Statement of

James R. Eads, Jr.
Executive Director
Federation of Tax Administrators

Before the
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
United States House of Representatives

March 31, 2009

Hearing: VoIP: Who Has Jurisdiction to Tax It?

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VoIP: Who Has Jurisdiction to Tax It? Regarding Proposed Legislation that May be Introduced by Mr. Cohen to Amend Title 4 of the United States Code to Apply the Sourcing Requirements for State and Local Taxation to Voice over Internet Protocol Services, and for other purposes.

March 31, 2009

Chairman Cohen, Ranking Member Franks and Members of the Subcommittee:

The Federation of Tax Administrators (FTA) is an association of the principal tax and revenue collecting agencies in each of the fifty states, the District of Columbia and New York City. Its purpose is to improve the techniques and standards of tax administration through a program of research, information exchange, training, and representing the interests of state tax administrators before the Congress and the Executive Branch.

The Federation of Tax Administrators appreciates this opportunity to appear before you to discuss possible changes to Title 4 of the United States Code that would apply sourcing requirements for State and Local Taxation to Voice over Internet Protocol Services. The Federation is receptive to some of the concerns the industry has raised regarding this issue and hopes to be able to find a way to alleviate those concerns before any legislation is considered for action. However, we are not supportive of some of the suggestions being advocated.

Our concerns about possible legislation in this area are two-fold. First, those advocating the application of the principles of the Mobile Telecommunications Sourcing Act to Voice over Internet Protocol services are proposing unnecessary changes to that Act, a law that was enacted a relatively short time ago and that represented a collaboration of parties with multiple interests. The Federation of Tax Administrators cannot support changing settled law when the changes do not appear to relate to Voice over Internet Protocol Services, which was our understanding to be the issue to be addressed. Even if a provision relates to VoIP, it should also relate to sourcing only. Second, FTA opposes restrictions on the ability of states to enact and administer their own taxes in ways that suit their unique needs without a demonstrated necessity for doing so, as is being proposed by industry.

If Congress legislates in this area, the public's interests as well as those of the states and industry must be balanced. A primary consideration is to maintain the administrability of the current sourcing rules. Settled principles of law upon which individuals, businesses and the states have come to rely should not be changed unless circumstances strongly require such change. Many of the proposals being advocated would unsettle the law without reason and lead to wholly unnecessary interpretive conflicts that can be exploited. This is the kind of intrusion into state authority and the disruption of state revenue systems, particularly during this time of severe economic stress that Congress should reject.

Concerns with the Proposed Legislation

In 2000 Congress approved and President Clinton signed into law the Mobile Telecommunications Sourcing Act (P.L. 106-252). The Act was intended to address, for transactional tax purposes only, the problem of determining the situs of a wireless telephone call, which had proven to be difficult under normal standards of sourcing transactions. The Act addresses this problem by sourcing all wireless calls and mobile telecommunications services to the "place of primary use" (PPU), which will essentially be the customer's residence or business address. Only the state and/or sub-state taxing jurisdictions encompassing the PPU could tax the calls or service.

The Act provides a mechanism for assigning PPUs to taxing jurisdictions. It further provides, in Sections 119(c) and 120(a), that a wireless carrier will be held harmless against errors that might occur in such assignments if one of the two designated methods of assigning the PPU is used.

The FTA, the industry and other interested parties worked to establish a compromise law that, if it did not give everyone what they wanted, at least achieved a solution that is workable and generally acceptable. Some of the ideas for change being advocated do not relate to Voice over Internet Protocol (VoIP) Services or even appear to address sourcing. The rationale for these changes is not apparent and represents a departure from the much discussed and ultimate accommodation among competing interests that resulted in that legislation being passed in 2000. These changes represent an effort to rewrite what the states view as relatively useful and settled principles.

Some examples of proposed modifications to settled law that do not relate to issues of VoIP or sourcing as enacted in the MTSA are:

1. An expansion of the charges from which the providers would be held harmless from the current law's "any tax, charge, or fee liability in such State," to now include "any disallowance, claim, liability, including but not limited to taxes, charges, fees, penalties or interest that otherwise would be due or could be asserted" (with "in such State" deleted). The rationale for this change is not apparent. If it is necessary it would appear that the change enlarges the scope of matters from which service providers would be held harmless, yet there is no evidence of which FTA is aware to justify this change. It would open the door to

interpretative questions as to what is covered and lead to originally unintended tax avoidance at worst and customer, industry and governmental confusion at best. For example, 911 fees and other charges might be "deemed" to be charges that are to be sourced to the principal place of use, when that is not the current law under MTSA

2. A provision apparently unrelated to sourcing that would impose a limit on taxation of multiple VoIP service lines, in that it provides that there is a limitation on certain fixed charges. It provides that to the extent a tax, charge or fee levied by a taxing jurisdiction is a fixed charge per VoIP service line, it shall be levied on no more than the number of VoIP service lines on an account that are capable of simultaneous unrestricted outward dialing. The necessity of such a restriction on taxing jurisdictions is not clear, especially in view of the fact that the existing MTSA law provides that it does not modify, impair, supersede, or authorize the modification, impairment, or supersession of the law of any taxing jurisdiction pertaining to taxation except as expressly provided in sections 116 through 126 of this title.
3. A change to the existing MTSA to apply to state Universal Service Fund payments is also proposed. This changes bears no relationship to VoIP and it is unclear why it is a sourcing issue. Even if there is some relationship, it is a change to existing law that was the product of compromise and agreement in 2000. The application of MTSA to revenues other than those which were agreed upon, without some credible reason that can be considered by the parties who negotiated in good faith to enact MTSA, will lead to misunderstanding and could lead to litigation. If the entire MTSA is to be opened up, state tax administrators could have some changes they might propose.

Absent justification for changing P.L. 106-252 in ways unrelated to Voice over Internet Protocol or addressing issues to taxation unrelated to sourcing, the Federation of Tax Administrators believes that these changes are unjustifiable policy options and should not be considered for enactment. Unsettling current law without a compelling reason that can be understood by the courts will lead to litigation which could consume years.

State Tax Sovereignty

Many of the changes sought by industry are an intrusion into state tax sovereignty. If enacted, that would arbitrarily circumscribe the ability of the states to structure their taxes in the most efficient and appropriate ways based on the considerations and action of their elected representatives and chief executives. While some might consider the concept of state tax sovereignty to be esoteric, it is fundamental to our system of federalism and to the operation of states. Determination of their fiscal destiny is a core concept of the existence of the states. Within their sphere of responsibility, states are able to define the level of government services they desire. Further, they are, within the bounds of the United States Constitution, free to tax the activities occurring within the state to finance those services. The two responsibilities go hand in hand.

The importance of state tax authority to state sovereignty and our federal system virtually requires that Congress tread lightly in limiting the authority of the states and do so only

on a showing of compelling need and only after balancing an array of significant and appropriate interests.

Federation of Tax Administrators Policy Statement

The FTA has addressed this specific issue of telecommunications tax policy as long ago as 2006, when a resolution was adopted by the membership at its annual meeting that says in pertinent part:

"WHEREAS, many states have specifically included VOIP, and have included other electronic products and services in their tax bases, and

WHEREAS, taxation of telecommunications and related products and services provides a critical pillar in the foundation in the state fiscal systems, therefore let it be

Resolved, that as Congress considers updating federal telecommunications laws, it refrain from adopting provisions that limit or abrogate states' rights to apply their taxes to Voice Over Internet Protocol and other electronic products and services in a rational and evenhanded manner, and be it further

Resolved, that given the dramatic changes in the nature of the communications services available to U.S. consumers and in the entities and manner by which such services are provided, states should examine their taxes on communications services and electronic products and services to ensure that they are applied in a rational and evenhanded manner." (Resolution 24, adopted June 7, 2006).

Conclusion

The issues addressed by this proposal are complex and in need of thoughtful consideration by all of the parties with an interest in making tax administration more straightforward and compliance simpler. That being said, those complex issues deserve careful consideration so that the solution does not become more complex than the problems and result in tax economic and administration turmoil.