

ST 14-0003-PLR 06/26/14 TELECOMMUNICATIONS

In the event this may not be a defined location, as in the case of mobile phones, paging systems, and maritime systems, service address means the customer's place of primary use as defined in the Mobile Telecommunications Sourcing Conformity Act. 35 ILCS 630/2(n). (This is a PLR.)

June 26, 2014

Dear Xxxx:

This letter is in response to your letter dated August 6, 2013, and your email dated January 22, 2014, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY A, for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY A, nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter dated August 6, 2013, you have stated and made inquiry as follows:

"COMPANY B submits this private letter ruling request pursuant to 2 Ill. Adm. Code 1200.110 from the Department of Revenue on behalf of its client COMPANY A (the 'Company'). We respectfully request a private letter ruling affirming that the Company may use the methodology described below to apply the Illinois telecommunications excise tax to its Services. We further request confirmation that the manner in which the Company plans to present the telecommunications excise tax on information provided to its Users is in accord with Illinois tax law.

To the best of both the Company and our knowledge, the Department has not previously ruled on the same or similar issue for the Company or a predecessor, and neither the Company nor any representative previously submitted the same or similar issue to the Department.

I. Facts

A. Overview

The Company is the seller of record of a number of products (the 'Services')¹ to U.S. users (the 'Users'), many of which will fall within the definition of telecommunications services for purposes of Illinois tax law. The Company is not a regulated telecommunications provider for federal and state regulatory purposes.

The Services include subscriptions (e.g., unlimited calling for a month to China) ('Subscriptions') and per minute/pay-as-you-go based telecommunications and internet access services ('Usage').

The Services are accessed and used through a variety of computing devices. Often these devices are portable and do not have a fixed location. The Users can pay for Services using a variety of means, including through third party payment providers like PayPal. As a result of the mobile nature of the Services and the manner in which they are sold, the Company does not have accurate billing address information, and often does not have any address information for Users.

B. *User Registration and Purchases*

To purchase the Services, Users register using the internet. Once a User registers, an online account ('Account') is created for the User. The User can then make purchases through the Account or through third-party retailers. To streamline the registration process, particularly for Users accessing the website on a mobile device, and to allow new Users to quickly begin to use the Services, a User is only required to provide limited information to register and make purchases.

The registration process begins with the User registering and creating an Account by choosing a user name and password. After the User creates an Account, the User must provide a first and last name and an email address prior to making a purchase. Once a User is registered, a User may make one of two types of purchases. The User may purchase credit, which is deposited into their Account, and used at a later date to purchase the Services. Alternatively, a User may purchase Services directly.

An email is sent to the User confirming purchases of credit and Subscriptions. Users do not receive confirmation emails when purchasing Usage. Users do not receive the equivalent of a cash register receipt or phone bill when purchasing the Services. When purchasing credit or Subscriptions, Users may view, or in some cases, download an invoice on-line.

C. *Use of the Services*

A User may originate calls from any location where the User is able to access an Internet connection. Users may also use their credit to connect to wi-fi internet access hot-spots through third-party providers.

The User may connect to the Internet and use the Services from a computer, laptop, or mobile device. Because the User is able to use the Services from mobile

¹ Because a number of the products fall within the definition of telecommunications services for purposes of Illinois tax law, those products are referred to herein as telecommunication services or Services.

devices, the User can originate or receive calls, or access wi-fi hot spots, from virtually any location where the User is able to access the Internet.

D. *User Location*

The Company does not have accurate billing address information, and often does not have any address information, for the Users. Some Users may choose to supply address information at the time of registration or at the time they purchase Services, however, the Company does not, and in many cases cannot, verify the accuracy of such information. In many cases where the User enters address information, such information is incomplete or inaccurate.

Users' Internet protocol addresses are captured at the time they register for the Services ("Registration IP"). The Company is able to use third party software to associate the Registration IP with a physical address. The Company can associate this physical address with an Account. The physical address associated with a User's Registration IP is maintained, and this information is used to identify the location of the Users for a number of purposes. The Registration IP addresses are auditable and are more accurate than User provided address information.

E. *Presentment of Taxes*

The billing system is limited in how it can describe taxes and fees to the Users. Additionally, in many cases, the User does not receive any receipt or statement of account.

The invoice that a User may view or download on-line for credit or Subscriptions will indicate that tax has been applied, but will not separately itemize taxes. Instead of separately itemizing specific taxes on the invoice, there will be a link to a list of all taxes and the rate of each tax applicable to the Services.²

II. *Rulings Requested*

1. The company may source sales for purposes of the state sales tax and the state telecommunications excise tax based on Registration IP.
2. The Company is not in violation of ILCS § 630/5 when it advertises and charges a tax-inclusive price to a User provided that the Company discloses to the User that it is charging a tax-inclusive price, the Company offers the User the ability to view the tax rate for their jurisdiction, and the Company does not state or infer that it is absorbing the tax.

III. *Law*

A. *Sourcing of Taxes*

Under Illinois tax law, a telecommunications excise tax is imposed upon the act or privilege of originating or receiving both intrastate and interstate telecommunications

² For local taxes, a range of rates will be provided.

by a person. ILCS §§ 630/3, 630/4. 'Telecommunications' is defined as, 'in addition to the meaning ordinarily and popularly ascribed to it, includes, without limitation, messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiber-optics, laser, microwave, radio, satellite or similar facilities.' ILCS § 630/2(c).

Prepaid calling arrangements are not subject to the telecommunications excise tax. ILCS §§ 630/3; 630/4. Illinois defines 'prepaid calling arrangements' as 'the right to exclusively purchase telephone or telecommunications services that must be paid for in advance and enable the origination of one or more intrastate, interstate, or international telephone calls or other telecommunications using an access number, an authorization code, or both, whether manually or electronically dialed, for which payment to a retailer must be made in advance, provided that, unless recharged, no further service is provided once that prepaid amount of service has been consumed ... includ[ing] the recharge of a prepaid calling arrangement.' ILCS § 620/2)(o). Excluded from the definition of 'prepaid calling arrangement' is 'an arrangement whereby a customer purchases a payment card and pursuant to which the service provider reflects the amount of such purchase as a credit on an invoice issued to that customer under an existing subscription plan.' *Id.*

Generally, Illinois's telecommunications excise tax is imposed on the 'gross charge' for telecommunications. ILCS §§ 630/3; 630/4. Illinois defines 'gross charge,' in part, as 'the amount paid for the act or privilege of originating or receiving telecommunications in [Illinois].' ILCS § 630/2(a). 'Amount paid' is defined as 'the amount charged to the taxpayer's service address in [Illinois] regardless of where such amount is billed or paid.' ILCS § 630/2(b).

Illinois law provides specialized sourcing rules for mobile telecommunications services. Illinois taxes the charge for mobile telecommunications services based on 'the customer's place of primary use, regardless of where the mobile telecommunications services originate, terminate, or pass through.' ILCS § 638/20(b). Illinois statutes defines 'place of primary use' as 'the street address representative of where the customer's use of the mobile telecommunications service primarily occurs, which must be: (i) the residential street address or the primary business street address of the customer; and (ii) within the licensed service area of the home service provider.' ILCS § 638/10.

B. All Inclusive Price

Illinois provides that '[w]henever possible, the [telecommunications excise tax] shall, when collected, be stated as a distinct item separate and apart from the gross charge for telecommunications.' ILCS § 630/5.

IV. Legal Analysis

A. Sourcing Receipts from the Sale of Telecommunications Services Provided over the Internet

Intrastate and interstate telecommunications are sourced for Illinois's telecommunications excise tax purposes based on the 'service address' of the customer. ILCS § 630/2(b). Illinois defines 'service address' as 'the location of telecommunications equipment from which the telecommunications services are originated or at which telecommunications services are received by a taxpayer.' ILCS § 630/2(n). If that location is not determinable, 'service address' means the customer's place of primary use. *Id.*

This sourcing rule that considers the origination, termination and an address is generally referred to as the 'two out of three rule.' This rule stems from the U.S. Supreme Court decision in *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989). In *Goldberg* the U.S. Supreme Court stated that in order for a state to impose its tax on an interstate telecommunications service, both of the following must occur: (1) the origination or termination of the interstate telecommunication service must be in the state, and (2) the telecommunications service must be charged to a service address within the state or billed to a billing address within the state. *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989).

Mobile telecommunication services are sourced for sales tax purposes based on the customer's place of primary use. ILCS § 638/20(b). Illinois's sourcing of mobile telecommunication services is based on the Federal Mobile Telecommunications Sourcing Act. Pub. L. 106-252, 114 Stat. 625 (2000).

A few commonalities exist with regard to the manner in which different types of telecommunications service are sourced for purposes of applying Illinois's telecommunications excise tax law. First, notwithstanding the type of telecommunications service or the type of tax, taxes have generally been applied based on a proxy for the location of the customer (e.g., service address, place of primary use, etc.). Second, the sourcing methodologies permitted by the Department ensure that multiple taxes do not apply to the same service. These methodologies are consistent with the Supreme Court's holding in *Goldberg* and the intent of Federal laws like the MTSA.

Third, statutorily permitted methodologies, like the Mobile Telecommunications Sourcing Act, have reflected the manner in which the services are provided to customers and the types of information available to telecommunications services providers. For example, a customer's service address may have no correlation to the location where the customer purchases or uses the services, but this address is often maintained by a telecommunications services provider.

The Registration IP represents the best and most appropriate User location available to the Company to source its receipts for the purposes of applying Illinois's TET. The Registration IP is representative of the User's location and cannot be manipulated. It also ensures that the Services purchased by a User are only subject to tax by a single state if this sourcing methodology is applied consistently by all states. The Registration IP also reflects the manner in which the Services are sold and is based

on information available to the Company. At the time the User registers for the Service, the User accesses a website through an Internet connection. This Internet connection is the first location from which the customer will connect with the Company and will provide a unique IP and auditable address with which to associate the User.

B. *All Inclusive Price*

The Company may advertise that its prices include all taxes imposed on the User and charge an all-inclusive price to Users. The prices that the Company advertises on its website will include taxes that the provider is required to collect from the User, and there will be a clear statement to the User that tax has been included in the sales price. The Company will also separately account for the taxes and the receipts from the sale of the service in its books and records.

It is currently not possible for the Company to separately calculate and collect communications tax on each sale or for the Company to separately state the tax given that no receipts are issued for taxable sales made using credit. An additional complexity arises from the flat-rate structure that allows a User to know exactly how many minutes he has left before he makes a call. If the Company were required to calculate and separately state tax on each sale, the Company would have to calculate tax on each transaction that a User makes in advance of the transaction to determine whether a User has enough credit in their Account to cover the phone call and the associated tax. Given the potentially high volume of transactions, including individual phone calls, this is currently not possible. The Company also does not issue receipts or invoice to Users. The User may choose to download a receipt for a transaction purchased from the Company's website. But when a User uses credit in their account to obtain a product or service, the Company does not issue a receipt and the User does not have the option to download a receipt for purchases made using the credit. The Company will include a statement on its website that 'rates include applicable taxes.'

Additionally, the Company makes invoices available to Users through their Account. For all purchases of credit and any purchases of Services from the website that are not made using credit, Users can chose to view or download an invoice through their Account and the Company will include a statement of the total tax charged to a User on that invoice. The invoice will include a statement that is substantially similar to: 'our rates include the cost of your product as well as all of the taxes and fees that we are obligated to collect from you.' The User will be able to link to a table that displays all taxes that are included in the tax amount and the rate of each tax.

V. *Adverse Authority*

We have been unable to locate authorities contrary to the views expressed herein.

VI. *Conclusion*

We respectfully request confirmation that the Company may source its Users for Illinois telecommunications excise tax purposes based upon Registration IP and that the Company's tax inclusive model is not in violation of ILCS § 630/5.

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Thank you in advance for consideration of this request. Please feel free to contact me at 202.383.0909 if you have any questions or require additional information.

In your email dated January 22, 2014, you have stated:

“PRODUCT is essentially software that allows users to communicate with peers using a variety of devices that are connected to the Internet. The most common use of the PRODUCT software is communication between two personal computers. This PC to PC communication can be voice only, but it could also include video communications provided at least one party has a webcam. PRODUCT users can also communicate with each other or a group using instant messaging. The PRODUCT instant messaging program allows for users to send messages, and to also share video and files. In addition to computer to computer communication, the PRODUCT software can be loaded on a variety of other devices like mobile phones, tablets, and televisions. Calls to other users within the PRODUCT service are free of charge, and these free services account for virtually all of the communication traffic generated by the PRODUCT software. It is estimated that only X% of PRODUCT users pay for services.

In addition to the free communication platform, PRODUCT offers a few services that users must pay for. These paid services include:

- 1) Using PRODUCT to call a landline or mobile phones -- either domestic or international;
- 2) Receiving calls from landline or mobile phones -- either domestic or international;
- 3) Sending an SMS message to a mobile phone;
- 4) Receiving voicemails; and
- 5) Using a Wi-Fi hotspot to access the internet (e.g. Bingo)

The paid services can be obtained through subscriptions (e.g., \$4.00 for unlimited calling for a month to China) or based on a per minute/pay-as-you-go basis (e.g. \$.023 per minute to the UK). The Users can pay for services using a variety of means such as directly to COMPANY A using a credit card; third party payment providers like PayPal; stored value cards purchased at retailers like Wal-Mart; or promotional vouchers.

Because of the general structure of the PRODUCT platform, obtaining accurate physical addresses for every user is virtually impossible. PRODUCT is a worldwide offering, which means its customer interaction screen must be uniform and work consistently in many different languages. For the XX% of those users who rely on PRODUCT for free communication, there is simply no reason to know the physical address of users. Requiring users to enter that information would slow down the registration process, result in fewer users, and interfere with COMPANY A's ability to use a worldwide customer landing screen. To avoid these issues, COMPANY A does not require users to provide an address when they sign up. Users are urged to provide address information to complete their profile, and some do. However, because there is

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no real need to have the address and no way to verify the address, users make up addresses. For example, many PRODUCT users list 1600 Pennsylvania Avenue, Washington, DC as their address, but they do not live in the White House.

As to the X% of PRODUCT users who pay, it is equally difficult to obtain addresses for a variety of reasons. First, most paid users start as free users. Consequently, they may have already entered incomplete and inaccurate information. There is simply no method to correct errors and omissions once a user starts paying. Second, many users want to remain anonymous. PRODUCT is used by most to supplement existing communication rather than replace. These users typically do not want their address connected with an account. Third, there is no valid business reason to obtain an accurate address. Unlike remote sellers of tangibles who need a physical address to deliver goods, sellers of intangibles and services do not need an address to provide service. PRODUCT even differs from other sellers of communication services who need addresses to provide a correct phone number (e.g. area code) or to hook up a line. PRODUCT has no such needs. Fourth, many times a paid user will use credits that are purchased from third parties. If a user buys credits through PayPal or through the iTunes store, COMPANY A does not get reliable address information.

PRODUCT has determined that for all of these reasons, it is impossible for them to require their user to provide accurate addresses. Consequently, COMPANY A determined that IP address was a much more accurate method to determine the location of the user. It cannot be manipulated and is becoming increasingly accurate. COMPANY A will pay COMPANY C to convert the obtained IP addresses to physical locations. I have attached a study showing that COMPANY C's conversion to be 99.9% accurate."

DEPARTMENT'S RESPONSE:

Based on your letter and email, it is our understanding that a user of the Company's service may originate calls from any location where the user is able to access the Internet, and the user may connect to the Internet using a computer, laptop or mobile device; and, based on the nature of the service the Company provides and the users it obtains, it is not possible to obtain accurate service addresses for its users. Users' Internet protocol (IP) addresses are captured at the time users register for services, the Company uses third-party software to associate the Registration IP with a physical address with significant accuracy, and the Registration IP addresses are auditable. If the Registration IP is associated with a physical address located within Illinois, the Company will collect and remit Telecommunications Excise Tax, as well as any applicable Simplified Municipal Telecommunications Tax, on all telecommunications services purchased by the user. It is also our understanding that the Company's website will reflect that rates include all applicable taxes and the user will be able to link to a table that displays all taxes that are included in the charges or in the tax amount shown on an invoice.

The Illinois Telecommunications Excise Tax Act imposes a tax on the act or privilege of originating or receiving intrastate or interstate telecommunications by persons in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers by such persons. 35 ILCS 630/3 and 4.

“Telecommunications,” in addition to the meaning ordinarily and popularly ascribed to it, includes, without limitation, messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiber-optics, laser, microwave, radio, satellite or similar facilities.

“Gross charges” means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money whether paid in money or otherwise, including cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of materials used, labor or service costs or any other expense whatsoever. “Amount paid” means the amount charged to the taxpayer’s service address in this State regardless of where such amount is billed or paid.”

“Service address” means the location of telecommunications equipment from which telecommunications services are originated or at which telecommunications services are received by a taxpayer. In the event this may not be a defined location, as in the case of mobile phones, paging systems, and maritime systems, service address means the customer's place of primary use as defined in the Mobile Telecommunications Sourcing Conformity Act. For air-to-ground systems and the like, “service address” shall mean the location of a taxpayer's primary use of the telecommunications equipment as defined by telephone number, authorization code, or location in Illinois where bills are sent. 35 ILCS 630/2(n) and 35 ILCS 636/5-7.

Under the Mobile Telecommunications Sourcing Conformity Act, only those charges for mobile telecommunications that are billed to the customer’s “place of primary use” in Illinois by the customer’s home service provider may be subject to tax in Illinois. 35 ILCS 638/20. “Place of primary use” means the street address representative of where the customer's use of the mobile telecommunications service primarily occurs, which must be: (i) the residential street address or the primary business street address of the customer; and (ii) within the licensed service area of the home service provider.”

“Whenever possible, the tax imposed by this Article shall, when collected, be stated as a distinct item separate and apart from the gross charge for telecommunications.” 35 ILCS 630/5.

The Company may use the address associated with the Registration IP as the service address to collect and remit Telecommunications Excise Tax, as well as any applicable Simplified Municipal Telecommunications Tax, on all telecommunications services purchased by the user. The manner in which the Company plans to convey to customers the telecommunications excise taxes imposed on customers is acceptable, as long as the rate of tax imposed under the Telecommunications Excise Tax and the actual rate of tax imposed under Simplified Municipal Telecommunications Tax for a customer’s service address is identified or can be determined by the customer.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this

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letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Chairman, Private Letter Ruling Committee

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