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VoIP: WHO HAS JURISDICTION TO TAX IT?

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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VoIP: WHO HAS JURISDICTION TO TAX IT?

TUESDAY, MARCH 31, 2009

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:16 p.m., in room 2141, Rayburn House Office Building, the Honorable Steve Cohen (Chairman of the Subcommittee) presiding.

Present: Representatives Cohen, Sherman, Johnson, Scott, Franks, Jordan, Issa, and King.

Staff Present: Norberto Salinas, Majority Counsel; Adam Russell, Majority Professional Staff Member; and Stewart Jeffries, Minority Counsel.

Mr. COHEN. This hearing of the Committee on the Judiciary, Subcommittee on Commercial and Administrative Law will now come to order.

Without objection, the Chair will be authorized to declare a recess of the hearing, which we will have to do when we go into votes, which is not going to be too far from now.

I will now recognize myself for a short statement.

Telecommunications have moved from a fixed phone line between two individuals, or in some places two coke cans and a long line, to the point where anyone can place a call on a wireless device from and to almost anywhere in the world. Today someone using an iPhone can even video-chat with another person.

But as technology evolves, many of our tax laws have not kept pace—cultural lag. For example, just 10 years ago States maintained a telecommunications tax structure based on a call's origin. This structure worked well because telephone calls at the time were placed from a fixed location. But mobile telecommunications do not fit neatly into that tax structure because mobile users rarely place calls from the same location.

State and local governments had to refine their tax systems to address the broad use of mobile telecommunications devices. This resulted in the passing of the Mobile Telecommunications Sourcing Act of 2000, hereafter known as MTSA, which created sourcing requirements for State and local taxation of telecommunications services. In essence, MTS would be taxed based on the customer's place of primary use.

State and local governments, providers, and consumers now face a similar situation with the newest form of telecommunications:

Voice over Internet Protocol. With Voice over IP, users are able to place calls over the Internet as long as they have access to broadband Internet access. Some providers and State legislatures have grown concerned that current tax policies are difficult to apply to VoIP and urge that Congress help resolve the taxation issue as it did with mobile telecommunications.

Today's hearing will provide Members of the Subcommittee the opportunity to hear testimony about Voice over IP and the impact of its expected growth in usage. Members will also hear testimony about State and local taxation of VoIP to determine whether a taxation issue does exist and whether Congress should intercede to resolve it. Accordingly, I look forward to receiving today's testimony.

And, at this point, I recognize my colleague, the gentleman from Arizona, Mr. Franks, the distinguished Ranking Member of the Subcommittee, for his opening remarks.

Mr. FRANKS. Well, thank you, Mr. Chairman.

I want to welcome all the Committee here. I met Mr. Montgomery earlier. He seems tall enough that he can reach out and touch someone without a telephone. But it is a pleasure to meet you, sir.

Today we are considering whether and how the Mobile Telecommunications Sourcing Act should be modified to address changes in telecommunications technology. The law was designed to resolve questions as to which States and localities could tax cellular calls. Existing Supreme Court precedent held that a State had a jurisdiction to tax telecommunications if two of three factors were in alignment: the source of the call, the destination of the call, and the billing or service address of the telephone.

Traditional wireline communications has presented very few difficulties. A call placed from Arizona to Tennessee was likely made on a phone whose billing address was in Arizona. However, with cell phones, a call placed from Arizona to Tennessee could be made with a phone whose billing address is in the District of Columbia. Under such a scenario, the three factors established by the Supreme Court could theoretically never be in alignment.

To address this problem, Congress enacted the Mobile Telecommunications Sourcing Act, which defined the place of primary use of service and mandated that only the State of the place of primary use could tax mobile telecommunications. This helped consumers by ensuring that they could not be double-taxed for their cell phone calls. It helped States by ensuring that at least one, and only one, State would be eligible to tax those calls. And it made it easier for mobile telephone companies to properly assess taxes on customers' bills.

So now we are back to consider whether the rules that apply to mobile telephones should also be used for Voice over Internet Protocol, or VoIP. VoIP allows a consumer to use their broadband connection like a telephone line. VoIP is often cheaper than traditional land lines, particularly for long distance and international calls.

Recently, the telephone companies have rolled out a new technology known as nomadic VoIP—boy, they just keep coming up with this stuff, don't they—which enables a consumer to use their VoIP phone number and account number wherever they may be. The implications for taxation are clear: Like mobile phones, calls

made from a nomadic VoIP no longer must be made from the same location as the billing or service address.

Accordingly, this Subcommittee has the opportunity to examine whether changes to the Mobile Telecommunications Sourcing Act are appropriate. To that end, we have representatives from both industry and the States here today. It is my hope that we can work together to quickly resolve the issues identified today so that States, industry, and, most importantly, consumers can have the clarity and certainty that they need to conduct their affairs.

And, Mr. Chairman, with that, I welcome the panel members and yield back.

Mr. COHEN. I thank the gentleman for his statement.

Without objection, other statements of Members will be permitted in writing and included in the record.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Voice over Internet Protocol is a new telecommunications technology that is expected to overtake traditional land-line telecommunications in the near future.

It allows users to communicate with one another by transmitting voice signals over the Internet. It is less expensive than using analog land-line telecommunications, and offers mobility to users.

Some are concerned that the mobility of Voice over Internet Protocol does not lend itself to falling clearly under current State and local tax systems.

For instance, a State may tax an individual if a nexus exists between it and the individual at the time of the transaction.

As a result of Voice over Internet Protocol's mobility, however, several States may claim nexus to tax the user. This could make it difficult for providers to determine which taxes to collect, cause some States and local governments to lose tax revenues, and result in double, or even multiple, taxation for some users.

Additionally, the taxing may impede interstate commerce, and therefore be unconstitutional.

Therefore, State legislatures and some providers have asked Congress to consider legislation that would provide for the home State of the user to be the sole authority to tax Voice over Internet Protocol services.

Today's hearing will, I hope, help us consider three critical questions.

First, we should determine whether there does exist an issue concerning State and local taxation of Voice over Internet Protocol.

Second, if there does exist a taxation issue, we should consider whether Congress can and should address it.

Third, if we determine that Congress can constitutionally address this issue, and is better suited to doing so rather than leaving it to the States to resolve, then we should determine the best course of action.

For example, is there an existing framework to simplify State and local taxation of Voice over Internet Protocol?

Or should Congress impose a new structure to determine which taxing authority can tax Voice over Internet Protocol?

Today's testimony should help us answer these questions. I look forward to hearing from the witnesses.

Mr. COHEN. We have 15 minutes for votes. And I think, while we could start and maybe get through one gentleman's testimony, if you don't mind, I think we probably ought to vote and come back and do all the testimony at the same time.

So, without objection, and in spite of the fact that we have our largest attendance yet in this early spring training, I would ask, without objection, that we take a recess and return after votes are finished and promptly return.

Without objection, we are in recess.

[Recess.]

Mr. COHEN. Thank you, gentlemen. We are back in session.

I am now pleased to introduce the witnesses and hear their testimony today.

I understand, Mr. Montgomery, you have a 4 o'clock flight?

Mr. MONTGOMERY. Five.

Mr. COHEN. Five o'clock?

I am going to go ahead and take him out of order, if that is all right with the other witnesses. Why don't we do that and have Mr. Montgomery go first. And if he can stay for a while, maybe we can get to ask questions, but if you have to leave, you have to leave.

All right, I have to tell you the rules.

The first rule: Don't leave the University of Memphis for Kentucky. That has already been violated. Bad day, bad day.

Your written statements will be placed in the record. We ask that you limit your oral remarks to 5 minutes. You will note that we have a lighting system. When it is green, that means you have 5 minutes; yellow means 1 minute; red, over.

After each witness presents his or her testimony, the Subcommittee Members have an opportunity to ask you questions subject to a 5-minute rule.

Those are the rules.

Our first witness is Mr. Phil Montgomery. He was elected to the Wisconsin State Assembly in 1998 and has chaired a variety of committees, including the Assembly Insurance Committee, Financial Institutions Committee, and the Telecommunications Task Force. Most recently, he served as chairman of the Assembly Energy and Utilities Committee for 4 years, where he played a vital role in several key energy and telecommunication reforms, including the Cable and Video Competition Act.

During the upcoming 2009-2010 legislative session, Representative Montgomery will represent northeast Wisconsin on the legislature's powerful Joint Committee on Finance, where he will take a leading role in crafting the State's budget.

Thank you, Representative Montgomery. As a former State legislator, I appreciate your service and welcome you here. Would you proceed with your testimony?

TESTIMONY OF THE HONORABLE PHIL MONTGOMERY, WISCONSIN STATE ASSEMBLY

Mr. MONTGOMERY. Thank you, Mr. Chairman. I greatly appreciate the indulgence.

Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee on Commercial and Administrative Law, I appreciate the invitation to testify before you today on behalf of the National Conference of State Legislators.

I am Phil Montgomery, a member of the Wisconsin Assembly. And I serve as the chairman of NCSL's Standing Committee on Communications, Financial Services, and Interstate Commerce.

Mr. Chairman, I am pleased to acknowledge your long history as an active member of NCSL. Speaking on behalf of your colleagues in the State legislatures, we are proud of your past service as a State Senator and now your leadership in Congress. We hope that

during your tenure as a Member of Congress and your chairmanship of this Subcommittee, we will have numerous opportunities to work together to foster a strong Federal-State partnership on interests of mutual concern.

Mr. Chairman, you may recall that, while you were a member of the Tennessee Senate, you voted to implement Public Law 106-252, the Federal Mobile Telecommunications Sourcing Act. The legislation established a national framework that, when implemented by the States between 2001 and 2002, provided a mechanism on how mobile telecommunications calls involving multiple jurisdictions should be assigned for purposes of tax. The MTSA created the concept that the customer has a place of primary use, which is the jurisdiction with the right to tax wireless calls even if the call neither originates nor terminates in that jurisdiction.

The MTSA was a win-win for both the industry and government. State and local governments supported the MTSA to prevent "nowhere" taxation and to bring administrative simplicity and cost savings to the tax administration. Furthermore, government organizations supported the legislation to avoid potential congressional preemption of State taxing authority based on burdens of interstate commerce.

The wireless industry supported the legislation to prevent multiple taxation to achieve administrative simplicity and cost savings in the billing process, to avoid expensive audit and litigation exposure when multiple States claim jurisdiction to tax the same call, and to avoid class-action lawsuits from customers who claim that companies are improperly collecting taxes even when they are merely complying with State laws.

NCSL is once again pleased to support and urge passage of legislation to extend the MTSA provisions to VoIP. This legislation will merely clarify how VoIP calls involving multiple jurisdictions should be sourced for State and local tax purposes. It will not change the tax status of any VoIP provider.

As is the case with wireless calls, it is just as important for VoIP communications that there be a clear, national rule for determining what jurisdiction is permitted to tax a call and, thus, avoid situations where multiple jurisdictions may try to tax the same call or that a call might escape taxation all together.

While the thought of tax-free communications may be appealing, we must acknowledge that, if a government taxes communication services, as policymakers, we have the obligation to ensure that all providers, regardless of the medium used, should be treated similarly for tax purposes. Taxes on communication services must be applied in a competitively neutral manner without being used to benefit one provider over another in the marketplace.

In conclusion, last year the National Conference of State Legislators' membership unanimously approved a request to Congress for legislation that would extend the MTSA sourcing provisions to Voice over Internet Protocol. The legislation to extend MTSA provisions to VoIP should be considered noncontroversial and should move without any opposition. For this reason, we should request that the VoIP sourcing legislation not become a vehicle for nongermane or slightly related amendments that would only slow and probably keep the legislation from enactment.

Mr. Chairman, thank you for inviting me to express the concerns of NCSL with regards to the assessment of taxation on VoIP services and our support for legislation on national sourcing rules.

[The prepared statement of Mr. Montgomery follows:]

PREPARED STATEMENT OF THE HONORABLE PHIL MONTGOMERY

Chairman Cohen, Ranking Member Franks and members of the Subcommittee on Commercial and Administrative Law, I appreciate the invitation to testify before you today on behalf of the National Conference of State Legislatures (NCSL). I am Phil Montgomery, a member of the Wisconsin Assembly and I serve as Chairman of NCSL's Standing Committee on Communications, Financial Services & Interstate Commerce. As you know Mr. Chairman, the National Conference of State Legislatures is the bi-partisan national organization representing every state legislator from all fifty states and our nation's commonwealths, territories, possessions and the District of Columbia.

Mr. Chairman, I also am pleased to acknowledge your long history as an active member of NCSL, especially during your service on NCSL's Executive Committee. Speaking on behalf of your colleagues in state legislatures, we are proud of your past service as a state Senator and now your leadership in Congress. We hope that during your tenure as a member of Congress and your chairmanship of this Subcommittee, we will have numerous opportunities to work together to foster a strong federal-state partnership on issues of mutual concern.

I am pleased to have the opportunity to appear before you today to discuss Voice over Internet Protocol and the problems related to the assessment and collection of taxes on VoIP related services. I also am here to express NCSL's support for draft legislation—the "Voice over Internet Protocol Sourcing Act of 2009"—and I want to commend you Mr. Chairman for your willingness to sponsor this important legislation that goes directly to strengthening the federal-state partnership.

MOBILE TELECOMMUNICATIONS SOURCING ACT (MTSA)

Mr. Chairman, you may recall that while you were a member of the Tennessee Senate, you voted to implement Public Law 106–252, the Federal Mobile Telecommunications Sourcing Act (MTSA). This legislation established a national framework that when implemented by the states between 2001–2002 provided a mechanism on how mobile telecommunications calls involving multiple jurisdictions should be assigned or sourced for tax purposes.

Prior to the enactment of the MTSA, the Supreme Court decision in Goldberg vs. Sweet governed the question of which jurisdiction has authority to tax all interstate calls, both wireline and wireless. Under the Goldberg rule, a jurisdiction could impose a tax on a call if the call either originated or terminated in the jurisdiction and the call was charged to a "service address" in that jurisdiction.

Because of the mobile nature of wireless telecommunications, it had become more difficult to determine whether wireless calls met the two-out-of-three "Goldberg" rule of origination or termination plus service address, calling into question states' ability to tax such calls. Furthermore, as customers increasingly selected single rate, fixed-usage plans, the wireless industry's determination of which jurisdiction has authority to tax the calls become more complicated. With the growing popularity of the single rate plans, there was a decreasing need to track individual calls for billing purposes. Tracking individual calls solely for tax purposes unnecessarily wastes company resources.

The MTSA solved both of these problems. It created the concept that the customer has a "place of primary use," which is the jurisdiction with the right to tax wireless calls, even if the call neither originates nor terminates in that jurisdiction. Thus, the federal law allows states and localities to tax calls that they could not have taxed under the "Goldberg" rule and precludes their ability to tax other calls that they may have historically taxed.

The MTSA also provided a means to avoid another very contentious fight between state and local governments, Congress and industry as was the case just two short years before its enactment. You may recall, that in 1998 in response to an effort by some states to tax access to the Internet, Congress passed and President Clinton signed into the law the first Internet Tax Freedom Act. The new law prohibited taxation of access to the Internet by any government, federal, state or local. The legislation did grandfather approximately 13 states, but the number is now down to 9 to 10 states. With the rapid growth of the Internet in the late 1990's, some state tax departments merely extended the taxation schemes that existed in their states' telecommunications statutes without any recognition of the impact on a new inter-

state communications service. Applying the old tax scheme to an emerging technology led to protests and complaints from communications providers and Internet service providers. While Congress intended the original moratorium to be a temporary measure, it has now been extended until 2014 and will likely be made permanent. The MTSA is a model in avoiding another Internet Tax Freedom Act type battle between Congress, state and local governments and industry. It is for this reason that we seek quick congressional action to pass legislation that would extend the sourcing provisions of the MTSA to Voice over Internet Protocol and get it to the President's desk for his signature.

The MTSA was a "win-win" for both industry and government. State and local governments supported the MTSA to prevent "nowhere taxation" and to bring administrative simplicity and cost savings to tax administration. Furthermore, government organizations supported the legislation to avoid potential Congressional preemption of state taxing authority based on the above mentioned burdens on Interstate Commerce.

The wireless industry supported the legislation to prevent multiple taxation; to achieve administrative simplicity and cost savings in the billing process; to avoid expensive audit and litigation exposure when multiple states claim jurisdiction to tax the same call; and to avoid class action lawsuits from customers who claim that companies are improperly collecting taxes even when the are merely complying with state laws.

The MTSA was enacted in July 2000 and in two years, all fifty state legislatures and the Council of the District of Columbia passed legislation to bring their states into compliance with the federal legislation. The MTSA has served state and local governments well as it ensured a vital revenue stream and provided clarity and uniformity for providers in collecting our taxes and fees on wireless services. The MTSA has served as a model of federal, state and private sector cooperation.

NCSL is once again pleased support and urge passage of legislation to extend the MTSA provisions to VoIP. We will work with the other state and local organizations to obtain their support for a VoIP sourcing rule. This legislation will merely clarify how VoIP calls involving multiple jurisdictions should be sourced for state and local tax purposes; it will not change the tax status of any VoIP provider.

As is the case with wireless calls, it is just as important for VoIP communications that there be clear, national rules for determining what jurisdiction is permitted to tax the call, and thus avoid situations where multiple jurisdictions may try to tax the same call or that a call might escape taxation all together. While the thought of tax free communications may be appealing, we must acknowledge that if a government taxes communications services, as policymakers we have an obligation to ensure that all providers, regardless of the medium used, should be treated similarly for tax purposes. Taxes on communications services must be applied in a competitively neutral manner, without being used to benefit one provider over another in the marketplace. This legislation endeavors to ensure competitive neutrality.

VOICE OVER INTERNET PROTOCOL

Ten years ago when negotiations were taking place between state and local governments and providers on the sourcing of wireless calls, few had any notion that soon another developing technology would provide another medium for voice communications that would once again challenge the way government taxes communications services.

Voice over Internet Protocol or VoIP enables packet transmission over data networks which in essence converts voice to data and allows for voice transmission over the Internet. I will leave the basics and types of VoIP transmissions to the experts on this panel. However, as a legislator and an advocate for enhanced communications services, I am concerned about how my colleagues in state governments may attempt to collect taxes on VoIP communications service. Under what "tax rule" will state tax departments attempt to assess VoIP services for taxation? It certainly does not meet the standard of the Goldberg rule I mentioned above and while in some respects the mobile telecommunications sourcing rules could apply, VoIP technology also has differences from wireless technology that will need to be addressed.

The legislation to source VoIP services provides the clarity that state and local governments need to assess and collect taxes on VoIP services. It ensures that well meaning tax officials do not try to impose existing tax regimes on VoIP that will only lead to confusion, litigation, lost revenue and possibly federal preemption.

This legislation will expand the sourcing rule adopted in the Mobile Telecommunications Sourcing Act to VoIP services. This will ensure consistent tax treatment of VoIP across all states. It will provide consumers, vendors and state and local governments with certainty, thus avoiding needless litigation. It ends the likelihood of

multiple taxation of the same call and eliminates the possibility of "nowhere" taxation.

As with the Mobile Telecommunications Sourcing Act, this legislation allows the jurisdiction the customer identifies as their place of primary use (PPU) to tax VoIP services and conforms with the sourcing provisions of the Streamlined Sales and Use Tax Agreement.

VoIP providers may offer VoIP services that provide multiple telephone numbers only a limited amount of capacity or lines for making calls outside of the internal network. With VoIP it is important to understand that telephone numbers do not necessarily equal a traditional wireline access line. Therefore the VoIP sourcing rule will only count those lines that a customer can make simultaneous calls as a line for tax purposes.

As I mentioned previously, what this legislation does not do is change the taxability of VoIP services. If VoIP is already taxable in a jurisdiction, this legislation only provides certainty in how services will be sourced for tax purposes, it does not force a state or local government to impose any new taxes. As VoIP service is an Internet protocol, it is possible that a VoIP service provider may not have nexus in a state where it has customers. If a VoIP service provider does not have nexus in a state, this legislation does not provide any new authority to the state or local governments in that state to tax the service provided by the non-nexus VoIP service provider.

CONCLUSION

Last year, the National Conference of State Legislatures held a total of three hearings on the question of assessing taxation on VoIP services in which we invited all stakeholders to express their concerns. At our annual meeting last summer, NCSL's membership unanimously approved a request to Congress for legislation which would extend the MTSA sourcing provisions to Voice over Internet Protocol. A copy of the NCSL resolution is attached to my testimony.

The legislation to extend the MTSA provisions to VoIP should be considered non-controversial and should move without any opposition. For this reason, we also would request that the Voice over Internet Protocol sourcing legislation not become a vehicle for non-germane or slightly related amendments that would only slow and probably keep the legislation from enactment.

Mr. Chairman, thank you for inviting me to express the concerns of the National Conference of State Legislatures with regard to the assessment of taxation on VoIP services and our support for legislation on a national sourcing rule. We stand ready to work with you and the other members of this Subcommittee to ensure quick congressional passage of a sourcing rule for VoIP

Thank you.

ATTACHMENT

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

NCSL SUPPORTS FEDERAL VoIP COMMUNICATIONS SOURCING ACT

NCSL STANDING COMMITTEE ON COMMUNICATIONS, FINANCIAL SERVICES & INTERSTATE COMMERCE

WHEREAS, State and local transaction taxes and fees imposed on communications services should be applied uniformly and in a competitively neutral manner upon all providers of communication services; and

WHEREAS, the Mobile Telecommunications Sourcing Act (P.L. 106-252) established uniformity of sourcing mobile telecommunications for state and local tax purposes; and

WHEREAS, NCSL worked with other state and local organizations as well as the wireless industry in developing the Mobile Telecommunications Sourcing Act; and

WHEREAS, NCSL supported the enactment of the Mobile Telecommunications Sourcing Act and assisted states in complying with the federal legislation; and

WHEREAS, Interconnected Voice over Internet Protocol (VoIP) services, as defined by the Federal Communications Commission are not uniformly sourced for tax purposes and may unnecessarily subject consumers, businesses and others engaged in interstate commerce to multiple, confusing and burdensome state and local taxes; and

WHEREAS, the general rule of the Mobile Telecommunications Sourcing Act sources the tax on wireless services to the "customer's place of primary use, regardless of where the services originate, terminate, or pass through, and no other taxing jurisdiction may impose taxes, charges, or fees on charges for such services"; and

WHEREAS, such a sourcing rule should also apply to Interconnected VoIP services;

NOW, THEREFORE BE IT RESOLVED THAT, the National Conference of State Legislatures supports federal legislation that would require sourcing for purposes of state and local taxation of Interconnected VoIP services to be the same as the sourcing rule for state and local taxation of wireless services as contained in the Mobile Telecommunications Sourcing Act and

BE IT FURTHER RESOLVED THAT, a copy of this resolution be sent to the President of the United States and all members of Congress.

Adopted by the NCSL Communications, Financial Services and Interstate Commerce Committee, July 23, 2008.
Unanimously passed the full NCSL Annual Business Meeting, July 25 2008.

Mr. COHEN. Thank you for your testimony, Representative Montgomery. You must not realize this is the United States Congress; we don't have nongermane and irrelevant and extraneous types of amendments, something you must be used to in Wisconsin.

Mr. MONTGOMERY. Sir, in addition to my understanding of legislative time, we have some of the same things back home, as well.

Mr. COHEN. Thank you, sir.

Our second witness is John Barnes. Mr. Barnes is director of Global Advanced Voice Product Development. He is primarily responsible for the development, maintenance, and enhancement of Verizon's VoIP suite of services and Contact Center suite of services targeted at business customers.

In this capacity, he is responsible for managing the software development and network deployment initiatives associated with VoIP and Contact Center services. Additionally, he is responsible for the development and maintenance of implementation and post-implementation support procedures and corresponding systems.

Before joining Verizon in 2005, Mr. Barnes served as director of Voice over IP service product development for MCI, where he was primarily responsible for the development and enhancement of MCI's VoIP services targeted at business customers. He held management positions focusing on the development of MCI's VoIP services from 2001 onward.

Thank you for coming, Mr. Barnes. We will proceed with your testimony.

TESTIMONY OF JOHN L. BARNES, DIRECTOR, PRODUCT MANAGEMENT AND DEVELOPMENT, VERIZON BUSINESS

Mr. BARNES. Chairman Cohen, Representative Franks, and the Members of the Subcommittee, thank you for this opportunity to testify on an issue that will benefit both individual consumers and businesses, drive technological innovation, and boost the U.S. economy.

My name is John Barnes. I am the director of product development for global advanced voice services, including Voice over IP services, at Verizon. My testimony should provide a better understanding of Voice over IP services, how they work, why the technology is inherently mobile, and why the taxation of Voice over IP services requires modernization.

VoIP stands for "Voice over Internet Protocol." VoIP is the conversion of traditional analog and digital voice into data packets that are transmitted over an IP-enabled data network.

Historically, voice transmissions originated from analog and digital telephones required a dedicated connection to the public switched telephone network, or PSTN. This connection was fixed to a certain location and dedicated to the customer all the way to the PSTN. With VoIP, these voice transmissions are converted to IP signaling and media data packets using either an IP phone or other conversion device. They are routed over an IP-enabled data network, including the public Internet. Unlike traditional telephony, when one customer is not using the capacity, it can be used by other customers, resulting in greater network efficiency.

Many equipment providers produce a wide variety of IP phones and devices. Telecommunications carriers have developed services

using these devices. Carriers' network architecture provide intelligent call routing, instructions on how and where to route these calls. And they also provide basic features such as caller ID and call waiting. Enhanced features include features like simultaneous ring or routing incoming calls to multiple devices simultaneously and selective call screening, to name a few. Voice over IP technology is highly customizable, and many of the features are controlled by the customer without any direct intervention from the service provider.

Most Voice over IP devices have a traditional 10-digit telephone number; however, they also have an IP address. This is similar to the electronic serial number assigned to wireless devices.

IP addresses are a global phenomena. They have no correlation to a physical address or geography. As a result, a VoIP device can be moved to any location where it can be connected to an IP-enabled data network, including the public Internet, and continue to send and receive calls. The network recognizes and validates the IP address, but it cannot determine the physical location of the device.

Software and equipment manufacturers continue to enhance Voice over IP devices. For example, software can be installed on a laptop computer and send and receive VoIP calls. As a result, customers can place calls virtually anywhere they can carry their laptop and connect it to a wired or WiFi Internet connection. I brought an example of one such software device that can be used in conjunction with a laptop computer.

Like wireless services, Voice over IP services are typically packaged as a collection of basic and enhanced features and local and long-distance calling for 1 monthly price. These bundled pricing packages benefit consumers and businesses with predictable monthly pricing and the opportunity to reduce their monthly cost. However, they complicate the ability to correlate specific charges to the physical location of a Voice over IP device that may have been mobile sometime during the billing period.

For businesses, Voice over IP services provide several benefits. First, they achieve cost savings through converging both voice and data services over a common network. They can realize operating efficiencies by offering businesses with multiple locations the ability to share physical access capacity across multiple locations, substantially reducing the overall capacity requirement and corresponding costs. This is just simply not technically feasible with traditional PSTN services.

In conclusion, the technology has simply outpaced the rules that apply to taxation for telephone services. Consumers are demanding, and the technology will continue to provide new Voice over IP services that are inherently mobile.

A new system is needed to determine State and local taxation for VoIP services, and the good news is such a system already exists for wireless devices. Congress enacted the Federal Mobile Telecommunications Sourcing Act in 2000. The industry and government are in general agreement that Congress needs to expand the Federal sourcing rules to include Voice over IP services.

Thank you for the opportunity to testify today, and I would be glad to answer any questions you might have.

[The prepared statement of Mr. Barnes follows:]

PREPARED STATEMENT OF JOHN L. BARNES

Chairman Cohen, Representative Franks, and members of the subcommittee, thank you for this opportunity to testify on an issue that will benefit individual consumers, small and large businesses, continuing technology innovation, and the economy of the United States.

My name is John Barnes and I am the Director of Global Advanced Voice Product Development for Verizon. My primary responsibility and area of focus is the development, maintenance and enhancement of Voice over Internet Protocol (VoIP) services that Verizon markets to business customers.

The testimony that follows is intended to cover:

- a definition of VoIP services
- a brief description of how these services technically work
- why the services are inherently mobile
- description of how the services are typically packaged and sold to customers
- why the services are beneficial to businesses and consumers

This testimony should provide a better understanding of VOiP services, the technology and how VOIP is inherently mobile, necessitating modernization of the taxation methodology that applies to such services.

DEFINITION OF VOIP

VoIP stands for Voice over Internet Protocol. Simply put, VoIP is the conversion of traditional analog or digital voice into data packets that are then transmitted over an IP enabled data network.

Historically, in the large business context, voice transmissions originated from analog telephones or digital telephones connected to a PBX or key system. In a PBX or key system, there are multiple internal or intercom lines and a much smaller number of trunk lines that allow those internal lines to dial out to the public switched telephone network (PSTN). This is best demonstrated by the need to dial "9" from an inside line to reach an outside line. The voice calls are then routed to sending and receiving switches on the PSTN in order to be delivered to a receiving analog or digital telephone. In the consumer context, voice transmissions originate on a telephone at the customer's premises and travel over a line that is dedicated to that customer all the way to the PSTN. This requires every household to have a dedicated line that sits idle much of the time and cannot be used by other households.

With VoIP, these voice transmissions are converted to IP signaling and voice media packets using either a VoIP phone or other conversion equipment at the customer location and are routed over an IP enabled data network. The IP enabled network may be either a private network or the public Internet. However, when one customer is not using the capacity, the capacity can be utilized by other customers resulting in greater efficiency and better utilization of telecommunication lines and maximization of resources. If VoIP calls are destined for another VoIP device, they may route directly to the receiving device over the IP enabled data network where they are converted back to a voice transmission using a VoIP phone or another conversion device at the terminating customer's location. If the calls are destined for a traditional telephone connected to the PSTN, the calls are first routed to a device, commonly referred to as a media gateway, where the signal is converted back into a digital voice transmission and then routed to the PSTN where the call can be terminated on a traditional telephone at the terminating customer's location. A media gateway is a device that is connected on one side to the PSTN switches and on the other side to an IP enabled data network. The function of the media gateway is to translate and route voice transmissions between other VoIP devices connected to an IP network and traditional telephones connected to the PSTN

HOW CARRIER BASED VOIP SERVICES WORK

Today, many VoIP telephony equipment manufacturers produce a wide variety of IP phones, IP enabled PBXs and key systems as well as analog or digital VoIP adaptors/gateways all designed to send and receive VoIP calls.

Over the past several years, telecommunications carriers have developed and marketed services to customers using these VoIP devices available in the marketplace.

Creation of these services has resulted in the development and deployment of carrier network architectures designed to provide intelligent call routing instructions and features. Specifically, VoIP devices interact with call routing intelligence (also referred to as a call control server, an application server or a proxy) to receive instructions regarding how and where to route a particular call. In addition to pro-

viding call routing instructions to VoIP devices, these call control servers provide basic and enhanced features to the VoIP devices through association to the customers. Basic features would include typical capabilities, such as Caller ID or Call Waiting. More enhanced features would include capabilities such as simultaneous ring (the ability to route an incoming call to multiple devices simultaneously) or selective call screening (the ability to screen an incoming call and route to the VoIP device or voicemail or other routing option based upon criteria). These call control servers are highly capable and highly customizable and serve as the foundation to support future advanced service options. These features are all part of the VoIP service package many of which can be controlled by the customer without any interaction needed on the part of the VoIP provider. As you know, traditional telephone service requires a customer to separately subscribe to each desired feature which must then be enabled by the telephone company to work for that particular telephone number.

WHY VOIP IS INHERENTLY MOBILE

For most VoIP services, the customer operated VoIP devices described above have a traditional 10 digit North American Numbering Plan telephone number assigned to them. However, the uniquely identifiable characteristic for a customer operated VoIP device is the IP address assigned to that device. This is very similar to the electronic serial number (ESN) assigned and used to identify and validate wireless devices. This IP address is used by the carrier in conjunction with authentication information (user names and passcodes) transmitted by the VoIP devices to recognize and authenticate the customer operated VoIP devices and to provide services and features to those devices. IP addresses are a global phenomenon and have no correlation to physical addresses or geography.

As a result, while a VoIP device may have a traditional telephone number assigned to it, the VoIP device can be physically moved to any location where it can connect to an IP enabled data network and continue to send and receive calls. The call control server does recognize the IP address and validates the authentication credentials of the VoIP device but cannot determine the physical location of the device based upon its IP address.

This IP address associated with a customer operated VoIP device provides a unique type of mobility in that the devices can be connected and used to send and receive calls virtually anywhere they can be connected to an IP enabled data network including the public Internet. As carriers and software and equipment manufacturers continue to develop and enhance VoIP devices to become more portable, VoIP services will become even more mobile. For example, some equipment and software manufacturers and carriers have developed application software that can be installed on a laptop personal computer that can be used to send and receive VoIP calls just like any physical VoIP device. As a result, customers are enabled to place calls virtually anywhere they can carry their laptop computer and have wired or WiFi access to an IP network.

In an effort to accommodate emergency services call routing in the presence of this inherent mobility, most service providers have developed methods for permitting individual VoIP device end users to define a temporary location address for emergency services call routing purposes. Based upon temporary address information provided by the end user, service providers can validate the temporary address to determine whether it is within a service area in which the service provider can route calls to an appropriate emergency service provider. If the address is not within a served area the VoIP device can be disabled from placing calls over the service providers VoIP service until it returns to an address for which the service provider can route calls to the appropriate emergency service provider.

The portability and IP address association that characterize these devices facilitates the VoIP service mobility that has been described above. While these technological changes provide substantial benefits to consumers, they also necessitate a reconsideration of the rules applicable to voice services that have traditionally been associated with the physical service address of the originating telephone device, such as taxation.

HOW SERVICES ARE PACKAGED FOR CUSTOMERS

For both business and individual consumers, VoIP services are typically packaged as a collection of basic and enhanced features as well as unlimited or defined local and long distance calling services for a monthly fixed price.

For business customers, the monthly pricing model is often extended one step further to be applied to simultaneous call capacity instead of individual VoIP devices. Specifically business VoIP services are often priced using structures similar to the

purchase of traditional PSTN access capacity like the PBX system mentioned above. As a result, customers purchase sufficient simultaneous call capacity to support the maximum number of VoIP devices that may be communicating with the PSTN at the customer's busiest hour of the day/month and pay a monthly fee based on simultaneous call capacity. In an effort to optimize costs, the amount of simultaneous call capacity to the PSTN that a customer purchases is most often far less than the total number of VoIP devices that the customer may have in service, anticipating that not all VoIP devices will communicate with the PSTN at the same time. Again, this is similar to the intercom lines and the PBX trunk lines that require dialing "9" but it is much more flexible allowing the capacity to be shared by multiple locations and can take advantage of different time zones to reduce the total capacity needed.

While these bundled pricing structures do provide individual consumers and businesses with predictable monthly pricing and the opportunity to reduce their monthly costs, they do further complicate the ability to correlate specific charges for services to the physical location of an individual VoIP device that may have been mobile for some portion of time during the month.

VOIP BENEFITS TO BUSINESSES AND CONSUMERS

Most frequently, the primary benefit to businesses and consumers attributed to VoIP services is cost savings associated with combining their voice services with their IP network services, reducing the overall expense of having to purchase these two services separately.

While this is certainly a benefit, it only scratches the surface of the advantages afforded to businesses and consumers as a result of the operating efficiencies and enhanced applications made possible by VoIP services.

For businesses, VoIP services not only provide cost savings through converging their voice and data networks into one, because of the architectural flexibility of VoIP, but they also enable service providers to extend additional operating efficiency and business continuity benefits. As referred to above, in the area of operating efficiencies, some service providers can now offer the ability for business with multiple geographically distributed locations to share physical access capacity across the locations within their enterprise, substantially reducing their overall capacity costs. This is not technically feasible with traditional PSTN based services. Additionally, VoIP affords the architectural flexibility to reroute traffic real time. So, for example, in the event of a power outage or natural disaster a customer can reroute traffic real time from an affected area to an unaffected area to maintain business operations. And with the mobile nature of VoIP services the business continuity benefits are extended even further.

In addition to cost savings benefits, both businesses and consumers benefit from the continually expanding array of hosted basic and enhanced features enabled by VoIP services, some of which were discussed earlier such as simultaneous ring and selective call screening.

Carrying the concept further, many service providers have expanded the scope of their VoIP offerings far beyond traditional voice calling, to include a host of unified communication options such as instant messaging, short text messaging, and audio conferencing.

Through industry collaboration between service providers, software manufacturers and equipment manufacturers, through leveraging VoIP technology, voice calling becomes much more tightly integrated into the electronic tools that businesses and consumers use to communicate, making the communication options far more flexible and the communication itself far richer.

VoIP services significantly improve and enrich businesses' and consumers' voice calling experiences through enhanced features and capabilities, architectural flexibility, cost savings and operating efficiencies. As a result, demand for these services has grown exponentially and is expected to continue to grow to ultimately displace traditional PSTN voice services. With this growth, so grows the potential and propensity for these services to be increasingly mobile. Because of this inherent mobility of VoIP services combined with their exponential growth, it necessitates a near term reconsideration and modernization of the rules applicable to voice services that have traditionally been associated with the physical location of the telephone device, such as taxation.

CONCLUSION

Technology has outpaced the old rules that apply to the taxation of telephone services. Consumers are going to demand, and technology will provide, new VoIP services that are inherently mobile and cannot be taxed according to the rules that have applied to landline telephone services for many years. The rules need to be

modernized so that a fair tax system will apply at the state and local levels to these new services. The good news is that such a system already exists for wireless services—Congress enacted the Federal Mobile Telecommunication Sourcing Act (MTSA) in 2000. I believe industry and government are in general agreement that Congress needs to expand the federal sourcing rules for wireless services to cover taxes applicable to VoIP services so that all parties can have certainty in the taxation of these services. My colleague from Sprint will explain further how this can be achieved by Congress to benefit consumers, businesses, technological innovation and state and local governments all at the same time.

Thank you for this opportunity to testify regarding Voice over IP services, the relevant technology and the inherently mobile nature these services. I would be happy to answer any questions the committee may have regarding my testimony.

Mr. COHEN. Thank you for your testimony.

Our next witness is Mr. Rob Cole, tax research manager for Sprint Nextel, a position he has held since 2003.

He has worked with industry coalitions and elected officials on a variety of tax policy issues. Mr. Cole was heavily involved with the coalition that worked to seek passage of the Internet Tax Nondiscrimination Act in 2003-2004 and the extension of the act in 2007. Mr. Cole has also worked with several other coalitions involved with telecommunications taxation legislation on State and local levels.

He worked as a tax analyst for Sprint from 2001 to 2003 before becoming the tax research manager. Prior to coming to Sprint, he worked as an attorney and law clerk with BillSoft, Inc., a telecommunications taxation software company in Kansas.

Thank you, Mr. Cole. You are no longer in Kansas. Will you begin your testimony?

TESTIMONY OF ROBERT W. COLE, MANAGER, TAX ACCOUNTING, SPRINT NEXTEL CORPORATION

Mr. COLE. Chairman Cohen, Representative Franks, and Members of this Subcommittee, thank you for the opportunity to testify on an issue of significance to millions of customers, 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. This shift involves the transition from fixed-location, circuit-switched landline services to Voice over IP, or VoIP, and nomadic broadband service.

With opportunity and advancement, however, we are confronted with fitting this new and dynamic service into existing tax laws. The laws were written for services that had a fixed location and phone numbers that identified a specific geographic location.

However, there is a precedent for resolving this issue. The wireless providers had similar issues with fitting mobile services into existing tax laws prior to the enactment of the Federal Mobile Telecommunications Sourcing Act in the year 2000.

The Mobile Sourcing Act is one of the great success stories in both clarity and cooperation between our industry and State and local government. It provides clear and simple guidance for the sourcing of wireless telecommunications services for the purpose of collecting and remitting sales, telecommunications, 911, and other taxes and fees. The Mobile Telecommunications Sourcing Act man-

dates that wireless carriers collect taxes and source these taxes to the customer's place of primary use. The industry is here to advocate the same sourcing rules for VoIP services.

Traditionally, the answer as to which State and local jurisdiction has the authority to tax interstate fixed landline services is well-settled. The U.S. Supreme Court in 1989 decided *Goldberg v. Sweet* and in that decision held that the location of a call would determine the taxability of that call. And that rule is basically the two-out-of-three rule. If two out of three of the following points of a call—origination, termination, and the service address—are in a single jurisdiction, then that jurisdiction has the sole legal authority to tax.

However, you can see where this would be a problem with VoIP services. *Goldberg* is simply inapplicable for VoIP. First, it is not possible for VoIP providers to comply with *Goldberg* because VoIP providers may not have geographic information as to the location of the call's origination or termination.

Additionally, VoIP customers have the option to choose an out-of-area telephone number. This could be done, for example, if you live in Washington, D.C., but your family is in Tennessee. You could get a Tennessee telephone number, and your family could call you without incurring long-distance charges.

Additionally, as we have heard from Mr. Barnes, many VoIP services are nomadic or mobile in nature; they can be moved around. And they can be originated anywhere there is a broadband or high-speed Internet connection.

Additionally, VoIP services are commonly sold as a flat monthly charge for the service rather than as a call-by-call basis. And, finally, there is no call detail record generated. Again, we have no identifying information other than an IP address for many VoIP calls.

These are very similar to the issues that wireless faced before the enactment of the Mobile Sourcing Act. Under the Mobile Sourcing Act, a jurisdiction designated by the customer's place of primary use would have the sole authority to levy taxes and fees. And we would advocate this be extended to VoIP services. Thus, if a VoIP user has a Washington, D.C., place of primary use, only D.C. Has the authority to tax that call. If a tax jurisdiction determines that place of primary use as applied by the customer is not correct, the act outlines a procedure for notifying the VoIP provider and for the VoIP provider to make those changes on an ongoing basis.

The existing Mobile Sourcing Act has been successful in providing clarity to the wireless service providers, to customers, and to taxing jurisdictions. Expanding that act to include 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 to tax VoIP services, multiple or "nowhere" taxation scenarios would be avoided. This protects State and local governments and reduces disputes regarding tax situs. Furthermore, the act protects consumers by ensuring that taxes based on lines of service, such as flat-rate 911 fees, are only imposed on the number of lines that provide simultaneous outward access to the public switched telephone network.

Our industry is facing an important deadline in this issue, as billing systems need to be created or modified in order to correctly bill and tax on VoIP services. 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. The simplest and most efficient way to accomplish this is to expand the scope of the existing Mobile Sourcing Act to include VoIP service.

Again, Mr. Chairman, thanks for the opportunity to testify. And I am happy to answer any questions that you or Members of the Subcommittee might have.

[The prepared statement of Mr. Cole follows:]

PREPARED STATEMENT OF ROBERT W. COLE

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 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 that can be originated anywhere that there is a broadband or high speed Internet connection. There is no fixed origination, termination, or service ad-

dress. 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.

Mr. COHEN. Thank you, Mr. Cole.

The final witness is Mr. Jim Eads, executive director of the Federation of Tax Administrators starting in September 2008, capping a career of over 30 years in State tax work. He leads the Federation of Tax Administrators staff in D.C. and around the country as they seek both to serve and represent the tax agencies of the 50 United States, the District of Columbia, and New York City.

Prior to accepting this position, he was director of public affairs for Ryan, a major tax consulting company where he represented Ryan and its clients regarding State tax policy and legislation across the country. He has also served as a partner in the National Tax Department of Ernst & Young; a senior attorney and government relations counsel with AT&T; senior tax attorney with Sears, Roebuck; and chief counsel of the Revenue Division of the Arkansas Department of Finance and Administration. He is a past president of the National Tax Association and former chairman of the Electronic Commerce Task Force of the Council on State Taxation.

Thank you, Mr. Eads. Will you please proceed?

TESTIMONY OF JAMES R. EADS, JR., EXECUTIVE DIRECTOR, FEDERATION OF TAX ADMINISTRATORS

Mr. EADS. Thank you, Mr. Chairman and Members of the Committee. I am pleased to be here today and to speak to you about this issue.

I find myself in a unique position, that I am able to associate myself with some of the remarks of all the preceding witnesses. I think all the preceding witnesses said that the Mobile Telecommunications Sourcing Act was the product of a lot of negotiation and discussion between government and industry some 9 years ago and has resulted in beneficial effects, we think, both for industry and government as it has been implemented over the course of the years.

I am not here to obstruct in any way the discussion of these issues. The Federation of Tax Administrators does believe, however, that, because of the way that the Mobile Telecommunications Sourcing Act came into being and because it has worked so well, that applying its principles to Voice over Internet Protocol, while it may indeed be meritorious, needs to be done without making any substantive changes to the existing Mobile Telecommunications Sourcing Act.

Again, because of the way it was negotiated, because of the cooperation that existed then and, I think, continues to exist between the industry and government, what we would urge is that there be some continuing dialogue, working with your staff, Mr. Chairman, to try to make sure that nothing is changed in the Mobile Telecommunications Sourcing Act that isn't absolutely necessary to be changed to supply its principles to Voice over Internet Protocol.

I have submitted written testimony, and I would be glad to answer your questions if you have any.

[The prepared statement of Mr. Eads follows:]

PREPARED STATEMENT OF JAMES R. EADS, JR.

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.

Mr. COHEN. Thank you, sir. I appreciate that, and I appreciate your testimony.

At this time, we have questions.

And I would like to ask first, Mr. Barnes, is that the kind of device that Osama bin Laden has?

Mr. BARNES. To be honest with you, I can't tell you what type of device——

Mr. COHEN. But he could use that. That is the kind of thing you could kind of go and—you said nomadic-type thing. I mean, he could take that and you couldn't find him, could you?

Mr. BARNES. It is true that nomadic devices do provide extensive mobility advantages. But all of those services have to be connected to a Voice over IP service provider's service that comes along with order entry information and customer authentication credentials that help define who the customer is and what use they will put the services to.

Mr. COHEN. So when you get that type of equipment, you can hide it from everybody but the taxman, is that right?

Mr. BARNES. Or the service provider.

Mr. COHEN. Or the service provider. Okay.

Mr. Cole, you indicated in your written statement that the industry is facing an important deadline on this issue, as billing statements have to be modified and developments. When is that deadline and what is the deadline?

Mr. COLE. Well, sir, it is coming very close.

Because this is the future of landline telephone service, in my opinion—and I think Mr. Barnes would concur with that—I think we, as an industry, are moving many of our large enterprise customers toward this type of service. And as you have necessary allocation of dollars for system development, it is important that we make a decision on this now—and when I say "now," I think immediately—in order to make sure that, one, there is no revenue loss to State and local governments; two, that we stay out of the courts, States fighting over who has the right to tax; and three, in fairness to our customers.

You know, I deal with questions from customers, and very rarely do I get questions about tax situs, and when I do, it is very easy for me just to point to the Mobile Sourcing Act, and the customers are satisfied. It is a great piece of legislation. It is clear, it is concise. It says exactly, you know, how the provider is to bill and remit taxes and determine the situs for those taxes.

So, in order to have that same level of clarity and certainty for what is really an exponentially growing industry, the answer would have to be sooner rather than later.

Mr. COHEN. Thank you.

Representative Montgomery, you have suggested that the Mobile Telecommunications Sourcing Act would be a model for legislation to provide the clarity that State and local governments need to assess and collect taxes on this type of Voice over Internet Protocol.

Before basing any legislation on a past act, we need to know whether and how well that act has held up in court challenges. Do you know if there have been court challenges to the MTSA? And, if so, what was the basis of the action?

Mr. MONTGOMERY. I am going to defer to my lawyer, but, as far as I know, there has not been—again, in fact, it has brought better clarity and order to what could be a very confusing situation. And so using, again, that model of clarity to both the provider, the consumer, and to governments I think is the major benefit from it. And so if there have not been challenges, I would, again, for the sake that it has brought that clarity, would use it as a model.

Mr. COHEN. I got you. What is the Senator's name there from the capital, that has been there forever? Fred, is it Reichert?

Mr. MONTGOMERY. Risser.

Mr. COHEN. Is he still there?

Mr. MONTGOMERY. He is. He kind of got crossways of his leader and got removed as the longest-serving member in history on the Building Commission, but they reinstated him after there was a bit of an uproar. But he is a great colleague, and he and I share ties.

Mr. COHEN. Well, he is a gentleman. Thank you. Remember me to him, if you would.

Mr. Eads, in your written testimony, you expressed concerns about three proposed modifications to the MTSA, which you say go beyond the scope of merely applying sourcing principles to VoIP. Would you elaborate on those three particular proposed modifications? And who is proposing them, and what are your concerns?

Mr. EADS. Yes, sir, Mr. Chairman, I would be glad to. I have used those in my written testimony as examples. Obviously, we haven't seen any final version of a bill. We have simply seen versions of the bill as it has evolved and may be introduced.

Changing the language of the MTSA relating to the hold-harmless provisions for the industry seems to us to be of some concern, inasmuch as we are not sure why that change would have any applicability to making those MTSA principles applicable to Voice over Internet Protocol services. The provision relating to multiple VoIP lines may, in fact, be benign. It is just simply an issue that we believe needs some further discussion. And, finally, with regard to the Universal Service Fund, there is some disparity of treatment of that issue by the States, although I think the vast majority of the States do it in a way that this bill contemplates.

All we are suggesting is that these are not fall-on-

your-sword, undermining-the-foundation-of-the-republic issues. We believe that they are simply changes to MTSA that don't appear to be directly related to VoIP, and therefore we would like to have some further explanation of them, working with your staff and with the proponents.

Mr. COHEN. Staff has been so instructed and will do that. Thank you, sir.

Mr. Scott, the gentleman from Virginia who has a new basketball coach, one of his choosing I think, you are recognized.

Mr. SCOTT. Thank you, Mr. Chairman.

Let me just get all the witnesses just to give us an idea of what is going on now, what the present law is and where you are taxed. If you buy a phone in Maryland, you use your phone in Washington, DC, you live in Virginia and your best friend lives in New York, so you have a 212 area code. Now, on cell phones, where do you get taxed today with a cell phone? Where would you get taxed today with VoIP? And if a bill passes, what would change?

Mr. COLE. Okay, you may have to run by those locations.

Mr. SCOTT. Okay, you buy your phone in Maryland. You use your phone in D.C. You live in Virginia. Your best friend lives in New York City, so that is where you are calling back and forth.

Mr. COLE. What we would do as a provider, under the Federal Mobile Sourcing Act, with mobile telecommunication services, not VoIP services, would be to rely on the place of primary use that you provide me. What the language of that Mobile Sourcing Act says is that we can default to your home address. So, if I kept track of this correctly, that would be in Virginia. You live in Virginia, correct?

Mr. SCOTT. Right.

Mr. COLE. Okay. So, under the Mobile Sourcing Act, and if that was the primary place of use that you provided——

Mr. SCOTT. Well, if I am using the phone and if all outgoing calls are coming out of D.C., since that is where I work and that is where I am during the day——

Mr. COLE. Again, that would have to be—if you provided us with a D.C. Business address——

Mr. SCOTT. No, I gave you my home address as my address, but I use the phone in D.C.

Mr. COLE. If you provided your home address, then it would be Virginia. Under the Mobile Sourcing Act, your home street address is—that jurisdiction that encompasses that has the sole authority to tax those calls.

Now, moving along in your question, for VoIP right now, I think you have illustrated the nature of the question: Which State does get to tax that? We don't know. Right now we simply do not know. If the Mobile Sourcing Act were to be expanded to include VoIP, then we would rely on that same place of use that you provide, your home address, and that would be Virginia.

Mr. SCOTT. Now, I provided the home address. Is there a little box you can check off or a little blank you can fill in where the primary use is?

Mr. COLE. Actually, I can't speak for other providers, but that is something that we require our customer service reps when we set up an account, we ask them specifically, "What is your place of primary use," because that is required by Federal law.

Mr. SCOTT. Okay. And if I find out that North Carolina doesn't have a tax, can I say Raleigh?

Mr. COLE. You can find that out, but it would be a violation of Federal law.

Now, the corrective measure in the Mobile Sourcing Act is that, if Virginia comes in on audit and determines that is incorrect, that you, the customer, have been giving us false information, here is the beauty of the Mobile Sourcing Act: We are not held harmless, going backwards, because it is not our fault, we as the provider. And the State is able to say, going forward, "Hey, this is incorrect. This place of primary use is really in Virginia. You need to bill and remit these taxes in accordance with a Virginia place of primary use."

And that is why I think the Mobile Sourcing Act has been such a great success. It is a win-win situation for all three of the parties. And, frankly, I am not aware of any issues, in my time at Sprint, where a customer has attempted to game the system in that fashion.

Mr. SCOTT. Well, you have said primary use. If I only use the phone in D.C. And all of the calls that you have a list of start off in D.C. And none of them are in Virginia because, by the time I get back home, it is too late to be using the phone in Virginia, you still tax at my home address?

Mr. COLE. Right. And there are two reasons for that. One, it is the place of primary use that you provided us. And, two, the default under the Mobile Sourcing Act—and this is also consistent with Streamlined—is your home address—the Streamlined Sales Tax Act.

Mr. SCOTT. But with cell phones, you have a record of where the calls are coming from. Do you ever check?

Mr. COLE. No, because we are not required to under Federal law. Under the Mobile Sourcing Act, we are not required to do that. And the reason why is to prevent D.C. And Virginia from fighting over those tax revenues. This provides Virginia with a clear mandate that they have the authority, and they alone, to tax those calls.

Mr. SCOTT. And if I were to move to Maryland, move my home address to Maryland, then the taxing would change?

Mr. COLE. Correct. You would have to provide——

Mr. SCOTT. So the only thing that seems to matter is the home address.

Mr. COLE. That is correct. That should be the place of primary use provided by the customer.

Mr. SCOTT. Whether it is the primary use or not.

Mr. COLE. Correct.

Mr. SCOTT. Can you argue that your primary use is in a lower tax jurisdiction?

Mr. COLE. You could argue that, but then, again, if we get——

Mr. SCOTT. Well, I mean, if D.C. has a lower tax than Virginia and I am actually using it in D.C., can I argue that the primary use is D.C.?

Mr. COLE. Not if you didn't present that as your place of primary use.

Mr. SCOTT. When I bought the phone.

Mr. COLE. Right.

Mr. SCOTT. And if the primary use location changes, what happens then?

Mr. COLE. Then it is the customer's responsibility to provide that information to the telecom provider.

Mr. SCOTT. Okay. Thank you.

Mr. COLE. And, again, this has been the settled law for almost 8 1/2 years now. And I think it has worked very well for both the State and local governments and for industry and, frankly, for consumers. I have gotten a handful of questions about this sort of thing from customers, and it is very easy to say, "Hey, you know, this is why you are getting these taxes, it is because you provided this place of primary use," and then they understand that no one is trying to play games, no States are trying to fight over these taxes, the industry is doing it as required by law.

Mr. SCOTT. What is the complication of expanding it to include the VoIP?

Mr. COLE. I don't see a complication. I think that is the answer to the problem where, going back to your scenario with a VoIP device, a nomadic VoIP device like this here, you have those very same questions, you know, purchased in Maryland, used in D.C., home address in Virginia, there is no clear answer in Federal law or State law as to where to tax that call. And so that is why——

Mr. SCOTT. The computer could be in D.C.

Mr. MONTGOMERY. And this is one of many issues that we are dealing with at the State. In Wisconsin, we just enacted the streamlined sales tax, where if you purchase something in Wisconsin or you purchase it on the Internet, we are able to collect the tax in another State. And part of that is getting the verbiage of whatever it is you are purchasing down to something discernable. So if you buy a bottle of water or a bottle of juice, it is, in essence, taxed the same way.

So this is just another area where we are dealing with a new generation of telecommunications that we are trying to make it, again, incumbent on the customer to say, "I live in Virginia, but almost all my calls are in Maryland," and so you would then declare Maryland as your primary point. But if you declare your home as Virginia, they can come back later and if they see 99.9 percent of your calls are actually in Maryland, then Maryland would have a case to say, "Well, no, your primary point of use would be Maryland."

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. COHEN. Thank you, Mr. Scott.

Mr. King, you are recognized. And if you have questions of Mr. Montgomery, I would ask that you try to ask them first, so he can take off to the airport. He has a plane to catch.

Mr. KING. Thank you, Mr. Chairman. I would be happy to accommodate that.

Mr. Montgomery, it just raises a little a curiosity in me, having just passed the streamlined State sales tax that you mentioned, how many States have conformed with the language that Wisconsin has approved?

Mr. MONTGOMERY. I believe 28 now have. And, again, one of the misconceptions of streamlined sales tax is that it has to be a revenue enhancer. In fact, you can implement it as part of your overall tax policy without having to raise taxes by implementing it.

Mr. KING. "Revenue enhancer." How would you then, Representative Montgomery, how would you deal with it in Wisconsin—having just been through this debate and having a real feel for trying

to broaden and level these sales taxes out so that there are fewer exemptions and that you can conform the exemptions—how would you then react as a State legislature if we were to do the prudent thing here in this Congress and eliminate the IRS, the Federal income tax code, and impose a national consumption tax to supplement your State sales tax?

Mr. MONTGOMERY. Yeah, and, again, it is a very fine line for us to—again, when you are advocating for simplicity and then again having Federal preemption, as always I will stand by the States and ask that you allow us to work in conjunction with each other to determine that.

But, again, as I go down my Main Street and I talk to my retailers of computers and everything else, they are automatically, in a very competitive market, put at a 5 percent disadvantage if the consumer chooses to use the Internet.

So there are a number of different issues that come into this. But, overall, I would say that, again, the States have done a great job of working together through NCSL to address those issues.

Mr. KING. And have you worked with the American Legislative Exchange Council, as well, or what is their level of dialogue in this discussion?

Mr. MONTGOMERY. I apologize, I could not hear the group?

Mr. KING. The ALEC, the American Legislative Exchange Council?

Mr. MONTGOMERY. Yes, you know, and I have, in fact, because I am a member of that organization, as well. And they take a different approach, again, or a little bit more on wanting each individual State. Again, there is a balance.

And, again, when I talk to people at ALEC, again, you can implement this without raising people's taxes. I won't use the "revenue enhancement," but you can implement this and, again, represent your people on Main Street that are having to compete on the Internet against providers.

I have a provider of Sony computers in my district. He is a very big supporter of University of Wisconsin-Green Bay. He regularly loses out on bids to people that don't even live in our State, let alone pay any kind of property tax or support to the university.

Mr. KING. I agree with you, Representative Montgomery, that it is a disadvantage to our Main Street businesses that have a disproportionate sales tax that might be sold over the Internet as part of the motive for this.

It is your hope, then, that the rest of the States will follow and conform to the legislation that you have passed in Wisconsin and the 27 other States?

Mr. MONTGOMERY. Well, again, I would hope that they each look at it in such a way that—I did not implement it in my State. In fact, I voted against it, because it was used as, again, as a revenue enhancer as opposed to an overall tax policy.

But I would say this, that, again, the aspect of it that levels the playing field for my Main Street, brick-and-mortar businesses is something that I totally agree with.

Mr. KING. I thank you, Mr. Montgomery. And I want to make sure that, if you do have to run and catch that plane, I won't come

back with a follow-up question to you. But I did have a couple of others that I wanted to direct across the panel.

Just a short one to Mr. Eads before I go to the telecommunications companies, and that was also in response to one of your responses to the questions I think, Mr. Eads, or perhaps when I read your testimony. But are you as an organization working hand-in-glove with NSCL?

Mr. EADS. Representative King, we are in same building as NCSL. We are in the same building with the National Governors Association. We are in the same building with a lot of associations of State officers.

The Federation of Tax Administrators represents tax agencies. So I don't come from a constituency in which I can come up here and sign off on behalf of the States on something. I come as a representative of an organization that has what we hope is some technical knowledge about how tax administration works and how tax policy gets implemented.

And so, the short answer to your question is, yes, we work with NCSL, we have worked with the National Governors Association. But we are here primarily as a resource about what are the technical and policy issues regarding tax administration, and that is what we try to provide to Congress.

Mr. KING. Mr. Eads, I understand your professionalism in this. And I am curious as to what level of involvement, then—in the same building with NCSL—how involved, then, is the American Legislative Exchange Council? Are you able to work with them also?

Mr. EADS. We work—ALEC is not in our building. I have worked with ALEC in my prior lives. I know ALEC members. And the Federation of Tax Administrators is willing it to work with anybody who is interested in efficient tax administration and good tax policy, absolutely.

Mr. KING. And That really does, I think, answer my question. I just wanted to bring that up to that level. And I see my light has turned red. However much curiosity I have, I am going to defer to the rules of Committee and——

Mr. COHEN. If you would like it to ask another question, you have been here, and I appreciate it, and you go ahead, Mr. King.

Mr. KING. Well, thank you.

And I do have—and I listened to each of you. I would go to Mr. Barnes, if I could.

And I mentioned the situation and you are concerned about how taxation, multiple taxation that might take place, the possibility of multiple taxation. What is your level of comfort, after testifying in this hearing, that there won't be multiple taxation on the services that you provide?

Mr. BARNES. Excellent question.

I believe that, as we define clear and concise taxation methodology from the outset, that we can establish those rules in advance of tax assessment. And, as a result, we can avoid in advance any opportunities for double taxation.

Mr. KING. Thank you.

And, Mr. Cole, same question?

Mr. COLE. I think, frankly, sir, if this legislation is passed, I don't think you will see any multiple taxation. I think if this legislation is not passed, I think you could conceivably have a customer that receives taxes from several jurisdictions. One provider might choose to look at the law in that State one way, Sprint may look at it another way, and the customer may get different State taxes from different providers. I mean, it is really a situation where that type of confusion could exist if we don't establish a clearer framework at the outset.

Mr. KING. Okay. And I am presuming here a little bit because I didn't hear the early part of the question, I regret I was called away. But do I understand this that we would have and we would deploy the technology that would automatically direct the taxes to the jurisdiction where they should be applied because of predominant use?

Mr. COLE. That is correct, yeah. We already have that on the wireless side, and it would be much easier to implement if we were to go to this on the VOIP side. And I know that it would probably be just as easy for the third-party software providers like Vertex that provide some of our tax rating software to the various carriers.

Mr. KING. Let me just submit that, in my experience, looking at efficiency and mistakes and error, that the most persistent errors are created by human beings and the most efficiency that we provide is with machines and technology. So, with that, I am always going to want to err on the side of let the technology make the decision, because human beings are fallible.

I appreciate the testimony of all of you.

Mr Chairman, I appreciate this, and I would be happy to yield back the balance of my time.

Mr. COHEN. Thank you, sir. I appreciate your attendance, and that of Mr. Scott and Mr. Johnson here earlier.

I thank all the witnesses for their testimony.

Without objection, Members have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask you to answer promptly. They will be made part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any other additional materials.

Again, I thank everyone for their time and patience, particularly Mr. Eads. You have had previous lives, you and Shirley MacLaine. It is nice to have had you here.

This hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 4:04 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

RESPONSE TO POST-HEARING QUESTIONS FROM THE HONORABLE PHIL MONTGOMERY, WISCONSIN STATE ASSEMBLY

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on VoIP: Who Has Jurisdiction to Tax It?
March 31, 2009

The Honorable Phil Montgomery, Wisconsin State Assembly
Chair, NCSL Committee on Communications, Financial Services & Interstate Commerce

Questions from the Honorable Steve Cohen, Chairman

1. **You indicated in your written testimony for the hearing that NCSL membership passed a resolution requesting Congress pass legislation which would extend the Mobile Telecommunications Sourcing Act sourcing provisions to Voice over Internet Protocol. Did any state legislatures express concern about the resolution or the need to involve Congress?**

   Response: No. This concept was presented to and vetted by the NCSL's Executive Committee Task Force on State and Local Taxation of Communications and Electronic Commerce, which recognized that such legislation would confirm states' authority to tax, if they so choose, the entire VoIP service as long as the customer's place of primary use is located in the state. The NCSL resolution was then passed unanimously by the NCSL Standing Committee on Communications, Financial Services and Interstate Commerce and then by a unanimous vote of all 50 states at the NCSL annual business meeting.

2. **How would legislation modeled on the Mobile Telecommunications Sourcing Act eliminate the possibility of "nowhere" taxation?**

   Response: One of the features of mobile VoIP service is that it can be used from any location at which the user has a broadband connection to the Internet. Therefore, the customer's "service address" for purposes of the traditional "2-out-of-3" rule for sourcing telecommunications services for tax purposes can vary depending on where the service is used; and it is impossible for carriers or taxing authorities to know these various locations.

Therefore, under the traditional sourcing method, it is possible that this mobile usage would not be sourced to any state. The proposed legislation remedies this by authorizing the state in which the customer's place of primary is located to tax, if it so chooses, the entire charge for the service regardless of where it is actually used at various times.

3. **How have some states attempted to collect taxes on Voice over Internet Protocol communications services?**

   Response: The laws of most states do not contain special rules for taxing or sourcing VoIP services. However, the laws of states conforming to the Streamlined Sales and Use Tax Agreement sourcing rules contain provisions that source VoIP services in the same manner as the MTSA, i.e., based on the customer's place of primary use. While there is some authority to support this method of sourcing from a commerce clause perspective, the proposed legislation would provide complete certainty as to its constitutionality in addition to providing uniformity.

4. **It is rare for a state legislator, on behalf of all state legislatures, to come to Congress and ask it to set aside federalism principles and intercede on its behalf. Please explain why you did so on March 31, 2009.**

   Response: While I strongly support the principles of federalism, I also recognize that there are situations in which it is appropriate and desirable for Congress to act. As we did almost ten years ago with our support of the MTSA, state legislators realize that in the "new" economy state boundary lines are not as enforceable for some purposes. We need to establish a national framework or rule that allows for each state if they so choose to tax VoIP service and at the same time does not cause a multiplication of taxes from various states or localities on the consumer. A national sourcing rule such as we supported in MTSA is indeed the way federalism should work.

5. **Mr. Eads' expressed in his written statement for the hearing that any proposal to amend Title 4 to apply the sourcing requirements based on the Mobile Telecommunications Sourcing Act to Voice over Internet Protocol should be limited only to Voice over Internet Protocol or sourcing. He expressed concerns about three proposed modifications.**

Would you please respond to his concerns and provide reasons for why the industry and state legislatures are looking to expand beyond the sourcing principles of the Mobile Telecommunications Sourcing Act?

Response: Mr. Eads did express concern about three changes to the MTSA that have been proposed by the industry but which he felt are not strictly related to extending the MTSA sourcing provisions to VoIP. One of these is a proposed change to the hold harmless provisions to make it clear that, as long as a provider diligently follows the MTSA situsing rules, it will be held harmless from any adverse consequences of an inadvertent situsing error, regardless of how the consequences are characterized. In my view, this was the intent of the original hold harmless provisions; and I believe that amendments extending the MTSA sourcing provisions to VoIP service present an appropriate opportunity to clarify this point, which has become an issue for some carriers. Mr. Eads also expressed concern about a proposed provision concerning the application of fixed "per-line" charges to VoIP service. Now that I understand its purpose, I believe this change does relate to the extension of the MTSA to VoIP service and feel it is needed because of the different manner in which certain VoIP services are sold, i.e., based on capacity, or bandwidth, and which unlike traditional wireless service is unrelated to the number of telephone numbers that may be associated with the service. The third item Mr. Eads mentioned was a proposed change that would have the MTSA sourcing provisions apply to state USF fees. When the MTSA was originally enacted almost 10 years ago, no states imposed USF fees; and therefore there was no need to carve them out of the exclusion that was intended to apply to federal USF fees. Now, however, many states impose such fees and it makes sense that they be treated the same as other state and local transaction taxes, charges and fees. Finally, I would like to point out that since my testimony in March, the industry has been working closely with the FTA, of which Mr. Eads is the Executive Director, on the scope and language for each of these provisions; and I am confident that they will reach an agreement by the time a bill is introduced.

RESPONSE TO POST-HEARING QUESTIONS FROM JOHN L. BARNES, DIRECTOR, PRODUCT MANAGEMENT AND DEVELOPMENT, VERIZON BUSINESS

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on VoIP: Who Has Jurisdiction to Tax It?
March 31, 2009

John Barnes, Verizon Business

Questions from the Honorable Steve Cohen, Chairman

1. **Voice over Internet Protocol is an amazing technology. But just like the telegraph and soon the telephone, it will be surpassed by another technology. What is on the horizon for improving telecommunications? And how would the current tax systems account for that new technology? Will we have to revisit this issue but with a different technology in the next decade?**

Response:

You are correct. Telecommunication is evolving and is expected to continue to evolve. In the foreseeable term, Voice as an application and telecommunications in general appears to be continuing to evolve leveraging Internet Protocol (IP) technology. To this end, the nature of this IP evolution is centering around expanding the access network options and the capabilities of those network options as well as combining voice with other IP enabled applications to enrich a consumer's and business' communication experience.

Regarding the expansion of access network options, with the advent of advanced technologies such as fiber optics access to the home and wireless broadband data transport, these new technologies and others are enabling exponential increases in bandwidth and reliability to support more advanced applications, as well as to facilitate unprecedented mobility of Voice over IP and other advanced applications.

Additionally, with Voice over IP made possible by these new technologies, voice communications becomes simply another IP enabled application that can be more easily combined with virtually any application that is IP enabled, making voice communications far more accessible and capable. Voice communications can be combined with desktop and web based applications like email, address books and

web pages making it easier and more intuitive for consumers and businesses to launch into a voice transaction, enhancing communications convenience and productivity. Similarly, voice communications can be more easily combined with other forms of communication like video, net conferencing, instant messaging, text messaging and file sharing enhancing and expanding the overall communication experience. These VoIP tax sourcing rules will apply to charges for, or associated with, the provision of VoIP service, or any charge for, or associated with, a service provided as an adjunct to VoIP service, that is billed to the customer by or for the VoIP service provider. Accordingly, the existing tax language should address other IP enabled services used in conjunction with VoIP applications.

While at present, these voice communication enhancements are all being developed by leveraging IP technology, it is clear that consumers and business are driving service providers and equipment providers to continue to evolve voice telecommunications and communications capabilities with the goal of permitting further mobility, enabling consumers and businesses to effectively and productively communicate whenever and where ever they may be. In the event other technologies create the ability of a particular service to be mobile and no longer provided only a fixed location, the rule for taxing mobile services such as commercial mobile radio service and VoIP at the place of primary use should be applied to those technologies.

As a result, actions taken by this committee and this Congress to provide sustainable taxation rules for mobile services at the customer's place of primary use for IP voice services that are becoming increasingly mobile in nature, should transcend the technological evolution that is based on the development of IP applications associated with these voice services and likely be applicable through the next decade and beyond.

2. **Please explain more why the industry predicts that consumers and businesses will choose Voice over Internet Protocol over traditional landlines. Or in place of their wireless phones, which now have the ability to download songs, take pictures, make calls, play music, access the Internet, among many other things.**

Response:

Consumers and businesses are already flocking to Voice over IP in large numbers and their numbers are continuing to grow exponentially year over year. Initially, they were attracted to Voice over IP for economic reasons because a

broad assortment of service providers could offer more cost effective technological solutions at lower price points.

But as application advancements continue, consumers and businesses are finding greater opportunities to enrich their communication experience and manage their communication experience by combining it with other applications. For example, businesses can embed voice communications in their business applications and employee desktop software making their employees and customers more productive. Additionally, they can manage those services through IP enabled command and control applications to access capabilities and enhancements that they have to rely upon their service provider or equipment provider to do for them with their traditional PSTN based service.

Regarding their wireless phones and the advanced applications they support such as the ones you referenced, consumers and businesses are not moving away from them. Instead, they are driving service providers and equipment providers to evolve their Voice over IP and other communications applications, such that their wireless communications becomes a fully integrated component of their total communication experience. For example, service providers and equipment providers have evolved their services and devices to support seamlessly moving voice transactions between their wireless and IP enabled wireline phones, and the networks over which they operate, without disrupting the call in progress in any way. Further, wireless and wireline integration demand has driven the development of additional advanced applications that reside on wireless devices to better manage their services such as applications for managing service feature enablement and unified voicemail management. However, the existing Mobile Telecommunications Sourcing Act only applies to CMRS – wireless systems. Expansion of the tax rules to the wireline networks with which they are increasingly integrated or any other technology that is mobile in nature is necessary.

So, rather than displacing wireless services, Voice over IP service providers and equipment providers are leveraging IP technology to fully integrate the wireless and wireline communication experience offering the service benefits of both technologies to consumers and businesses.

RESPONSE TO POST-HEARING QUESTIONS FROM ROBERT W. COLE,
MANAGER, TAX ACCOUNTING, SPRINT NEXTEL CORPORATION

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on VoIP: Who Has Jurisdiction to Tax It?
March 31, 2009

Robert W. Cole, Sprint Nextel Corporation

Questions from the Honorable Steve Cohen, Chairman

1. **Mr. Eads' expressed in his written statement for the hearing that any proposal to amend Title 4 to apply the sourcing requirements based on the Mobile Telecommunications Sourcing Act to Voice over Internet Protocol should be limited only to Voice over Internet Protocol or sourcing. He expressed concerns about three proposed modifications and discussed them briefly during questioning by the Chairman. Would you please respond to his concerns and provide reasons for why the industry and state legislatures are looking to expand beyond the sourcing principles of the Mobile Telecommunications Sourcing Act?**

   If I recall correctly the three concerns were as follows – why is there a proposed change to §117 regarding designation of a E911 location, why is there a proposed change to §119 regarding electronic databases, and why is there a proposed change to the hold harmless provisions in §119 and §120. The change to §117 is proposed in order to provide a clear mandate that the provider must use the customer's place of primary use, rather than a temporarily designated E911 address, to determine tax situs. This will eliminate any confusion with the temporary E911 address designation required for regulatory purposes that is required to route nomadic VoIP calls to E911 to the correct Public Safety Answering Point, a requirement that did not exist when the MTSA was passed. The change to §119 is proposed in order to correct a defect in the existing law. Although the current law specifies the database will designate "for each street address in the State, including to the extent practicable, any multiple postal street addresses applicable to one street location, the appropriate taxing jurisdictions, and the appropriate code for each taxing jurisdiction, for each level of taxing jurisdiction, identified by one nationwide standard numeric code", §119(a)(2)(A), the Act did not make clear that the database must contain those taxing jurisdictions for each level of tax, charge or fee covered by the

Act. This proposed change will correct this oversight. The change to the hold harmless provisions in §119 and §120 is proposed because the current MTSA language technically applies only to a service provider's potential liability for any additional amount of the underlying tax or fee that was not paid as the result of a customer situsing error. The amendment is intended to make it clear that the hold-harmless protection applies to any type of claim or disallowance that could be asserted by a taxing jurisdiction against a service provider based on a situsing error, regardless of how it is characterized. It is important to note that this provision, as currently proposed by the industry, would apply only to claims by the taxing jurisdiction and would not require the taxing jurisdiction to hold the service provider harmless from claims by other parties, such as customers, for situsing errors.

2. **You indicated in your written statement for the hearing that the "VoIP industry is facing an important deadline on this issue as billing systems have to be modified and developed." Although you briefly responded to a question about the deadline, please explain in greater detail why is there a deadline and what is the deadline?**

   The deadline is based on the fact that the product is being implemented very quickly. Traditional voice services to both individuals and businesses are being replaced by both nomadic VoIP applications and large IP based enterprise networks, respectively. As this technology has significant benefits and cost savings over prior models it will be adopted by customers regardless of whether tax sourcing rules are implemented.

3. **In terms of dollar figures, how much is it costing providers of Voice over Internet Protocol to comply with the current state and local government tax laws on Voice over Internet Protocol? How would a uniform system proposed by you and Representative Montgomery benefit providers and states?**

   It has not cost providers any substantial amount as of yet. However, that is because the product is only now being delivered to market on a widespread basis. States will not begin audits until 3 to 5 years from now. At that point, states will likely realize that the lack of a uniform system for tax souring of VoIP products will have cost states billions of dollars in incorrectly paid tax revenue. The cost will then be borne by states as they litigate with providers and other states over lost tax revenue, the providers as they fight the audit

and pay interest and penalties on assessed amounts, and the customer, who will be forced to pay higher monthly bills for telecom service.

4. **Besides following the sourcing principles of the Mobile Telecommunications Sourcing Act, is there another way to resolve these concerns you and Representative Montgomery have about the state and local taxation of Voice over Internet Protocol services?**

   There is not another workable solution short of states engaging in court challenges to each other's claim over a mobile telecom customer's tax revenue.

5. **You suggested that the Mobile Telecommunications Sourcing Act be a model for legislation to provide the clarity that state and local governments need to assess and collect taxes on Voice over Internet Protocol services. Before basing any legislation on a past Act, we would need to know how well that Act has held up to court challenges. Have there been any court challenges to that Act? If so, what was the basis?**

   I am not aware of any court challenge to the Mobile Telecom Sourcing Act.

RESPONSE TO POST-HEARING QUESTIONS FROM JAMES R. EADS, JR., EXECUTIVE DIRECTOR, FEDERATION OF TAX ADMINISTRATORS

Questions for the Record
Subcommittee on Commercial and Administrative Law
Hearing on VoIP: Who Has Jurisdiction to Tax It?
March 31, 2009

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

Questions from the Honorable Steve Cohen, Chairman

1. **You suggested in your written testimony for the hearing that if Title 4, which was amended by the Mobile Telecommunications Sourcing Act, were to be opened for amendments, state tax administrators would offer proposals. What would you propose? Would these changes benefit all interested parties?**

Answer from the Federation of Tax Administrators: My comment was only meant to reflect the fact that the MTSA was the product of extended negotiation between the interested parties when it was enacted and that the agreed-to principles that were the result of that negotiation did not need to be disturbed. But, if the industry insisted on opening up the MTSA provisions, states should have an equal opportunity to change its provisions. We do not have specific proposals at this time.

2. **Providers of Voice over Internet Protocol and state legislatures seem to believe that legislation addressing sourcing principles of Voice over Internet Protocol is needed. Yet, you suggest in your written statement for the hearing that change is not strongly required, just yet. Why? Is there a different approach to alleviate this expected issue? What can the states do without Federal intervention to resolve this expected issue?**

Answer from the Federation of Tax Administrators: I am not sure that all state legislatures believe that Congressional action is needed. If state legislators perceive a problem, what actions have they taken at their level to address the problem? It would seem arguable that if they have taken no action, perhaps they have not perceived a problem. Certainly they could have initiated some action if they felt it was necessary. My comment that action might not be necessary was

predicated on a lack of evidence as to the magnitude of the VoIP market today, the growth and growth potential of that market and the possibility that settled principles of constitutional and state law could adequately address the issues presented by the industry. The states are willing to initiate a project to draft model state legislation and/or regulations to address this issue and believe that such an approach is preferable to federal preemption. We are currently engaged in robust discussions with the industry and are working assiduously to arrive at some meaningful solution.

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