



Overview of Operational Systems and Professional Services Requirements Necessary to Ensure Compliance with Communications & VoIP Taxation and Regulatory Fees

1 Background

In 2014 there were estimated to be over 300 types of Telecom taxes, fees, charges, and surcharges imposed on potentially 685 different tax bases requiring potentially 48,000 different filings per legal entity across the U.S. in tens of thousands of jurisdictions at the federal, state, and local levels. The vast majority of these impositions currently apply to Interconnected VoIP services and state & local governments continue to extend impositions to I-VoIP services. As such, there is a level of complexity in calculating Telecom taxes that a vendor of traditional sales and use tax products and services would not normally be exposed to.

Some Telecom Taxes are legally imposed on the I-VoIP services customer or user, with the I-VoIP Service Provider acting as the collection agent, and some will instead be imposed on the Service Provider as the seller or the provider of the Telecom services. The difference in the legal incidence of the tax, fee, charge, or surcharge significantly affects a Service Provider's legal and regulatory obligations in regards to passing taxes on to a customer. Either tariff or contractual authority is required to pass on many of the Telecom Taxes. In some cases, Telecom Taxes may not be passed on as their own segregated cost to the customer. It is common in the Telecom industry to pass "prohibited" Telecom Taxes through to customers as part of a regulatory recovery fee (also referred to as a "Cost Recovery Fee").

An I-VoIP Service Provider's accounting, billing, accruals, collections, remittance, and reporting processes must be able to account for these unique recovery fees.

2 The Level and Type of Information That an I-VoIP Service Provider Must Collect from Customers

In order to correctly make taxability determinations and calculate Telecom Taxes, an I-VoIP Service Provider must gather a variety of information from their purchasers. A sample is the type of customer (e.g., business, government, residential).

Interstate and intrastate usage is taxed differently by different jurisdictions (e.g., in some jurisdictions only interstate telecom usage is subject to sales tax and intrastate telecom usage is nontaxable). The location where the customer primarily uses the Telecom services and/or meter usage of those services might be necessary to gather this information. Metering the usage of the I-VoIP service would show the percentage of actual use that is interstate versus intrastate. If metering of the I-VoIP service is not available or either technically or economically cost prohibitive, the FCC publishes "safe harbor" percentages for allocating certain Telecom services between interstate and intrastate usage categories. These FCC percentages are generally utilized by the industry and are often acceptable to state taxing authorities for sale tax

purposes. Telecom services often must be unbundled using the metered information of FCC safe harbor percentages by the tax engine in order to make the correct taxability determinations. These are all items that an I-VoIP Service Provider will have to prepare for and be able to calculate in order to obtain proper taxing decisions.

The customer classification might affect whether the customer is exempt from one or more of the applicable Telecom Taxes. Telecom exemptions are often specific to Telecom Taxes, and sales tax exemptions often don't apply to many Telecom Taxes. Customers holding sales tax exemption certifications generally should still be charged all Telecom Taxes, including sales taxes on Telecom services unless separate exemption certificates are procured for Telecom purposes. Therefore, a provider of I-VoIP service will need to be able to turn off and on each individual tax for each customer, in each jurisdiction.

The following is a sample of potentially partially exempt customer types (Customer Class) for which some, but not all, Telecom Taxes might be exempted depending on the Telecom service and the location:

- Federal Government
- State and Local Government
- Foreign Diplomat
- Member of Indian Reservation
- Non-Profit: Charitable
- Non-Profit: Education
- Non-Profit: Hospital
- Non-Profit: Mental Health Institution
- Non-Profit: Religious

An I-VoIP Service Provider's billing system will need a means to track residential and non-residential customers along with certain exempt and non-exempt business, non-profit or governmental customer classifications that implicate applicable exemptions.

3 **The Required Capabilities of a Tax Engine for Telecom Services**

Most companies in the Telecom industry utilize a Tax Engine that makes Telecom Tax determinations and calculates Telecom Taxes by location. A Tax Engine for Telecom Tax purposes often needs to receive more transaction details and return more imposition-level details than would normally apply in the sales tax world. Further, the actual Telecom content within the Tax Engine often needs to track significantly more information per tax rule than might be required for a Tax Engine that only supports sales and use taxes.

For instance, a Tax Engine to be utilized for Telecom purposes might require the ability to identify tax-rule details such as:

1. Which impositions are imposed on the buyer or the seller;
2. Which impositions are imposed on a regulated versus a non-regulated Telecom vendor;

3. Which impositions cannot be passed onto the customer unless “contractual” authority exists; and
4. Which impositions include (in their taxable basis) other impositions that are treated as revenue streams (including circular application for some impositions).

Due to the complexity of Telecom taxation, “off-the-shelf” Telecom content is generally uncommon and most I-VoIP Service Providers will likely need to configure or customize their Telecom content regardless of the Tax Engine that it selects.

Some smaller Telcos outsource their Telecom invoicing or use an “on-demand” service where the Tax Engine providers maintain and configure the Telecom content to some extent on behalf of their customers. Often, smaller Telcos do not require the significant Tax Engine customizations that larger Telcos perform if they only sell one or two very basic Telecom services.

Commercially available Tax Engines can generally be made to work in any particular environment, but often require modification and extensive configuration. Regardless of which Tax Engine is selected, the I-VoIP Service Provider will need to map their Telecom services to a corresponding product or service code within the Tax Engine (even when using on-Demand services). The product or service code dictates the tax decision matrix utilized by the Tax Engine. Depending on the product or service code that is selected, the Tax Engine might require different data elements to be supplied for Telecom tax determination and calculation purposes.

Before selecting a Tax Engine, an I-VoIP Service Provider should confirm that the Tax Engine vendor’s content aligns with its current and anticipated future Telecom product offerings. The I-VoIP Service Provider will need to consider the data elements that the chosen Tax Engine utilizes for calculating Telecom Taxes and whether or not Unify will be capable of supplying the Tax Engine required details for calculation Telecom Taxes.

4 Primary Invoice Presentation Requirements

Whether directly imposed on the customer or on the seller and then passed on to the customer, many Telecom Taxes should be separately stated on the customer’s invoice. In many cases, specific language must be utilized to identify the impositions. At least one commercial Telecom Tax Engine supports thousands of imposition names to properly identify and name Telecom Taxes on invoices.

Telecom invoice presentation requirements generally require at least the following:

- The imposition name on the invoice needs to be based on the jurisdiction’s mandated imposition name. The Tax Engine should provide the legal or regulatory body’s mandated imposition name in its response to the billing system for use by the billing system when generating invoices.
- Summarized imposition totals can be presented on an invoice by grouping and summarizing imposition amounts based upon the combination of the jurisdiction ID

and the mandated imposition name. Summarizing imposition amounts generally happens for multiple invoice-line items that are billed for the same jurisdiction on an invoice.

Some regulatory bodies require different Telecom Taxes or impositions be grouped or displayed on an invoice using a prescribed format in order to fairly represent the impositions to the customer. For example, in a 2005 Order, the FCC required that where carriers choose to list charges in separate line items on their customers' bills, government mandated charges (mandatory pass-thru impositions) must be placed in a section on the bill that is separated from all other taxes, fees, charges and surcharges.

Similarly, some states specifically require that certain Telecom regulatory fees be presented separately from sales taxes. This state requirement, along with satisfying industry standards, and a history of class action law suits related to Telecom invoice presentation, creates requirements for an I-VoIP Service Provider's tax team to separately categorize at least 10 different types of charges on an invoice.

5 Tax Reporting, Remittance and Document Retention

The report data generated by the billing system and Tax Engine need to provide information for three critical purposes:

1. Ensuring that the I-VoIP Service Provider's Tax department can sufficiently calculate and remit seller "prohibited" pass-thru impositions through their offline processes and also determine and reconcile the G/L accounts;
2. Generating the monthly tax report that will be used in the compliance process, which will then remit the taxes to the appropriate tax authorities and jurisdictions; and,
3. Providing access to all the data required to properly support audit defense.

Each month, the I-VoIP Service Provider's tax team will need to generate a report for the tax compliance process. At a minimum, this report must contain Telecom Tax types, Authorities, tax location, and detailed tax amounts.

It is generally good practice to retain tax-on-tax (or "linked" tax) information in the event an auditor requests to see this information and/or for potential reconciliation needs. Tax-on-tax situations are where a tax is passed on to customers and then that tax gets included in the taxable base of another imposition (within another tax, fee, charge, or surcharge). For instance, New York Telecom Excise Tax may be included in the taxable base of New York State Sales and Compensating Use Tax. It would also be helpful to retain a detailed explanation of how the Tax Engine actually calculates tax.

An I-VoIP Service Provider might also need to modify its accounting processes in order to comply with the many Telecom requirements imposed by Federal, state, and local jurisdictions across the U.S.