

MYTHS & MISPERCEPTIONS EDUCATIONAL ADVISORY SERIES: Topic #1

**De-Mystifying the Regulation & Taxation of  
Telecom, Data & Internet Access Services**

THE MYTH:	<i>Data and Internet Access services are “the same,” and neither is regulated nor subject to transaction taxes (sales, use, excise, utility, etc.).</i>
THE REALITY:	<i>The belief that “Data” and “Internet Access” services are exempt from regulation and taxation is a commonly-held misperception. Regulation &amp; taxation of “Data” and “Internet” services is a grey area of the law. There are varying degrees of regulation and taxation depending on the specific factual details regarding the nature, type, and geographic jurisdiction of the service offering.</i>

There is a widely held belief among businesses (including many service providers, themselves) that *all* non-voice data and Internet Access services are not subject to either regulation or taxation. The origin of this misperception likely derives from decades of “siloes” regulatory and tax frameworks that provided clear delineations for older, “pre-Internet” forms of communications technology. However, technological convergence brought about by the commercial Internet caused such regulatory and tax regimes to lag behind the rapid developments in telecommunications technology, thus revealing a checkerboard landscape where data and Internet Access services may be regulated and/or taxed in some jurisdictions, but not in others.

The purpose of this Educational Advisory is to dispel the Myth & Misperception that *all* non-voice data and *all* Internet Access services are exempt from regulation and taxation, as well as to demonstrate the complexity and fluidity of the laws, regulations and policies governing these issues.

**Regulation of Data and Internet Access Services**

On the federal level, a service is subject to regulation by the Federal Communications Commission (“FCC,” or the “Commission”) depending on its service classification:

- *Information Service* – “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications . . . .”<sup>1</sup>
- *Telecommunications Service* – “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.”<sup>2</sup>

<sup>1</sup> 47 U.S.C. § 153(20).

<sup>2</sup> 47 U.S.C. § 153(46).

- *Telecommunications* – “the transmission, between or among points specified by the user, of information of the user’s choosing, without change in the form or content of the information as sent or received.”<sup>3</sup>

While information services are typically exempt from most forms of “direct” FCC regulation, offerings classified as either telecommunications or telecommunications services are subject to direct regulation, as well as certain state regulations. Providers of telecommunications are considered “private carriers,” and must comply with CALEA, make federal USF contributions/ FCC regulatory fee payments, but are exempt from TRS, NANP, and LNP contributions. On the other hand, telecommunications services providers are considered “common carriers,” and are subject to the full range of Title II regulation, including: disability access (“CVAA”); TRS requirements; consumer privacy (“CPNI”) requirements; E911 mandates; CALEA requirements; LNP/ NANP administration support; annual FCC regulatory fees, and a variety of market entry, exit, asset/control transfer, and discontinuance requirements, among others.

However, determining a service’s classification is not as cut and dry as it may initially seem. For example, many forms of private line services (*e.g.*, VPN, MPLS, even SIP Trunking) have not been formally classified by the Commission, and may be either telecommunications or telecommunications services, depending on how the service provider offers them to consumers. They may also be considered unregulated Internet Access services, *if* not offered on a mass market basis, and *if* the telecommunications transmission is inextricably intertwined with information processing typically associated with accessing the Internet. Mass market Broadband Internet Access Services, on the other hand, were recently deemed by the Commission to be a form of telecommunications service, and are now subject to limited Title II regulations<sup>4</sup> – reversing years of treatment of all Internet Access services as an information service.

What is important to recognize, however, is that point-to-point, raw data transmission services – even when lacking a voice component – are and always have been regulated by the FCC as a form of telecommunications (either private or common carriage, depending on the unique facts associated with the offering).

Sometimes, sufficiently integrating telecommunications with information processing will result in the telecommunications being subsumed by the information service, thus resulting in no direct FCC regulation of the finished, retail information service offering. The Commission determines whether or not a telecommunications service provided in conjunction with information processing will qualify as an information service on a case-by-case basis by scrutinizing the degree to which the basic telecommunications transmission component is “sufficiently integrated” with the enhanced services – often with *ad hoc* results (*e.g.*, audio bridging services qualify as telecommunications or telecommunication services, even when offered with enhanced services<sup>5</sup>). In contrast, it appears that for the moment, collaboration services are considered “sufficiently integrated” information

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<sup>3</sup> 47 U.S.C. § 153(43).

<sup>4</sup> See *Protecting and Promoting and Open Internet*, Report and Order on Remand, Declaratory Ruling, and Order, 30 FCC Rcd. 5601 (2015).

<sup>5</sup> See *InterCall, Inc.*, Order, 23 FCC Rcd. 10731 (2008). However, the Commission found previously that when the telecommunications component is merely “integral” to the data-processing capabilities of a service, then the entire service is deemed to be an Information service. See *Regulation of Prepaid Calling Card Services*, Declaratory Ruling and Report and Order, 21 FCC Rcd. 7290 (2006).

services pending a future decision by the Commission.<sup>6</sup> Until the FCC clarifies the treatment of these types of services, there is at least an argument that any telecommunications component is sufficiently integrated to be considered to be information services.

Thus, the FCC's regulatory treatment of non-voice, raw data transmission services is not as black and white as it initially seems. Instead, there are many exceptions to the general classification of such services as telecommunications, which in turn has a great impact on state regulation and taxation of such services.

### **Taxation of Data and Internet Access Services**

Similar to the federal regulatory treatment of non-voice data transmission services, state and local taxation ("SALT") of such services varies by jurisdiction, and is influenced by an *ad hoc* combination of federal and state law, state tax administrative rulings, and judicial decisions. Also, despite the popular belief that the federal Internet Tax Freedom Act's ("ITFA")<sup>7</sup> moratorium exempts Internet Access services from all transaction taxes, the reality is quite different. Indeed, the ITFA moratorium is: (A) not universal, (B) not absolute, and (C) subject to narrow interpretation, such that the specific facts of each purported "Internet Access" service requires evaluation in light of the statutory language, lest the particular service succumb to SALT.

#### *1. State Taxation of Telecommunications/ Telecommunications Services*

Data transmission services lacking a voice component may be taxable in one state, but exempt from taxation in another.

For example, in 2009 the New York State Department of Taxation and Finance found that communication network services (*e.g.*, value-added network ("VAN") applications, electronic data interchange, electronic mail and messaging services) were telecommunications services subject to both sales and telecommunications excise taxes.<sup>8</sup> In contrast, the Illinois Telecommunications Excise Tax expressly excludes "value added services in which computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission."<sup>9</sup> Furthermore, other states, such as Pennsylvania,<sup>10</sup> tend to align their definition of telecommunications services for the purposes of taxation with the FCC's framework, while other states, such as Washington, base their definition of telecommunications services for taxability purposes *not* upon the federal regulatory regime, but how the state regulatory agency defines such services.<sup>11</sup> Thus, whether a non-voice data transmission service is taxable as a telecommunications or telecommunications service may vary across state lines based on an intricate web of administrative decisions, state laws, and judicial decisions.

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<sup>6</sup> See *In the Matter of Cisco WebEx LLC*, Request for Review of a Decision of the Universal Service Administrator, WCB Docket No. 06-122 (filed April 8, 2013) (requesting FCC's review of USAC decision finding that WebEx's collaboration services were classified as a bundle of collaboration features and separable telecommunications as opposed to a single collaboration service).

<sup>7</sup> Internet Tax Freedom Act, Pub. L. No. 105-277, Title XI (1998), *as amended* ("ITFA").

<sup>8</sup> N.Y. Dept. of Taxn. and Fin., TSB-A-09(17)C (Dec. 15, 2009).

<sup>9</sup> 35 ILCS 630/2(c).

<sup>10</sup> See, *e.g.*, *American Online Inc. v. Commonwealth*, 932 A.2d 332 (Pa. Commw. Ct. 2007).

<sup>11</sup> See *Qwest Corporation v. City of Bellevue*, 116 P.3d 667 (Wash. 2007).

However, an increasing number of states have adopted the uniform definition of “telecommunications service” provided by the Streamlined Sales and Use Tax Agreement (“SSUTA”), which specifically excludes data processing, information services, and Internet Access service from the definition of telecommunications services. However, the SSUTA is specifically limited to sales and use taxes, thus taxability of data transmission services in SSUTA member states may remain for other taxes (*e.g.*, telecommunications excise taxes).

Therefore, the notion that data transmission services lacking a voice component are not subject to state taxation is a myth. In reality, the fact is that such services may be taxable in one state for certain forms of taxes, but be entirely exempt from all taxation under other state laws, administrative decisions, and judicial rulings.

## 2. *State Taxation of Internet Access Services*

While the ITFA generally exempts Internet Access services from state and local taxation, there are at least two exceptions to this rule where Internet Access services may be subject to taxation.

For the purposes of the moratorium, the ITFA defines Internet Access services as: “A service that enables users to access content, information, electronic mail, or other services offered over the internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users.”<sup>12</sup> Telecommunications services are specifically excluded from this definition – except to the extent that telecommunications services are used by the Internet Access provider to provide Internet access, then such services are *not* taxable.

However, there are two important exceptions to the ITFA’s moratorium on the state and local taxation of Internet Access services:

- *The “Accounting Rule”* – This rule states that Internet Access services may be taxable in cases where they are *aggregated* with telecommunications service charges or other taxable charges on a customer’s bill *unless* the service provider can reasonably disaggregate the Internet Access charges.<sup>13</sup>
- *Grandfathered States* – Ten states (Connecticut, Iowa, New Mexico, North Dakota, Ohio, South Carolina, South Dakota, Tennessee, Texas, and Wisconsin) and the District of Columbia are exempted from the ITFA, and are therefore permitted to tax Internet Access service because they imposed and enforced such taxation *prior* to the ITFA’s enactment in 1998.<sup>14</sup>

Thus, the idea that ITFA completely exempts Internet Access services from state and local taxation is a myth. In reality, Internet Access services may be subject to taxation depending on the state in which such services are offered, and whether these services are aggregated with other taxable communications services.

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<sup>12</sup> ITFA at § 1104(5).

<sup>13</sup> *Id.* at § 1106.

<sup>14</sup> *Id.* at § 1101(d).

## **Summation**

As this Educational Advisory illustrates, the notion that non-voice data transmission and Internet Access services are not subject to either regulation or taxation is a Myth & Misperception held by many industry participants. In reality, technological convergence over the past few decades has led to the complex regulatory and tax landscape seen today: where the legal status of a service is dictated by an intricate maze of statutes, administrative rulings, and judicial decisions existing across numerous federal, state, and local regulatory and tax jurisdictions.

Thus, service providers of data and Internet Access services should always consult with experienced legal counsel regarding the taxability and regulation of their specific service offerings, packages, and bundles of services to determine the appropriate treatment in each unique and discrete jurisdiction.

## **Contact Us for Assistance**

Analyzing the tax and regulatory ramifications of your company's data and Internet Access services is a complex endeavor. But the long-term risks of neglecting this important step can be disruptive and economically catastrophic.

Attorneys in The *CommLaw* Group's [Communications Taxes & Fees Practice Group](#) can help you unpack and understand the myriad issues, and how they may impact your business. Moreover, our Attorneys can assist in the development of practical and pragmatic strategies that will enable, and not inhibit, your company's ability to take full advantage of marketplace opportunities while mitigating exposure to regulatory and/or tax enforcement agencies.

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