

MYTHS & MISPERCEPTIONS EDUCATIONAL ADVISORY SERIES: Topic #2

**Regulatory and Tax Responsibilities for Retailers/  
Suppliers of Telecommunications Services**

THE MYTH:	<i>Retailers of resold telecommunications services do not need to register and/or pay taxes and regulatory fees if their Supplier has already done so.</i>
THE REALITY:	<i>Retailers of resold telecommunications services remain responsible for registration and payment of taxes and regulatory fees regardless of their Supplier's conduct.</i>

There is a common misperception that retailers of resold telecommunications services (*i.e.*, resellers) do not need to pay taxes and regulatory fees (*e.g.*, USF fees) directly to government agencies so long as the reseller is paying the taxes and fees passed through by their suppliers (*i.e.*, wholesalers). More than likely, this myth derives from a misperception regarding the general prohibition on “double taxation,” and also a fundamental misunderstanding of the supply-chain Tax and Regulatory Fee exemption system that is operative in jurisdictions throughout the United States.

The reality of the Tax and Regulatory Fee exemption system is that retailers generally bear the burdens of billing, collecting, and remitting taxes and regulatory fees on sales of telecommunications or telecommunications services to their end-user customers *regardless* of whether or not: (A) the retailer has already paid taxes and fees billed by their suppliers (*i.e.*, pass through charges); and/or (B) the retailer’s suppliers has already paid taxes and regulatory fees for the same services.

The purpose of this Educational Advisory is to dispel the Myth and Misperception that retailers of resold telecommunications services (including VoIP) do not have any registration or remittance obligations for taxes and regulatory fees if/when either: (A) the retailer paid taxes and fees to their suppliers; and/or (B) their suppliers are registered, and are remitting taxes and regulatory fees for the same services – based on sales to resellers.

**Regulatory Fees**

At the federal level, the issue of whether retailers and/or suppliers of telecommunications services are responsible for federal regulatory fees is most apparent in the regulations governing federal Universal Service Fund (“USF”) contribution obligations.

Generally speaking, revenues from end-user interstate telecommunications services are subject to USF contribution obligations – including resold services.<sup>1</sup> In order to prevent duplicative USF contributions, the Federal Communications Commission implemented the so-called “Carrier’s Carrier

<sup>1</sup> See 47 C.F.R. § 54.706.

Rule" ("CCR"),<sup>2</sup> which exempts wholesalers from contributing to USF on the basis of wholesale sales if they are "reasonably" certain that their reseller customers are contributing to the USF based on the telecommunications actually purchased from that wholesaler. However, if the wholesaler does *not* have a reasonable expectation that the reseller is contributing to USF, *and* the reseller fails to pay, then the wholesaler is liable for the fee.

In reality, compliance with the CCR involves complex and potentially costly verification procedures for service providers. Moreover, failure to follow such verification procedures may lead to USF contribution obligations for *both* the retailer and supplier:

- Wholesalers – If a wholesaler (*i.e.*, supplier) fails to demonstrate that it has a "reasonable expectation" that its reseller customer (*i.e.*, another reseller, retailer) is remitting USF, then the *wholesaler must report these revenues as retail end-user revenues*, and *becomes vicariously liable for any resulting USF fees if "wholesale" revenues are subsequently reclassified as retail end-user revenues*. Alternatively, a wholesaler is *exempt* from USF contributions on the basis of wholesale revenue if they are "reasonably certain" that either: (A) *the reseller customer is contributing to USF*; or (B) *customers of the reseller are contributing to USF*.
- Resellers – If a reseller of wholesale telecommunications services is unable to prove a USF exemption, then the reseller is *responsible for USF pass through charges from its wholesaler<sup>3</sup> in addition to any direct USF contribution obligations the provider may have* (*i.e.*, revenue derived from end-user interstate telecommunications services). Alternatively, a reseller is *exempt* from pass through charges from its supplier if the provider can prove a USF exemption. However, a reseller *remains responsible for any direct USF contribution obligations that the provider may have*.

Thus, at the federal level, it is clearly a myth that retailers of resold telecommunications services are exempt from USF reporting and contribution obligations if their supplier registers and contributes to USF for the same service ultimately provided to the end-user customer. In reality, retailers are *primarily responsible* for USF contribution obligations as they generally must contribute to the Fund based on end-user interstate telecommunications (including I-VoIP) revenue, and may be *additionally* liable for pass through USF charges from their suppliers if a supply-side exemption cannot be proven to the satisfaction of the applicable FCC rules and USAC policies.

## **Taxation**

As with federal regulatory fees, retailers of resold telecommunications services may be subject to state and local taxation ("SALT") regardless of whether their suppliers remitted such taxes. The reason for this is threefold:

- (1) The taxable event is generally considered by state and local tax authorities to be the retailer's sale of services to end-user customers;
- (2) Some states view the resale and retail components of a telecommunications service to be *separate taxable events*; and

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<sup>2</sup> See, *e.g.*, *Universal Service Contribution Methodology*, Order, 27 FCC Rcd. 13780 (2012).

<sup>3</sup> Wholesalers may generally pass through USF contribution obligations to their reseller customers.

- (3) Similar to the USF, many states require resale certificates in order for service providers to be exempt from taxation.

While the first reason is fairly straightforward, the latter two reasons are more nuanced, and are explained in more detail below:

1. *Separate Taxable Events*

Some states and localities consider the sale of wholesale and retail telecommunications services to be separate, taxable events, while others take the view of the end-user customer that the wholesale and retail components are part of an integrated telecommunications service – such that the taxable event does not occur until the sale of the service to the end-user customer.

For example, the Colorado Court of Appeals in *AT&T Communications of the Mountain States Inc. v. City of Boulder*<sup>4</sup> dismissed AT&T's argument that the purchase of access services from a local exchange provider ("LEC") constituted a wholesale transaction that was exempt from the city's sales tax. The Court concluded that AT&T never resold the access charges as part of its long distance service, as the charges merely enabled AT&T to use the LEC's equipment. Thus, the transaction constituted the purchase of *tangible property*, and not the purchase of *resold services* – which would otherwise have been exempt from the local sales tax.

In contrast, the Finance Department of the City of Greeley, Colorado ruled that a provider's sale of 900 services to an information service provider constituted a wholesale transaction. The Department concluded that the transaction was a component of the final service provided to the consumer, which was taxable *unless* the information service provider could delineate the wholesale and retail service amounts.<sup>5</sup> Similarly, the Massachusetts Department of Revenue found that the wholesale sale of 900 services was taxable as an integrated component of the service when viewed from the consumer's perspective – *unless* the charges could be separately stated by the reseller.<sup>6</sup>

Therefore, the notion that retailers are always exempt from taxation if their suppliers register and remit SALT is a myth. In reality, in some states *both* retailers and wholesalers may be subject to taxation for the same telecommunications service ultimately provided to an end-user customer, while other state and local tax administrators determine taxability from the customer's perspective – leading to a patchwork of tax obligations across numerous state and local taxing jurisdictions.

2. *Resale Certificates*

In addition to employing different perspectives on the taxable components of a telecommunications service, many states require service providers to prove their tax exemption status through the submission of a valid resale certificate. This is the approach adopted by the New York State Department of Tax and Finance, which requires such wholesalers to present a resale certificate to its reseller customers within 90 days of providing services – or be subject to the New York

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<sup>4</sup> 506 P.2d 53 (Colo. Ct. App. 1988).

<sup>5</sup> See Greeley, Colo. Dept. of Finance, *In re AT&T Communications of the Mountain States* (Sept. 6, 1994).

<sup>6</sup> See Mass. Dept. of Rev., *Technical Information Release*, No. 1991-1 (Mar. 29, 1991).

Telecommunications Excise Tax.<sup>7</sup> Additionally, some states require resale certifications to be submitted on an annual basis – specific to the tax type. For example, Florida requires service providers to submit separate Florida Sales and Use Tax and Florida Communications Service Tax exemption certificates on an annual basis.<sup>8</sup>

Thus, many state and local tax authorities employ tax exemption certifications for telecommunications service providers in many different ways, *e.g.*, limiting the exemption to either wholesalers or resellers, or by tax type. Therefore, in reality, whether a retailer of resold telecommunications services is subject to SALT can depend on a combination of the tax type, provider classification, and the specific jurisdiction.

### **Summation**

As this Educational Advisory illustrates, the notion that retailers are exempt from taxes and regulatory fees if their service suppliers pay taxes and fees for the same services ultimately delivered to an end-user customer is a Myth & Misperception held by many industry members. In reality, retailers of resold telecommunications services generally bear the primary tax and regulatory fee obligations, regardless of the conduct of their suppliers.

Thus, retailers of resold telecommunications services should not hesitate to consult with legal counsel regarding the taxability and regulation of its services in a specific jurisdiction.

### **Contact Us for Assistance**

Analyzing the tax and regulatory ramifications of your company's resold telecommunications 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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<sup>7</sup> N.Y. State Dept. of Tax'n and Finance, *Resale Certificates for Certain Telecommunications Purchases*, TSB-M-09(2)C (Jan. 12, 2009).

<sup>8</sup> Fla. Dept. of Revenue, *Communications Service Tax*, GT-800011 (2015).

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