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## SALES TAX

# How States Define Communications Products and Services Can Impact Tax Codes

As states continue to fine-tune how they define products and services included in communications tax, businesses will need to stay up to date on new requirements.

Nov. 07, 2022



In the 1990s, Voice over Internet Protocol (VoIP) was the new kid on the block but quickly gained popularity as a way to save money on long-distance and international calls. Regulations surrounding VoIP were slower to catch up.

Initially, many authorities thought VoIP shouldn't be taxed. Passing around bits of data online seemed far off from familiar phone services. But that feeling didn't last long. Seeing an untapped source of revenues, some states with regulations that broadly defined telecom services sought to assert their powers. Others passed new legislation to specifically address VoIP.

In 2004, the Federal Communications Commission **ruled** that the Minnesota Public Utilities Commission couldn't apply the regulations it uses for traditional phone companies to Vonage DigitalVoice. Then-Chair Michael K. Powell wrote, "To subject a global network to disparate local regulatory treatment by 51 different jurisdictions would be to destroy the very qualities that embody the technological marvel that is the Internet."

Minnesota made headlines again in 2019 when the U.S. Supreme Court declined to hear Lipschultz [Minnesota Public Utilities Commission] v. Charter Advanced Services. By doing so, the court essentially **denied states the ability to individually regulate VoIP services**.

But that didn't stop states from taxing VoIP. Many revised their definitions in sales tax and communications tax law to cover any technology that includes voice services, as well as those that might be developed in the future. Other states found a way to interpret existing definitions in such a way that they applied to VoIP.

Fast-forward to today and VoIP is everywhere. Sometimes it's subject to communications tax and other times not. The difference comes down to **definitions** and whether we're talking about static VoIP calls, which are made from a fixed address, or nomadic VoIP calls made over the internet. Further complexity surrounds the type of service, which can be separated into two buckets: non-interconnected VoIP (sometimes known as "peer-to-peer VoIP") or interconnected VoIP, which lets you make and receive calls from a regular phone network. If you're lost, you're not alone. All of this can get confusing, especially as companies develop new products that integrate VoIP.

**Some states making inroads in regulating streaming faster than others**

Now we're seeing much the same story among jurisdictions looking to fill their coffers with taxes on streaming. They typically fall into three categories, depending on which route they took to get there:

### **Pave-the-way wayfarers**

First, there are those states that — by forward thinking, luck, or happenstance — already had laws on the books that enabled them to collect tax on streaming services. For Florida, the path forward was a shortcut. [Florida is unique because it has a communications services tax](#) with a very broad definition of pay TV, developed back when authorities considered how they could collect from satellite TV. Netflix and Hulu have been paying in the Sunshine State since the get-go.

[Chicago has a decades-old amusement tax](#) that defines paid television programming and performances broadly. While many states struggle to modify or replace cable franchise ordinances to address streaming, Chicago's law provided a relatively smooth avenue to tax streaming.

### **Bumpy-road warriors**

Second, we have states that try (sometimes unsuccessfully) to apply more narrowly defined laws to new tech. Many find the trek to be a steeper ascent than they were equipped for.

Many California cities have asserted that their utility taxes apply to streaming video services. However, in a setback, a [California court](#) found that Netflix didn't qualify as a "video service provider" under the state's Digital Infrastructure and Video Competition Act.

A judge sided with Netflix and Hulu in a [class-action lawsuit](#) brought by several tax jurisdictions in Texas. The suit centered on whether the companies must pay a franchise fee for using the state's broadband wireline facilities. Similar suits are ongoing in several other states.

A district court in Arkansas ruled streaming businesses qualify for an exemption under the [Internet Tax Freedom Act](#). A federal court in Reno, Nevada, barred the city from collecting a 5% tax on streaming services, saying that [local franchise fees don't apply](#).

### **Get-up-and-go explorers**

Third, many states are exploring ways to pass new legislation. [Maryland passed a law to impose sales and use tax on digital services including streaming.](#) The law covers streamed news and entertainment including movies, sporting events, and prerecorded or live music and performances. West Virginia still exempts digital products from sales and use tax, but [now taxes streaming services.](#) The state [differentiates](#) between streaming services that provide “access to curated entertainment” like movies, music, or video games, and downloadable digital products that can be bought or rented.

Kentucky already had a law on the books that broadly defined taxable communications services. Nonetheless, the Kentucky Board of Tax Appeals [ruled in 2015](#) that Netflix streaming services weren’t taxable under the state’s gross revenues, utility gross receipts license, and excise taxes. The board considered the definition of “multichannel video programming services,” described as “programming provided by or generally considered comparable to programming provided by a television broadcast station.”

It found that while on-demand TV and streaming were similar, the on-demand feature wasn’t enough to meet the definition and that streaming also didn’t fit in the state’s definition of cable services. Not to be outdone, the Kentucky General Assembly [passed a law](#) in 2019 that added video streaming services to the definition of multichannel video programming services, making streaming subject to taxes.

If the future is anything like the past, we may see states go the extra mile to develop completely new tax regimes that address streaming.

### **Let a communications tax compliance partner be your compass**

As states continue to fine-tune how they define products and services included in communications tax, businesses will need to stay up to date on new requirements. Monitoring statutes and rules that vary and change frequently across thousands of jurisdictions is a huge undertaking for any company. A communications tax compliance expert that specializes in automation [can be a trusted guide](#) on your compliance journey, clearing the road ahead.

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