

Written Testimony of

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The VoIP Sourcing: The sourcing of VoIP for the purpose of state and local taxation

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Chairman Cohen, Representative Franks, and members of this subcommittee, thank you for this opportunity to testify on an issue of significance to millions of consumers, businesses, and state and local governments across the United States. The emergence of new technologies in the telecommunications industry has accelerated over the past two decades. Our industry is in the opening phases of another technological shift in how we provide telecommunications service to our customers. The technological shift involves the transition from traditional fixed location, circuit-switched landline service to voice over internet protocol or VoIP that is mobile.

VoIP technology allows providers to use the Internet and private Internet Protocol networks to provide voice telephone services to our customers. This technology is more efficient for providers because telecommunications capacity no longer requires a dedicated line from a household to the public switched telephone networks, while allowing customers greater flexibility and convenience. With opportunities and advancement, however, we are confronted with fitting this new and dynamic service into existing tax laws. The tax laws were written for services that had a fixed service location and phone numbers that identified a designated geographic location. The wireless providers had similar issues with fitting mobile services into existing tax laws prior to enactment of the Federal Mobile Telecommunication Sourcing Act or MTSA in 2000. The MTSA is one of the great success stories in both clarity and cooperation between our industry and state and local governments. The MTSA (4 USC Sections 116-126) provides clear and simple guidance for the sourcing of wireless telecommunications services for purposes of taxation. The MTSA “sources” wireless telecommunications services to the customer’s place of primary use. The industry is here to advocate the same sourcing rule for VoIP services

Traditionally, the answer to the question of which state and local jurisdiction has the authority to tax interstate telephone service is well settled. The U.S. Supreme Court decided in *Goldberg v. Sweet*, 488 US 252 (1989), that the taxing location of a call should follow what the industry refers to as the “two out of three rule”. If two out of three of the following points for a call, origination or termination and service address, are in a single state, then that state has the sole legal authority to impose tax on the call. For local telephone service that is static, the service address is always the taxable location because the service always originates from the service address. *Goldberg* and service address provide a clear rule for telecommunications companies charged with the collection of various state and local sales, telecommunications, emergency 911, and other

taxes as to which state and local taxing jurisdictions have the authority to tax. Furthermore, it provides these state and local governments with assurances regarding collection and remittance of this important revenue stream.

Goldberg and service address, do not, however, work for VoIP service. First, it is not possible for VoIP providers to comply with Goldberg and service address for a service that is not always provided at a fixed location and for which the telephone number may or may not have a geographic connection to the actual location where the VoIP service originates. VoIP customers generally have the option to choose an out of area telephone number. This may be done, for example, if you live in DC but your family members live in TN. If you purchase VoIP in DC with a TN telephone number, your family members can call you without incurring long-distance charges. Many VoIP services are “nomadic” or mobile in nature, in other words, they are services that can be originated anywhere that there is a broadband or high speed Internet connection. There is no fixed origination, termination, or service address. Additionally, VoIP is most commonly sold as a flat monthly charge for the service rather than on a call-by-call basis. Finally, most VoIP calls do not generate a “call detail record” that has any relation to the geographic location of the customer making the call. Many times the only information available to the telephone provider is an IP address or if a telephone number is provided, it may or may not relate to the geography of the caller. When no geographic location information is contained in the call detail record, the providers are unable to apply the Goldberg rule. Again, the VoIP sourcing issues are very similar to the wireless sourcing issues prior to the MTSA; however, VoIP providers have even less geographic location information than the wireless providers.

The issue of VoIP sourcing is further complicated by E911 routing database requirements. Currently, federal law requires VoIP providers to obtain from customers their location for purposes of identification of the correct E911 emergency communications centers. For example, a VoIP customer here in Washington, D.C. would provide his or her physical location to his or her VoIP provider, who in turn provides that location to the local public safety answering point for purposes of dispatching first responders in the event of an emergency. However, if that individual takes his or her nomadic VoIP device on a trip to Memphis, Tennessee, the individual is required to notify his or her provider of the new location so that it can be provided to the local public safety answering point for dispatch of responders in the event of an emergency. This makes perfect sense; however, it raises an interesting issue for tax purposes. Who has the authority to levy tax on the calls? Washington, D.C.? Memphis, Tennessee? Furthermore, the E911 location systems don't normally have a connection to the billing system that actually calculates the taxes. Although a provider may have a physical location for E911 purposes during the month, that information is not normally available in the billing systems without substantial programming. Finally, when the locations change throughout the month, it is not practical or feasible to prorate taxes or fixed line charges for 5 days in TN and 20 days in DC and 5 days in NY. Certainty is needed with respect to what location to use for purposes of calculating taxes, fees and charges.

Under the Streamlined Sales Tax Agreement that has been adopted by approximately 22 states, the place of primary use would apply to VoIP services but not all states have adopted the SSTP and the SSTP does apply to other taxes, fees and charges that are not sales taxes.

Under the VoIP Sourcing Act, the jurisdiction designated by the customer as their PPU, and applied by the VoIP provider in good faith, has the sole authority to levy taxes, fees or charges on amounts billed for VoIP services. Thus, if a user has a Washington, D.C. place of primary use, Washington, D.C. has the authority to levy tax on VoIP service charges to that user. This applies whether the user is making a call across the street in Washington, D.C. or is making a call while traveling in Tennessee, Arizona, or Kansas. As long as the service providers use an electronic database developed by a state or a designated database provider, enhanced zip code and applying due diligence or an alternate jurisdiction designated method to an accuracy level of 95%, the service providers are held harmless from retroactive taxes, fees or charges. If a tax jurisdiction determines a place of primary use is not correct, the Act outlines a procedure for notifying the VoIP provider and for the VoIP provider to make appropriate changes prospectively. The existing MTSA has been successful at providing clarity to the wireless service providers, the customers and the taxing jurisdictions. Expanding to MTSA to VoIP is sure to be just as successful.

By allowing only the jurisdiction identified by the customer as his or her place of primary use (PPU) to tax VoIP services, multiple taxation or “nowhere” taxation scenarios would be avoided. This protects state and local governments and reduces disputes regarding the proper tax sourcing location. This Act does not determine the taxability of VoIP services; it only identifies which tax jurisdiction can tax VoIP services if their law subjects VoIP services to tax. Furthermore, the Act protects consumers by ensuring that taxes based upon “lines” of service, such as flat rate taxes to fund E911 service, are only imposed upon the number of lines that provide simultaneous inbound or outbound access to the public switched telephone network.

The VoIP industry is facing an important deadline on this issue as billing systems have to be modified and developed and certainty is needed in order to program the proper tax sourcing functionality. VoIP technology will become exponentially more prevalent in the coming years. In order to have clarity for state and local governments and VoIP service providers, and fairness and simplicity for consumers and businesses, VoIP services should be sourced according to the user’s place of primary use in every state. The simplest and most efficient way to accomplish this is to expand the scope of the existing MTSA to include VoIP services as has been done with the VoIP Sourcing Act.

Mister Chairman and members of the subcommittee, thank you again for the opportunity to testify on this important subject, and I respectfully urge you to pass legislation that would extend the mobile telecommunications sourcing act to include VoIP services.