in the context of the company’s unique circumstances.

¹⁰ Competitive Positioning refers to the total price of service, including Taxes and Fees, and how total price of service compares to the pricing of similarly-situated competitors. More favorable competitive positioning can be achieved by reducing the exposure of revenue to the Federal USF, which consistently stands at 17% and higher, whereas comparable State USF programs are funded at much lower percentages, generally between 3% and 6%. The less revenue exposed to the higher Federal USF, the better the resulting total retail price of service, the better the company’s competitive positioning.

III. Conclusion

While the informal guidance we received from the Wireline Competition Bureau does not constitute affirmative agency action and is not binding on the Commission, it provides a degree of clarity regarding the appropriate regulatory treatment of vertical features offered in conjunction with an I-VoIP service that would be treated as “adjunct-to-basic” services when offered with a telecommunications service. If at any time the FCC confirms through formal agency action that the adjunct-to-basic line of precedent extends to I-VoIP services, I-VoIP providers must take steps to change their 499 revenue reporting practices accordingly.

Additionally, it is worth noting that most major tax and fee software solutions have created a category of services for VoIP features in their mapping guides. In most cases, services mapped as VoIP features will incur federal USF and other regulatory fees. Thus, providers wishing to treat typical adjunct-to-basic features offered in conjunction with an I-VoIP service as an unregulated information service should carefully review their mapping decisions and resulting outputs. This holds true regardless of whether providers provide such features on a stand-alone basis or as part of a bundled offering.

In summary, the reporting of revenue from practically any communications services in the FCC Form 499 is a complex and challenging process, thanks to the vast areas of uncertainty caused by technological and service delivery methodologies which consistently outpace the FCC’s ability to affirmatively decide on the proper regulatory classification of these services. The “rules” and “instructions” are often unclear (especially to the layperson) or simply incomplete, but neither uncertainty nor incompleteness is an excuse for not putting forth a reasonable effort to comply.

If you are concerned about your company’s FCC Form 499 / USF compliance profile and want to achieve greater peace of mind, contact [The CommLaw Group](#) today and inquire about our [USAC Compliance, Audit Preparation and Defense Practice](#).

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The *CommLaw* Group



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