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INTERNET OF THINGS: Quick Guide to Tax and Regulatory Considerations

Tax and Regulatory Considerations

Companies are realizing new value from traditional products by connecting devices to the Internet. Ovens, thermostats, cars, medical devices and even articles of clothing now have their own IPv6 addresses and numerous sensors with connected capabilities.

In 2009, the number of "things" connected to the Internet surpassed the number of people, and by 2020, there will be 50 billion connected devices, according to a 2015 Federal Trade Commission (FTC) report.

Businesses vary in their motivations for entering the Internet of Things (IoT) market. Many are looking to new growth opportunities or new revenue streams from subscriptions or increased sales. Meanwhile, others want to maintain or build brand loyalty, and they enter the market to ensure their competitive edge.

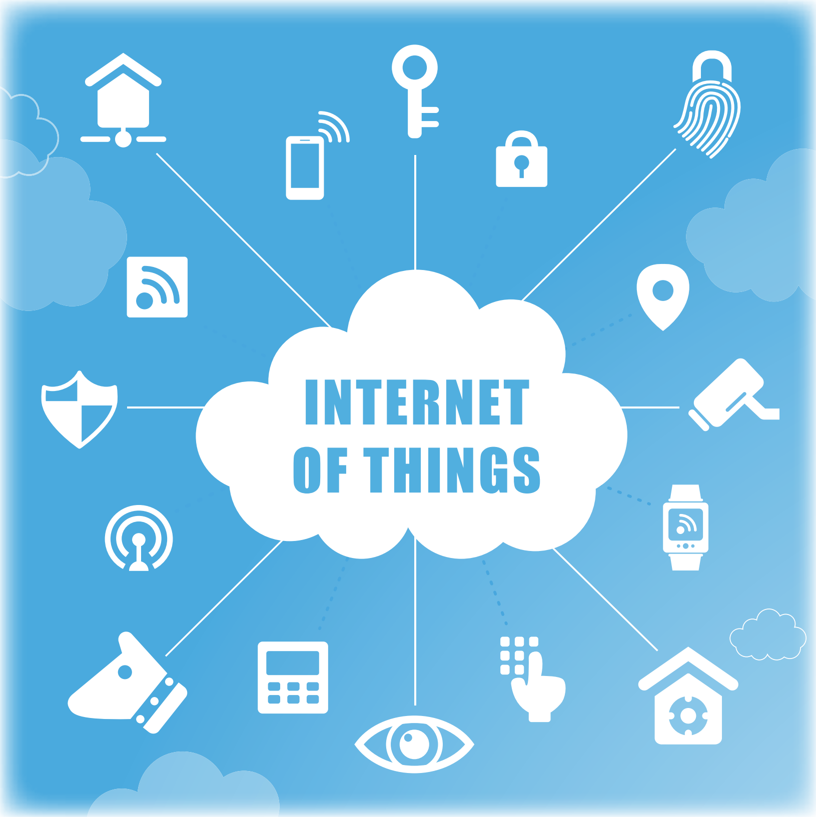
But while these businesses look to the future, many are neglecting to consider the regulatory and tax implications of entering a market with a voice and/or data transmission (communications service) component.

THIS BRIEFING DOCUMENT WILL:

- **PROVIDE** your business with information about the tax and regulatory fee implications of providing a connected product or service.
- **DISTINGUISH** between traditional products and communications services.
- **DESCRIBE** the complications of communications service regulation.
- **EXPLAIN** compliance options for companies developing Internet of Things products and services.

Classification of Communications Services

In an Internet of Things world, traditional companies that combine basic products with new communications services are opening the door to classification as communications service providers.



HERE'S AN EXAMPLE:

A company sells a product bundled with communications services that allow the product to access the Internet and to download and upload data.

In an audit, when a regulatory or tax agency reviews the product and service, the government agency will assess whether or not the product is a service providing telecommunications. As more and more of a company's revenue is derived from services rather than products, government auditors will be less likely to view the product as a traditional product. All of a sudden, the manufacturer of appliances, automobiles, or medical devices is a communications company that will be taxed and, potentially even regulated by federal and state regulatory authorities.

Complications of Communications Service Regulation

If the services your company provides fall into the category of communications services (voice and/or data transmission), you may face heavy regulatory oversight and a number of different taxes and fees. This result may be inevitable for some companies, but for others it is best to avoid this regulatory and taxability status.

In 2014, there were estimated to be over 300 types of telecom taxes, fees, charges, and surcharges imposed on potentially 685 different tax bases requiring potentially 48,000 different filings per legal entity across tens of thousands of jurisdictions at the federal, state and local levels.

When determining regulatory status, various complications arise. One important problem is the issue of nexus, meaning the connection of a company with a jurisdiction for purposes of taxation. Communications services are taxed based on where their customers are located or services are provided (billing or service address), whereas traditional businesses selling products are taxed based on the physical presence of the company in a jurisdiction or a substantial connection between the company and the jurisdiction.

Establishing nexus for communications services may create nexus for multiple tax types in a taxing jurisdiction – sales, use, communications, utilities, and even income taxes. Moreover, sales of communications services can "contaminate" other sales, which might have otherwise escaped taxation.

Some companies that are not used to telecom taxes and regulatory fees may not be prepared to analyze the regulatory impact of their services and to recognize issues that could increase their tax bill.

Compliance Options for IoT Companies

Companies investing in new Internet of Things technologies should analyze the tax and regulatory fees that may arise when incorporating new technological capabilities and new services into traditional products. Working with competent counsel, your business can get a better sense of what the line is between unregulated products and regulated services.

By obtaining tailored answers to compliance and tax questions, your management can make informed decisions on what kinds of products and services your company will offer. Designing products and offerings with compliance in mind will give your business greater peace of mind and flexibility and promises to reduce long-term risk.

For companies newly classified as communications service providers, structuring and planning for compliance today will help guard against tax penalties and regulatory fines tomorrow. Companies should also ensure that the decisions they make on regulatory classifications are defensible in the event of an audit.

Contact Us for Assistance

Analyzing the tax and regulatory ramifications of the Internet of Things and developing strategies to mitigate the potential unintended consequences of adding communications services to a "product" is a complex endeavor. But the long-term risks of neglecting this important step can be disruptive and economically catastrophic.

Attorneys in The *Comm*Law Group's Communications Taxes & Fees Practice Group can help you unpack and understand the myriad issues and how they may impact your business. Moreover, our Attorneys can assist in the development of practical and pragmatic strategies that will enable, and not inhibit, your company's ability to take full advantage of the Internet of Things.

CONTACT US:

Allison D. Rule
Partner, Co-Chair, Communications Taxes & Fees Practice
703.714.1312
adr@CommLawGroup.com

Jonathan S. Marashlian
Managing Partner, Co-Chair, Communications Taxes & Fees Practice
703.714.1313
jsm@CommLawGroup.com

www.CommLawGroup.com

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In association with The *Comm*pliance Group, which specializes in fixed-fee licensing and compliance services tailored to the communications industry, The *Comm*Law Group offers businesses the "Full Spectrum" of legal, regulatory, administrative, and consultative services.

The *Comm*Law Group was recently profiled in The Wall Street Journal as one of the Capital Region's Premier Law Firms.