



Advanced FCC Revenue Reporting: Misperceptions, Mistakes & Missed Opportunities

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Speaker Bios

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- Cloud Communications and other Communications as a Software ("CaaS") providers
- Traditional wireline telecommunications services, such as domestic & international Long Distance and Competitive Local Exchange
- Information & enhanced communications services
- Wireless services
- Broadband & Internet Access services
- Advanced communication application (apps) services & developers
- All forms of Internet Based (IP-based) services, including Voice over Internet ("VoIP") and other hybrid & convergent communications service providers
- Communications equipment manufacturers

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About the Firm. The *CommLaw* Group is unique among its peers, offering clients a scope of capabilities rarely found in boutique law firms. With a headcount rivaling the Telecom Practice Groups of most major law firms, we boast a team of attorneys, paraprofessionals and consultants possessing the skills, focus and resources necessary to serve the communications law needs of Fortune 100 companies, all without sacrificing the range of services and affordability which makes us the "go to" firm for new entrants and service providers of all sizes.

In association with The *Compliance* Group, which specializes in fixed-fee licensing & compliance services tailored to the communications industry, The *CommLaw* Group offers businesses the "[Full Spectrum](#)" of legal, regulatory, administrative and consultative services.

Change is Coming... but it's not here yet!

- FCC FNPRM on USF Contribution Reform
 - Connections
 - Capacity
 - Revenue (with fixes *lipstick on a pig?* and more expansive base)
- Section 254 requires Equitable and Non-Discriminatory
 - Current revenue-based system is “discriminatory”

“The current USF contributions system is... rife with outdated methods and procedures that create waste, inefficiency and **destabilizing competitive discrepancies.**”

- USTelecom, March 8, 2012 ex parte letter

- Likely to remain for at least 18 to 36 months (and probably a lot longer)

USF Contribution Reform NPRM

- Emphasis on Revenue-Based System
 - Over ½ NPRM addresses reforms to current system
 - Extensive discussion of broadening contribution base
 - More VoIP revenue
 - More Broadband revenue
 - More International revenue
 - More Intrastate revenue
 - Anything with “voice” component
 - Fewer exemptions, closing loopholes
- Adoption of Alternate Methodology possible, but don't hold your breath!
 - Outcome likely depends on November Election

Mistakes, Misperceptions & Missed Opportunities... **REVENUE ALLOCATIONS**

- Maximizing Opportunity and Minimizing Risk Under Current Revenue-Based System Requires Intelligent, Thoughtful and Effective Use of Revenue Allocations

“Our current contribution apportionment rules for bundled services... give providers fairly wide latitude to determine assessable revenues within bundled services, which may result in contributors adopting different methodologies to determine their contribution base. Taken to an extreme, if contributors have unrestricted latitude to determine assessable revenues, it jeopardizes the stability of the Fund and could lead to competitive inequities in the marketplace.” - USF Reform NPRM at ¶102

- Allocations are explicitly authorized by FCC Rules and Form 499-A Instructions in following circumstances:
 - Reporting Bundled Services Revenue
 - Geographic Jurisdictional Segregation – Intrastate, Interstate, International
 - Segregating Telecommunications and Non-Telecommunications Revenue

Accounting Allocations:

Reduce Revenue Exposure to Fees

“We are concerned that the lack of bright-line rules may encourage providers to minimize their allocation of revenue in a bundle to assessable services to reduce their contribution obligations in order to gain a competitive edge.”
– USF Reform NPRM at ¶105.

- FCC Program Fees funded by revenue reported in Form 499:
 - USF, FCC Annual Regulatory Fees, Telecommunications Relay Services (TRS) Fund, North American Numbering Plan (NANP), Local Number Portability (LNP) Administration Support
 - Corollary implications at State PUCs
- There is More than One Reasonable Methodology
 - Choose the best methodology and the one that fulfills management’s risk tolerance
 - Rely on properly implemented, Generally Accepted Accounting Principles
 - Support with carefully and thoughtfully labeled books, records and even “market studies” of comparable “stand alone” services & rates

REVENUE ALLOCATION: VoIP Services

- I-VoIP “Geographic Jurisdictional” Allocation
 - Actual Interstate Revenue
 - » Removes *Vonage Order* Shield from State Regulation
 - Traffic Study
 - » 47 out of 243 traffic study filers reported 0% interstate revenue!
 - » Average interstate percentage 22.1%
 - 64.9% Safe Harbor
- I-VoIP “Accounting” Allocation
 - Distinguish “Regulated” vs. “Non-Regulated”
 - FCC currently affords *wide latitude*, with *no bright line rules*

REMEMBER: Different opportunities exist re: Regulatory vs. Tax reporting; different rules and consequences associated with service bundle revenue

REVENUE ALLOCATION: Internet Access

- Since 2010 *TelePacific Order*, debate raging over regulatory treatment of non-facilities-based Internet Access services for USF assessment purposes:
 - TelePacific: Reseller of Internet Access via Leased T-1 Lines
 - Wireline Competition Bureau (WCB) Reversed USAC Decision Assessing USF Contributions on retail revenue from Internet Access
 - Insufficient Information to Determine Whether USF Contributions Must Be Assessed on Wholesaler Revenues from sale of T-1s to TelePacific
 - WCB Implied there is a “Telecommunications Component” to every non-facilities-based Internet Access service
- Bureau’s consideration of XO Petition re: MPLS and Grande Petition re: DLS-based Internet Access reflects its leanings towards policy of finding a “Telecom Component” in everything

REVENUE ALLOCATION: Call Bridging

- *InterCall Order* Declared Call Bridging/Conferencing Services “Telecommunications Services”
 - Subject to Title II regulations and USF contributions; extended findings to all similarly-situated providers
 - *MeetingOne Order* found “IP Audio Bridging” to be similarly-situated
- Before *InterCall*, “Contamination Doctrine” prevailed
- *InterCall / MeetingOne* not only killed Contamination Doctrine; FCC now appears poised to turn doctrine on its head
- Cisco ex parte meeting with Bureau (Apr. 2012) re: WebEx:

“[W]e confirm that under our existing requirements, a provider offering a bundled service comprised of telecommunications services and information services may not treat the entire bundled service as an information service for purposes of USF contribution assessment, but *must instead apportion its end user revenues between telecommunications and non-telecommunications sources.*”

CAUTION! SUPPORT YOUR ALLOCATIONS

- DON'T ASSUME USAC KNOWS WHAT YOU SELL
 - They don't!
 - Like a traveler in the desert... they see water, even when it's a mirage (*only the water they see is revenue from interstate telecom service subject to USF contributions*)
- DON'T ASSUME USAC KNOWS THE UNDERLYING LAW
 - They don't!
 - USAC tends to be “results-oriented” and when underlying law conflicts with their desired result (more USF contributions), the law frequently loses
- WHAT TO DO?
 - Take care when selling any service identified in marketing material or customer invoices as “Interstate Telecom” **or that can be interpreted as such by USAC**
 - Labels are important, both customer facing and internal
 - Careful labeling practices and meticulous accounting makes for smoother audit defenses
 - And when labels don't apply due to the invisible, “accounting only” nature of an allocation?
 - Document, document, document and maintain supporting records for at least 5 years

IMPLICATIONS & UNINTENDED CONSEQUENCES

- **CAUTION:** Increased potential for State & Local Tax Governments and Tax Authorities to expand reach into “Telecommunications Components” deemed “allocable” by FCC
 - Basis to chip away at and sidestep Internet Tax Freedom Act (ITFA)
 - Basis to demand “taxable” allocations of Internet Access (whether by T-1, MPLS, DSL or any other means), Conferencing / Call Bridging, even services like WebEx

Mistakes, Misperceptions & Missed Opportunities... WHOLESALE REVENUE

- What is the Carrier's Carrier Rule?
 - Supply chain enforcement of Federal Universal Service Fund (“USF”) contribution
 - Under FCC rules, only the end-user, retail service provider is responsible for remitting USF charges
 - Carrier's Carriers do not have to remit USF contribution to USAC, the USF Administrator
- As enforced by USAC and Bureau, the CCR mandates that wholesale carriers verify contributor status of their carrier customers and if not properly validated, to report revenue as end user subject to contributions

CARRIER'S CARRIER RULE: USAC's view

- As interpreted, formulated, and enforced by USAC, all wholesale providers must:
 1. Verify that reseller customers seeking exemption from pass-through surcharges possess a 499 Filer ID;
 2. Obtain a signed Exemption Certification stating that the carrier is either a direct contributor or exclusively sells to other providers verified as direct contributors; and
 3. Verify contributor status as listed in FCC Database
- Wholesalers failing to strictly comply with USAC's interpretation (as set forth in 499 Instructions) may be held vicariously liable for contributions owed by resellers

CARRIER'S CARRIER RULE: FCC's Rules

- USAC's view conflicts with FCC's Rules, Orders and Intent and, arguably, 499 Instructions lack a legally enforceable foundation:
 - Note: USAC lacks authority to “interpret” FCC rules; therefore, 499 Instructions are merely “guidance” and, by law, do not carry the force and effect of law
 - Nonetheless, consequences of non-adherence with 499 Instructions can be severe, long-lasting and financially debilitating
- Examples:
 - Vicarious Liability – *No support in FCC jurisprudence*
 - Mandatory FCC Database Verification of Status – *No support in FCC jurisprudence*
 - Requirement to treat any non-contributing carrier as “end user” – *No support in FCC jurisprudence*

Example of USAC’s Expansion of FCC Rule

ORIGINAL FCC INTENT	USAC EXPANSION AND FCC ACCEPTANCE
<p>“Entities that resell telecommunications and qualify for the de minimis exemption must notify the underlying facilities-based carriers from which they purchase telecommunications that they are exempt from contribution requirements and must be considered end users for universal service contribution purposes.”</p>	<p>For the purposes of filling out this Worksheet—and for calculating contributions to the universal service support mechanisms—certain telecommunications carriers and other providers of telecommunications may be exempt from contribution to the universal service support mechanisms. These exempt entities, including “international only” and “intrastate only” providers and providers that meet the de minimis universal service threshold, should not be treated as resellers for the purpose of reporting revenues in Block 3. *</p> <p>“End-user” telecommunications revenues include revenues from sales to carriers or providers that do not contribute to USF, such as de minimis carriers and [all other] exempted providers of interstate telecommunications. **</p>
<p><i>Universal Service Fourth Order on Reconsideration (1997), 13 FCC Rcd at 5482, para. 298</i></p>	<p>*Form 499-A Instructions at pg. 22 ** <i>In the Matter of Universal Service Contribution Methodology, a National Broadband Plan For Our Future</i>, Notice of Proposed Rulemaking, Docket 06-122 (2012)</p>

THE “LIRE” TRAP

- One of many unintended (or intended) consequences of USAC’s far reaching expansion of FCC Rules, Orders and Original Intent
- Impacts both Suppliers and Resellers of International Services
 - Under the Limited International Revenue Exemption (“LIRE”), if interstate traffic is less than 12% of the combined interstate + international traffic, only interstate traffic is subject to USF.
 - Carriers with a high volume of international calls often have low interstate revenue and are therefore are likely *de minimis*
 - These carriers therefore do not contribute directly to the USF
- Combine de minimis with LIRE, however, and these carriers are “trapped”
- **What is the LIRE Trap?**
 - Because upstream carriers wish to avoid vicarious liability, they treat de minimis, LIRE-eligible resellers as “end users”
 - Often times upstream carriers require such resellers to pay pass-through surcharges on revenue from both interstate and international services (otherwise exempt due to LIRE)
- USAC thereby uses wholesalers to impose contribution obligations “indirectly” on entities that are exempt from “direct” contributions

CARRIER'S CARRIER RULE BEST PRACTICES

- Despite questions about the CCR's legal basis, it is enforced as the law of the land
- Wholesaler choices:
 - A. Comply strictly and unyieldingly with 499 Instructions** – Risk loss of business
 - B. Comply, but only when convenient** – Risk USAC audit and revenue reclassification
 - C. Comply with FCC Rules, Orders and the Spirit of the Rule** – Balance Risks
- Before reporting Carrier's Carrier revenue in Block 300, wholesale providers should have a well-conceived Carrier's Carrier Rule compliance plan that fits management's unique risk tolerance and business goals

USAC Audits: Sustaining Fund Requires Enforcement

- Increase in Contributor Revenue Audits Expected in 2012 and Beyond
- Audits come in variety of flavors:
 - USAC Internal Audit Division (IAD)
 - Beneficiary and Contributor Audit Program (BCAP)
 - Soft Audits (aka “Desk” Audits)

BCAP Audit Program

- Recap and Projections
 - 2010-11: 5 Contributor Revenue Audits Completed (Out of 66 Total Audits)
 - 24 Contributor Audits In Progress
 - 343 Planned Audits (Over 1/3 expected to be Contributor)
- BCAP Audit Process
 - Targeted Enforcement + Random Selection
 - USAC Will Focus on Particular Type of Entity and from that Targeted Class, Auditee is Randomly Selected

Desk Audits: Cheap, Effective Coercion

- “Informal” USAC Staff Inquiry (with serious consequences)
 - No clear rules, no clear process, no clear authority;
Nonetheless, very effective and frequently used
- Typical Process
 - Email or Letter Sent to Contributor seeking explanation or justification for revenue reported in particular 499A line item
 - USAC vets compliance with 499 Instructions
 - Instructions considered Black & White by USAC, even though the underlying law & regulation are many shades of gray
 - Threat and fear of never-ending uncertainty and costs of appeal effectively coerces compliance with Instructions

Common Audit Issues

- Wholesale Revenues
 - Reseller Certification & CCR
- Bundles
 - Methodology & Recordkeeping supporting revenue allocations
 - Private Lines (10% rule), VoIP and Wireless (safe harbors, traffic studies)
- USF Recovery Surcharge
- Information Services
 - Internet Access, Conferencing & Call Bridging
 - Telecommunications sufficiently “sufficiently integrated”

Formal or Informal Audit: What to do?

- **BE PREPARED**
 - Proof of CCR Compliance
 - Support for Accounting
 - Document Retention
- **CONTACT EXPERIENCED REGULATORY / LEGAL COUNSEL UPON FIRST CONTACT**
 - BCAP or Desk Audit, consequences of both can be understood and mitigated with the assistance of experienced counsel
 - Knowledge is power; know what you are in store for before unwittingly providing USAC anything it can leverage to your detriment



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