Forecasting the Next Wave of Telecom Tax Litigation

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Agenda

- Separate Statement Requirements
- Anti-Absorption Laws
- Consumer Protection
- Tax-Inclusive Billing Models
- ITFA and State Taxation of Internet Access
Separate Statement Requirements

- Current law reflects the use of historic, more traditional receipts
  - Contemporaneous cash register receipts
  - Detailed paper bill

- Many states require tax to be separately stated on customer invoices
  - “The required amount of the tax collected by the vendor from the purchaser shall be displayed separately upon the check, sales slip, bill, receipt, or other evidence of sale.” Ark. Code Ann. § 26-53-124.

- Some states generally allow for tax to be included
  - “The amount of tax imposed under this act on a sale either shall be separately stated on the invoice or billing or the invoice or billing shall bear the statement: ‘All applicable sales tax is included.’” KS: Kan. Stat. Ann. § 79-3648.
Some states require the use of specific language to describe certain taxes on a bill in addition to the tax being separately stated.

- “Each dealer who makes retail sales of communications services shall add the amount of the taxes imposed or administered under this chapter to the price of the services sold by him or her and shall state the taxes separately from the price of the services on all invoices. The combined amount of taxes due ... shall be stated and identified as the Florida communications services tax, and the combined amount of taxes due under s. 202.19 shall be stated and identified as the local communications services tax.” Fla. Stat. § 202.35(4).
Separate Statement Requirements

Some states require separately stated tax to be on “first document”

- Whenever the customer is given any sales slip, invoice, receipt, or other statement or memorandum of the price, amusement charge, or rent paid or payable, the tax shall be stated, charged and shown separately on the first of such documents given to him. NYCRR 532.1

- If the purchaser is given any sales slip, invoice, receipt or other statement or memorandum of the price, or amusement charge paid or payable, the tax shall be stated, charged and shown separately on the first of such documents given to him. The tax shall be paid to the person required to collect it as trustee for and on account of the state. Vt. Stat. Ann. § 9778 Collection of tax from purchaser.
Separate Statement Requirements

Some states have issued rulings agreeing to non-traditional presentments in specific instances:

• “Despite this statutory prohibition, the Administrative Hearing Commission has held that it is permissible for a seller to not separately state the applicable sales tax on price as presented to the customer, so long as the seller notifies the customer in writing that tax is included.” Missouri Private Letter Ruling, No. LR 7314, 11/04/2013.

• Telecom may advertise that its prices include all taxes imposed on the user and charge an all-inclusive price to users, provided they give the user sufficient detail after the sale. Illinois Private Letter Ruling, No. ST 14-0003-PLR, 06/26/2014.
Separate Statement Requirements

- Some states make exceptions for circumstances where it may be “impracticable” due to the nature of the business practices within a certain industry to separately state taxes.
  - e.g., Florida, Kentucky, Vermont

- Potential Impracticable Scenarios:
  - Sales from coin-operated or currency-operated machines. MCA § 15-68-106(2).
  - Sales through mobile applications
  - Food Trucks
  - Amusements and special events
  - Farmers’ markets
Separate Statement Requirements

- Issues resulting from not separately stating

  - Unclear penalty regime available to administrators
    - Unlike anti-absorption rules, most states don’t tie a specific penalty to the requirement to separately state

  - Consumer actions

  - Adjust base to not exclude tax
    - $100 sale, where $95 is considered the sales price and $5 is included for taxes
    - DOR may argue that $100 is sales price

  - Purchaser use tax audits

  - Entity exemptions

  - Non-tax contractual disputes
Separate Statement Requirements


• Amounts collected as sales tax and remitted to the state will remain exempt from taxation if there is substantial compliance with the requirement to separately state sales taxes.

• Online travel companies remitted sales tax based on the net price charged by hotels for booking hotel rooms – but did not apply the tax to booking service fees.
  • Collected sales tax and forwarded to hotels, who remitted to D.C.
  • D.C. claimed amounts remitted to hotels were subject to tax.

• Sales tax base does not include any amount collected for purposes of the sales tax.
  • D.C. argued that failing to comply with separate statement requirement negated exclusion of tax reimbursement amounts.

• Court of Appeals held that amounts collected and remitted were tax reimbursements not subject to tax.
  • “[T]he remedy for the failure to comply with a given provision of the tax code is not necessarily greater taxation.”
Anti-Absorption Laws
Anti-Absorption Laws

– State anti-absorption laws prohibit retailers from absorbing applicable taxes or fees.

– Generally, there is also a prohibition against advertising to the public that a tax shall be assumed or absorbed by the retailer.

– Some states prohibit specific language, such as:
  • “Tax-free sales”
  • “Pay no sales tax”
  • “We’ll pay your sales tax”
  • “Tax credit sales”
  • “Sales tax stimulus sales”
Consumer Protection Laws
Consumer Protection Laws

- Federal Trade Commission Act prohibits “unfair methods of competition” and “unfair or deceptive acts of practices” by the sellers of products or services.
  - Very broad scope
  - Typically, the two most significant issues in analyzing whether marketing information is unfair or deceptive are:
    1. What would the consumer reasonably expect or think with regard to the advertising or marketing of the product or service?
    2. Is there material harm caused to the consumer as a result of any mistaken impression?

- Many states have consumer protection laws parallel to the FTC Act outlawing unfair or deceptive acts.
Consumer Protection Laws

**Ferrie v. DIRECTV, LLC, Class Action Complaint (D. Ct. Conn. January 12, 2016)**

- Connecticut imposes a “gross earnings tax” on satellite television providers.

- The legal incidence of the gross earnings tax is on satellite companies, not their subscribers.

- While a satellite company is not prohibited from passing the economic burden of the tax on to its subscribers, a phrase like "reimbursement for gross earnings tax" will be acceptable to DRS as not misrepresenting on whom the law imposes the tax.

- Class Action alleged that DirecTV recovered the tax under the item “Sales Tax,” which led customers to believe that surcharge was imposed directly on consumers by State.

- The case was sent to arbitration because of a mandatory arbitration clause in the user agreement.
Tax-Inclusive Billing Models
Tax-Inclusive Billing Models

— Back-end invoice model:
  • The carrier charges the customer a single, “tax-included” price (e.g., $40 per month) at the point of sale and calculates the applicable taxes and fees after the transaction is processed.
  • Detailed invoices identifying the cost of the service and applicable taxes and fees are made available to customers after the sale takes place.
  • An algorithm is used to back into the proper amount of taxes and fees.
  • The applicable terms and conditions reflect the tax-inclusive nature of the charge, including the number of minutes/credit balance reduced by the taxes and fees.
Tax-Inclusive Billing Models

— **All-inclusive, no tax calculation model:**
  - Charge the customer a single, “tax-included” price at the point of sale.
  - The applicable terms and conditions reflect the tax-inclusive nature of the charge, including the number of minutes/credit balance reduced by the taxes and fees.
  - Disclosures on customer invoice will reflect that the service charge includes applicable taxes and fees.
  - Customers are not provided the exact amount of the taxes and fees that apply to their service.
Tax-Inclusive Billing Models

- **Sales tax identification model:**
  - Pass through and separately state sales tax as a distinct line item on customer bills and invoices.
  - Customers are then charged a single price that includes all *other* applicable taxes and fees.
  - Disclosures on customer bills and invoices and in terms and conditions will reflect that the service charge includes applicable taxes and fees other than sales taxes.
  - Fine print on the back of the invoice or website typically allows customers to identify what taxes are included in the price.
  - Similar to the “no calculation” model above, customers receive notice of the applicable tax and the tax rate but not the amount of the tax.
ITFA and State Taxation of Internet Access
Federal Internet Tax Freedom Act (ITFA)

- ITFA § 1101(a) provides: “No State or political subdivision thereof shall impose any of the following taxes ... Taxes on Internet Access.”
- “Internet access” means “a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet.”
- ITFA was permanently extended by enactment of H.R. 644, “Trade Facilitation and Trade Enforcement Act of 2015.”
Federal Internet Tax Freedom Act (ITFA)

- ITFA also expressly prohibits states from imposing “discriminatory taxes on electronic commerce”
  • “Electronic commerce” is defined as “any transaction conducted over the Internet ... comprising the sale ... Of property, goods, services, or information[.]”

- “Discriminatory tax” is “any tax imposed by a State or political subdivision thereof on electric commerce that
  • (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; [or] ... 
  • (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means.”

- The permanent extension of ITFA and the Grandfather Clause do not apply to the prohibition against discriminatory taxes.
In 2004, ITFA § 1106(a) was amended to include a provision that allows the unbundling of charges for Internet access, even if not separately stated on the customer’s bill.

The relevant section provides:

• “If charges for Internet access are aggregated with and not separately stated from charges for telecommunications or other charges that are subject to taxation, then the charges for Internet access may be subject to taxation unless the Internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business.”
State Taxation - Unbundling of Internet Services

- Mobile Telecommunications Services Act ("MTSA") also provides for the unbundling of taxable vs. nontaxable services.

- The relevant section provides:
  - "If a taxing jurisdiction does not otherwise subject charges for mobile telecommunications services to taxation and if these charges are aggregated with and not separately stated from charges that are subject to taxation, then the charges for nontaxable mobile telecommunications services may be subject to taxation unless the home service provider can reasonably identify charges not subject to such tax, charge, or fee from its books and records that are kept in the regular course of business."
State Taxation - Unbundling of Internet Services

— State Unbundling Rules:
  • State and local transaction taxes typically apply to the total amount charged for taxable property or services sold at retail.
  • Absent some authority to the contrary, the total amount charged for a bundled transaction—a transaction with taxable and nontaxable components sold for a single price—will be taxed in most state and local jurisdictions, meaning that otherwise nontaxable components will be taxed by virtue of being bundled with taxable components.
  • Most jurisdictions have adopted standards for unbundling bundled transactions so as to tax only the taxable components of a bundled transaction.
Questions?