



Law Seminars Telebriefing

Doing Business in the *Cloud*: Regulatory and Tax Issues

SPEAKER BIOS

• **Jonathan S. Marashlian**, Managing Partner of Marashlian & Donahue, LLC, [The CommLaw Group](#) and principal of [The Compliance Group](#), the law firm's affiliated regulatory compliance administration and consulting division. Mr. Marashlian is responsible for leading the firm's telecommunications, VoIP, broadband and advanced communications services clientele through the maze of state and federal regulatory and communications tax requirements. Mr. Marashlian has comprehensively advised several Fortune 500 companies on regulatory and tax matters associated with entering the VoIP services marketplace, thereafter managing compliance through The *Compliance Group* and its partners.

• **Robert Dumas**, Principal and Founder of TaxConnex, LLC. Mr. Dumas began his public accounting career on the tax staff at Arthur Young & Co., followed by a brief stint at Grant Thornton. In the late 1980s, Robert joined BellSouth's tax department. In 1996, he left BellSouth to pursue a career as an independent consultant. Three years later, Robert founded Tax Partners, which became the largest sales tax compliance service bureau in the country. Robert served as president of Tax Partners and helped grow the business to \$16 million in seven years. The company was sold to Thomson Corporation in March 2005, and Robert served as vice president of operations in Thomson's transaction tax business unit until founding TaxConnex in 2006. Robert is a nationally recognized expert on telecommunications taxation and a frequent speaker on the subjects of transaction tax, business process outsourcing and sales tax compliance.

• **Allison D. Rule** is a Senior Attorney at The *CommLaw Group* and co-chairs the firm's Communications Taxes and Fees Practice. Ms. Rule specializes in communications taxes, Universal Service Fund (USF), E-911 and regulatory fee issues. As Chair of the firm's Litigation and Dispute Resolution practice, Ms. Rule also maintains an active administrative and civil litigation docket, including representing taxpayers in sales, use, excise and other tax audit proceedings in a variety of jurisdictions.

AGENDA



- **Cloud Computing: The Basics**
 - What is the cloud?
 - Are there different types of cloud-based services?
 - What are the benefits of doing business in the cloud?

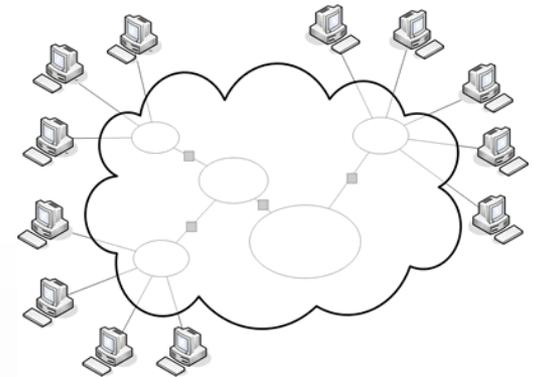
- **Cloud Computing: Shifting the Taxation Paradigm**
 - How does the element of a communications link change the taxability equation?

- **Nexus and Cloud Computing**
 - Coming to terms with nexus
 - Defining the tax base and sourcing revenue

- **Handling Compliance**
 - *Going forward*
 - Registrations with DOR and regulatory administrators
 - Calculating taxes and regulatory assessments
 - Handling invoicing
 - *Addressing past non-compliance*
 - Determining prior period of exposure
 - Evaluation of voluntary disclosure and amnesty options

Cloud Computing: The Basics

- What is cloud computing?
 - At its core, the “cloud” refers to the Internet
 - “Computing” can refer to an infinite number of services and solutions, but certain characteristics are universal:
 - On-demand self-service: get it when you need it
 - Broad network access: access it from any Internet connection
 - Resource pooling: share fixed costs
 - Measured services: pay for what you use



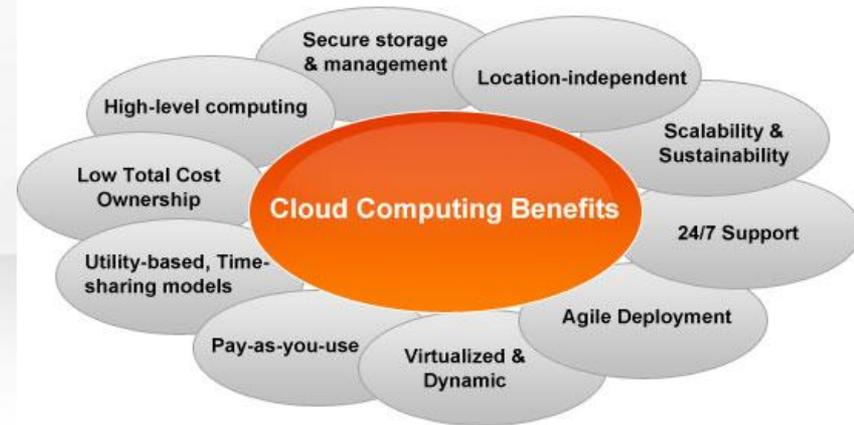
Cloud Computing: The Basics (Continued)

- Three categories
 - Software as a Service (“SaaS”)
 - Platform as a Service (“PaaS”)
 - Infrastructure as a Service (“IaaS”)
- Communications as a Services (“CaaS”) can be layered on to of any of these categories of services



Cloud Computing: The Basics (Continued)

- Benefits of Doing Business in the Cloud
 - Scalable solutions
 - Increased speed and agility
 - Providing enterprise class infrastructure to smaller companies
 - Pay-as-you go model/ease of licensing
 - Cost transparency to the end-user/business



Cloud Computing and the Shifting Taxation Paradigm: Adding a Communications Element

- What is the impact of adding a communications element to a cloud-based solution?
 - Establishes a link to taxing jurisdictions
 - Applies the unique universe of communications taxes
 - Communications excise
 - Gross receipts, franchise & other utility taxes
 - Triggers additional communications-related regulatory regimes at federal, state and local levels
 - Universal Service Fund (USF), E911 & other regulatory fees



Taxing the Cloud: Uncertainty and Inconsistency

Uncertainty and Inconsistency in Taxation

- The evolution of the Internet and associated services and delivery models has outpaced traditional brick and mortar tax laws
- The result is uncertainty and inconsistency among the multitude of taxing jurisdictions



Increased Taxation

- At the same time, states and local governments continue to grapple with budget shortfalls
- States are increasingly looking to digital products and services as revenue sources to replenish a declining tax base



Taxing the Cloud: Nexus and Revenue Sourcing

- Tax treatment of cloud based solutions creates a host of issues for taxing authorities
 - Nexus standards
 - How much presence is enough?
 - Defining the tax base
 - Is cloud computing tangible personal property, a digital product, a service or intangible property?
 - Sourcing revenue
 - What is the situs of the transaction?



Coping with Evolving Notions of Nexus

- **Nexus Defined**
 - Refers to the amount or degree of business activity that must be reached before a state can impose taxes on a company's revenue
- **Nexus for sales tax purposes**
 - Income tax nexus and sales tax nexus are not the same
 - Nexus for sales tax purposes is fact driven and fluid
 - Supreme Court's decision in *National Bellas Hess* established a physical presence requirement for sales and use tax nexus



Coping with Evolving Notions of Nexus – *Quill v. North Dakota*

- Supreme Court clarified nexus requirements in *Quill v. North Dakota*
 - Due Process and “minimal contacts”
 - Dormant Commerce Clause and “substantial nexus”
 - Determinations grounded on whether there is physical presence
- Traditional nexus applied to cloud-based services
- Evolving concepts of “affiliate nexus” and “economic nexus”
 - Amazon laws
 - Conflict and court decisions

Coping with Evolving Notions of Nexus: Adding a Communications Element

- Telecommunications Taxes and Nexus
 - Substantial nexus exists where a call originates or terminates if the customer is charged for the call to a billing address within the state
- Regulatory Fees and Jurisdiction
 - Call end-points



Defining the Tax Base

- Lack of guidance
 - Many states have not issued any definitive guidance on the taxability of cloud-based services
 - Cloud-based services do not fit into the Streamlined Sales and Use Tax Agreement (SSUTA) framework as “prewritten” software or digital products
- Differing treatment
 - Based upon interpretation of sale as sale of software or service (see appendix for examples)
- Bundling
 - Do bundled transaction rules apply when software, hardware and services are bundled together?

Sourcing Revenue

- Influenced by the classification of a cloud computing transaction
- Factors to consider:
 - Location of the server
 - Seller location
 - Customer billing address
 - User location



Fundamentals of Compliance

- Registration requirements
- Calculating and invoicing taxes
- Filing tax returns in multiple jurisdictions
- Addressing past non-compliance



Calculating Tax and Invoicing

- Complexity that increases exponentially as you add states
- Compliance Options
 - Manual computation in the beginning
 - Purchase and implement in-house software
 - Subscribe to a service for calculations



Registering with Departments of Revenue (DOR)



TAX
REGISTRATION
CERTIFICATE

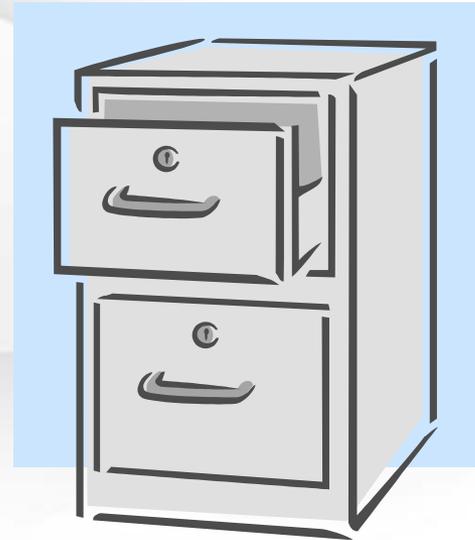
- Tax IDs
 - Each state where you need to collect and remit tax will require a sales tax ID
 - Some states, like Florida, require a separate communications tax ID
- Other Registrations
 - DOR/Tax registrations are distinct from registrations with Secretaries of State (SOS) and state Public Utility Commissions (PUCs), but registrations should be coordinated

Regulatory Registrations

- Separate and distinct from DOR registrations
- Federal Registrations
 - 499 Filer ID (FCC)
- State Registrations
 - State regulation of VoIP services evolving rapidly and remains an area of great uncertainty
 - At the state level, nine states have formally enacted PUC registration requirements for VoIP providers and two states have informally stated that registration requirements apply
 - Fifteen states have extended Universal Service Fund (USF) and/or Telecommunications Relay Services (TRS) Fund requirements to VoIP providers, some of which require registration
 - A number of states have pending regulatory proceedings addressing these issues

Filing Your Returns

- **Frequency**
 - Assigned by DOR
- **Manner**
 - Manual filing
 - Software to automate returns
 - Outsourcing
- **Additional Local Level Filings**
 - Required by some states
 - California cities assess Utility Users Taxes that require monthly reporting



Regulatory Reporting

- **Varied frequency**
 - Less uniform than tax reporting requirements
 - Some states require monthly reporting, others quarterly and others annual
 - Federal reporting can be either quarterly or annual, depending on the amount of assessable revenue
- **Highly complex**
 - Because of evolving regulatory status of VoIP, reporting is a science
 - At state level, there are often conflicts between state regulations and instructions provided by fund administrators
- **Missteps can be extremely costly**
 - Avoid the temptation to fully automate regulatory reporting
 - FCC's one-way ratchet rule
 - Nebraska and Ohio impose penalties for each day of non-compliance



Prior Period of Exposure - Taxes

- Quantify
 - Estimate additional taxes owed
- Remediate
 - Voluntary disclosure
 - Amnesty
- Evaluate
 - Determine the company's risk profile
- Prospective compliance
 - Register and file prospectively
 - Voluntary disclosure
 - Amnesty



Prior Period of Exposure – Regulatory Fees

- Federal limitations periods
 - FCC may seek fees as far back as 1998
- State limitations periods
 - State look-back periods are much shorter
 - State regulatory authority over VoIP was not formally clarified until 2010
 - Most states just starting to regulate VoIP
 - Most state retroactive enforcement is not yet as rapid as FCC/USAC
 - Focus on prospective reporting at state level



Voluntary Disclosure

- Voluntary Disclosure Agreement (“VDA”)
 - Limit the look-back period
 - Waiver of penalty and interest
 - Audit protection
- VDA Procedure
 - Typically a third party is involved
 - Anonymous negotiation to obtain a favorable position
 - Prior period returns are prepared or spreadsheet submitted with tax liabilities
 - Registration and prospective collection and filing responsibilities
 - Often not available to current tax payers



Amnesty

- State-specific
- Prior returns or spreadsheets filed
- Registration and prospective collection and filing responsibilities
- May be open to current tax payers



Regulatory Fee Remediation

- Federal fees
 - No VDA or amnesty program at FCC/USAC
 - MeetingOne Example
 - Settlements can be negotiated with USAC/FCC
 - Importance of maintaining clean and carefully labeled books and records
 - Presents opportunity to tailor the information provided
- State fees
 - Most states are just dipping their toes into VoIP regulation
 - Nebraska & California experiences

Questions



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W W W . C O M M L A W G R O U P . C O M

Appendix: Recent Tax Decisions in Cloud-Based Computing

- Colorado Letter Ruling PLR 11-007 (Dec. 20, 2011)
 - Web-based solution for sending, tracking and receiving large files not tangible personal property, not subject to sales tax
- Iowa DOR Policy Letter 12300002 (Jan. 11, 2012)
 - Hosted software not subject to state sales or use tax
- Texas Comptroller of Pub. Accts. Doc. 363237 (July 21, 1998)
 - Software hosted on a server in the state subject to sales tax
- Wisconsin Letter Ruling W1025002 (March 24, 2010)
 - SaaS not subject to sales tax
- California Board of Equalization Publication 109 (June 2012)
 - SaaS not subject to sales tax unless customer receives printed copy of electronically transmitted information