Communications Tax Impacts of VoIP Services

Voice over Internet Protocol (VoIP) is officially everywhere. From conference rooms to living room couches, it's become a communication method of choice — both at home and at work. Tens of millions of users rely on an array of VoIP-powered services, from audio confer- encing to video chats to digital calls, to meet with remote employees, communicate with clients, provide customer support or simply catch up with friends and family.

The drive toward VoIP services is here to stay. Depending on the type of service, there are often no complicated phone bills to worry about, no long-distance calling fees, and little equipment to invest in. For users, VoIP is a hassle-free, simple solution.

However, the same cannot be said for VoIP providers— particularly when it comes to taxes and regulatory fees. There is an array of variables that can impact tax determination, calculation, and, ultimately, compliance. And as state and federal regulators continue to scrutinize the service, additional regulations further complicate what's already a complex process.

This white paper serves to help VoIP providers understand what's at stake from a communications tax perspective and plan accordingly.

VoIP Defining Factors

At its core, VoIP is relatively easy to define. A system for converting voice analogue signals to a digital format that can travel over the internet, VoIP makes it possible to conduct voice calls using a work or home internet connection. Some VoIP services allow users to call others using the same service; others enable calls to virtually any long distance, wireless, or international phone number. While many of these calls are made from computers, they can also be made from special VoIP phones, traditional phones with adapters, and wireless phones. But while the method for delivery may differ, the overarching service is the same.

From a tax perspective, the definition of VoIP gets murky. This is be of communications tax (and regulatory fees) that apply can vary greatly depending on the ways the service is provided. Namely, there are two key elements that impact many

#1 Static VoIP Versus Nomadic VoIP

With static VoIP, calls are made from a fixed address, such as a private communications network, that makes it feasible to identify the origination point of VoIP calls from that service location. Static VoIP often uses physical infrastructure installed at the premise on a semi- permanent basis.

With nomadic VoIP, subscribers can make calls from any broadband internet connection—meaning a call may originate from, or terminate at, any location. From a tax and regulatory perspective, this can make it impractical, if not impossible, to identify call locations and separate out the intrastate and interstate portions of VoIP services for compliance with state and federal rules and regulations.

#2 Interconnected VoIP vs Non-interconnected VoIP

Non-interconnected VoIP, sometimes referred to as “Peer- to-Peer” VoIP, is a service that allows the user to contact other users operating the same VoIP software. However, the service does not allow the customer to make and receive calls from the public switched telephone network (landline phones and cell phones).

Interconnected VoIP, on the other hand, generally allows users to make and receive calls from a regular telephone network.

VoIP Tax Implications

To remain compliant, it’s critically important to understand what types of service deliveries will make a provider liable for which specific communications taxes and regulatory fees.

Generally speaking, there’s more to consider with nomadic VoIP services than with static VoIP—and regulatory fees are where the biggest difference lies. When the origin of a call isn’t definitive, there may be less ground on which to stand from a state regulatory fee perspective. Similarly, compliance issues will differ significantly based on whether a VoIP service is interconnected or non-interconnected.

When a VoIP service is considered interconnected, several FCC regulations and complex requirements can come into play. For example, interconnected VoIP providers are typically required to:

- Comply with Local Number Portability (LNP) rules
- Contribute to the Telecommunications Relay Services Fund (TRS), which is used to help provide communications services to people with speech or hearing disabilities
- ContributetotheUniversalServiceFund(USF),which supports communications services in high-cost areas and for income-eligible phone subscribers

In contrast, non-interconnected VoIP may be subject to less state and local tax. These services are usually not required to contribute to the USF. And because they often don’t include 911 functionality, local 911 fees do not apply.

Meanwhile, all types of VoIP services can make providers subject to b regulatory reports, including the FCC 499-A, an eight-page federal regul preceded by 50+ pages of instructions. This form collects categorized re data from VoIP providers to determine USF, TRS and other federal contr obligations. At the state level, things can get even more complex. States are free to state to another.

VoIP Compliance Tips

With so many disparities in the way VoIP taxation and regulatory obligations take shape, providers must take proactive steps to remain compliant. Here are three key steps all communications service providers (CSPs) would be wise to take:

1. Categorize revenue for reporting.

Many providers overlook this important step when starting out, which involves asking questions such as:

- What are our reporting requirements?
- Have we properly categorized revenue for that reporting?
- Haveweaccountedforeverypossibleclassification?

When processing transactions, it's imperative to be thoughtful about what information is collected, how it's summarized, and where it's stored in each of your various financial and reporting systems. Without a high level of detail, it can be a real struggle to pull all of the required information necessary for completing end-of-year communications tax filings.

Many reporting requirements and regulatory forms are so complex that they can take days or weeks to comprehend and complete. By ensuring categorization is set up correctly from the outset, providers can migrate the correct categorized information from the general ledger to the company's tax reporting engine for immediate analysis.

2. Approach safe harbor with caution.

Many regulatory obligations, including the Federal USF, require CSPs to report separate interstate and intrastate revenues—a particular challenge if you sell bundled calling The Federal Communications Commission (FCC) introduced safe harbor ratios as an option to simplify calculation and remittance for companies struggling to determine which portions of revenue come from interstate calls.

Here's how the agency describes the option:

"Wireless telecommunications providers and interconnected VoIP providers that choose to avail themselves of these safe harbor percentages for interstate revenues may assume that the FCC will not find it necessary to review or question the data underlying their reported percentages."

However, the current safe harbor ratio for VoIP is 64.9% interstate, which may be significantly higher than actual interstate revenue sources for some providers. Before a decision is made to rely on the FCC for nomadic VoIP services, it's a good practice to first conduct an internal traffic assessment to determine how much revenue is generated by interstate voice calls.

3. Update automated processes for accuracy.

When determining which tax rates and regulations will apply, there are critical questions to ask:

- Is theVoIPserviceinterconnectedornon- interconnected?
- Is it static or nomadic?
- Cantheservicebeassociatedwithstatic IPaddresses, or is it "over the top"?

- Can a bundled VoIP service be unbundled to have a lighter tax treatment applied?

This list goes on, and includes many more factors to consider at the state and local levels. With so many discrepancies, it's important to use a tax engine that's capable of determining the correct taxes and fees. It's less about automating the calculations, and more a matter of ensuring the correct calculations are applied. As state and federal regulations catch up to the technology, VoIP requirements change constantly. Remaining compliant requires a communications tax engine that's constantly researched, validated, and updated with the most current tax rules and rates.

VoIP Complications

The challenges outlined above are not limited to CSPs alone, but are increasingly faced by companies in a variety of industries. As these businesses begin to offer VoIP services for customers, they must be prepared to handle the resulting increased tax complexities.

For example, consider the SaaS company that decides to begin integrating in-app VoIP calls into its sales software. Rather than placing a traditional or wireless phone call, the customer can make instant connections via a VoIP "click- to-call" service. They simply click on a number from within the platform to initiate a voice call.

If the company does not already offer communications services, the tax team might assume that state and local communications taxes will not apply to these non-interconnected calls. But that may not always be the case, especially if the customer incurs an additional cost by using the VoIP service. And if the company uses a tax engine that hasn't been updated to reflect communications tax law, there may not be a safeguard in place to catch the oversight. As a result, missed tax liabilities could eventually result in steep fines and penalties as well as increased audit risks.

Even among experienced CSPs, it can be easy to misinterpret regulations as they relate to complex setups and relationships. For instance, many VoIP providers will pay a vendor fee to have 911 functionality integrated, and assume that those payments cover state and local 911 fees. However, in many instances it's a private vendor that's being compensated and not the actual 911 administration. The charge might look like a government fee on an invoice, when in fact the provider remains (unknowingly) on the hook for ensuring the actual government fee gets paid.

A Streamlined Solution

Regardless of what type of VoIP service a company provides, one thing is certain: To remain in good standing, providers must rely on continual research to ensure the latest rates and requirements are reflected in every filing and form. A lack of knowledge is never a sound defense for non-compliance, no matter how new you are to the communications tax industry or how complicated communications tax law may be.

The secret to ensuring communications tax accuracy lies in automation and expertise. With a system that's continually updated, CSPs never need to worry ab
complications in VoIP tax calculations. And when it comes time to file, r
services experts are meticulous about managing tax filings.

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