COMMUNICATIONS TAX SURVIVAL GUIDE

GUIDE

Avalara
Tax compliance done right

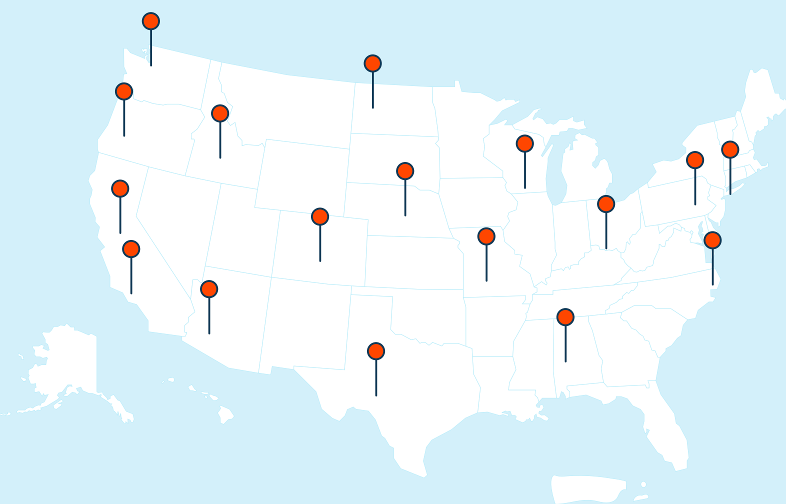
Contents

ABOUT AVALARA

Avalara helps businesses of all sizes get tax compliance right. In partnership with leading ERP, accounting, ecommerce, and other financial management system providers, Avalara delivers cloud-based compliance solutions for various transaction taxes, including sales and use, VAT, GST, excise, communications, lodging, and other indirect tax types. Headquartered in Durham, Avalara has offices across the U.S. and around the world in Brazil, Europe, and India.

More information at **avalara.com**.

THE COMMUNICATIONS INDUSTRY CHANGES EVERY DAY



The rapid pace of tech trends, innovations, mergers and acquisitions – not to mention the ever-evolving political landscape – all impact the taxation of services that include wireless, VoIP, unified communications, and managed services. And that's before you begin to factor in complexities related to things like bundling and identifying customer locations.

It's no wonder businesses with communications tax responsibility struggle to remain compliant. With more than 13,000 U.S. sales and use tax jurisdictions in a constant state of flux, the mere act of monitoring all those changes can be a full-time job. It can often feel like a struggle to simply survive.

AND WHEN YOU'RE IN SURVIVAL MODE, YOU NEED A SURVIVAL GUIDE.

In this guide, we summarize the top challenges facing communications service providers (CSPs) today, and offer several tactics that can be used to not only survive, but thrive, in their midst.

CHALLENGE #1

MANAGING COMPLIANCE PROCESSES WITH COMPLEX NEXUS

SURVIVAL TACTIC

Dedicated communications compliance specialists

Knowing when nexus is triggered can be difficult for any business. Factor in communications technology where there's little more than invisible radio waves and digital signals to track, and the process of managing compliance across numerous jurisdictions has the potential to become incredibly painful.

The reason: Many companies only think of sales and use taxes when determining if they have compliance obligations to a state, and therefore only consider retail scenarios where there are physical facilities, equipment, employees, and products that are relatively easy to track. Having a large warehouse or retail storefront may be a strong indicator that a company will fall within a state's definition of nexus from a sales and use tax perspective, but a very different set of factors apply when deciding if a CSP is obligated to register and comply with state communications taxes.

Even if a CSP doesn't own any network infrastructure in a state, complicated resale relationships with companies that do have infrastructure can create a legal relationship with physical facilities that may be counted toward a seller's presence in the state.

To complicate matters further, minimum thresholds vary widely from state to state. According to some states' economic nexus laws, the amount of sales in the state will determine when a CSP is required to comply with communications tax laws. In others, nexus is based on where your customers live and work.

Meanwhile, communications business models and the technology that drives them change all the time. So even if a tax manager understands what's needed for compliance across states today, there's no guarantee it will be the same in a month or in a year.

Remaining compliant means continually monitoring multiple jurisdictions to be certain the correct communications taxes are remitted everywhere the company has nexus. And that's a job for communications compliance specialists. Each time a communications business expands to a new jurisdiction, dedicated experts will need to gain a clear understanding of what the requirements are and how the company can remain compliant – then meticulously manage and adjust returns as activities and revenue streams evolve. Outsourcing the job to specialized professionals or designating a team of internal experts not only frees up staff to focus on critical business matters, but also helps ensure continual compliance across states as a company grows.

CHALLENGE #2

KEEPING UP WITH RATE CHANGES ACROSS JURISDICTIONS

SURVIVAL TACTIC

Specialized communications tax automation

In the perpetually advancing world of communications, there's so much more at stake than sales and use tax. Each new communications technology can lead to new questions around communications taxes and regulations.

How should states respond to this year's innovations? What will federal agencies regulate next? Which taxes and fees will be applied, and when? Governing bodies are asking these questions and many others like them, and so should CSPs.

The number of different rules and rates that must be monitored will continue to multiply each time a company grows to serve customers in another state. And things change constantly.

There are thousands of tax jurisdictions in the United States, and each one is working to keep its regulations current with rapidly changing communications technology. As a result, communications tax law can change suddenly and drastically.

Before a CSP expands its reach too far too fast, it's critical the company is equipped to stay updated on all the latest changes in each and every jurisdiction.

The best way to ensure communications tax accuracy across numerous states? Use a communications tax automation solution that's dedicated to tracking and applying the latest rates across U.S. tax jurisdictions – like AvaTax for Communications, which contains content for more than 60,000 jurisdictions in North America. The key is to automate with a focus on communications tax, not just on sales and use tax, for the vast range of complex calculations, fees, and surcharges to be monitored as they evolve.

CHALLENGE #3

AVOIDING MISCALCULATIONS RESULTING FROM INCORRECT LOCATIONS

SURVIVAL TACTIC

Geocoding

When it comes to communications taxation, location matters a lot. Pinpointing jurisdictions at the national, state, and local levels can have a big impact on compliance with communications taxes and regulations. Including incorrect customer locations on bills can result in underpayments to the appropriate taxing jurisdictions and lead to increased penalties and audit risks. It can also result in tax overpayments and lost revenue.

However, it's one thing to know you need to accurately source locations and another to get it right. Many of the location elements associated with billing addresses – street names, ZIP codes, phone numbers – seem simple on the surface but in fact are riddled with complications in the post-wired-line era. Because actual jurisdictional boundaries often don't align with addresses, ZIP codes, and other identifiers, CSPs that rely heavily on these less precise methods may be putting themselves at risk.

For example, when determining taxes based on a wireless customer's place of primary use (PPU), any number of issues can arise: An incomplete address could fail to reflect special tax districts or unincorporated areas, or the ZIP code database may have changed yet again. Or the information itself might not actually represent a "place of use," but rather a placeholder such as a P.O. box or virtual phone number.

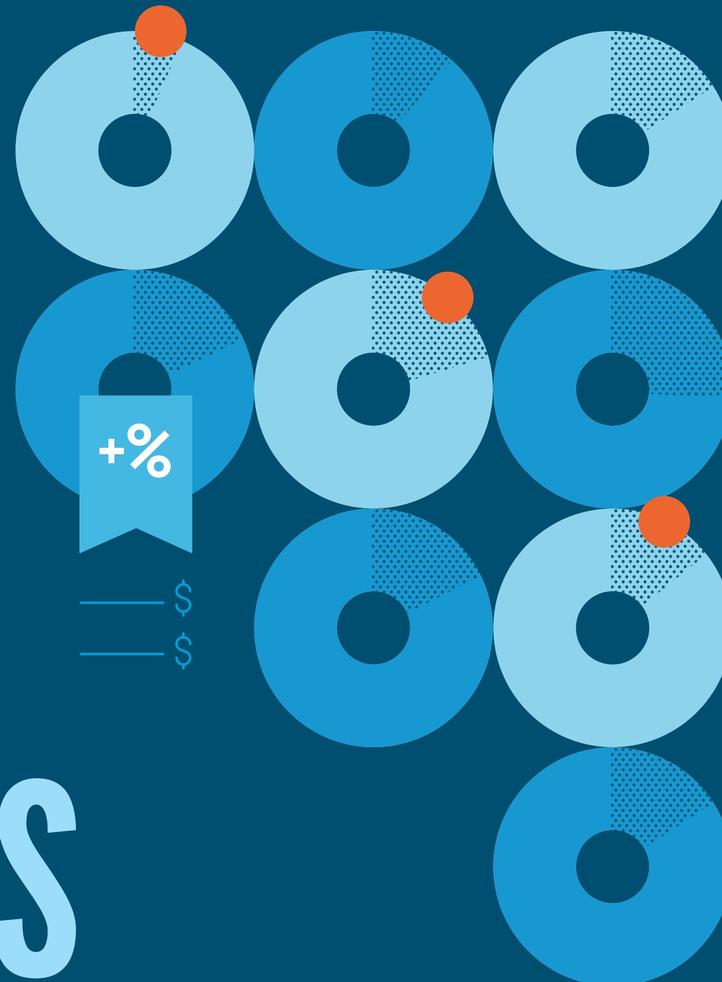
When a company fails to properly identify customer jurisdictions, tax calculations are practically guaranteed to be inaccurate. Failing to get locations right not only impacts profitability but can put a company in danger of unhappy customers, costly litigation, or noncompliance fees and fines. In fact, several jurisdictions aggressively target CSPs for location identification audits.

These audits are attractive because they can find liability without having to use experts who understand the more complicated issues of communications technology and tax law. They just have to establish that you applied tax in the wrong location, regardless of whether the services were otherwise taxed appropriately.

Pinpointing jurisdictions at the national, state, and local levels – all the way down to special tax districts – is a job that requires geocoding. Geocoding allows a company to identify the exact geographic coordinates of an address. This type of geographic information system (GIS)-based automation allows for true accuracy in a way other methods can't. By adding a geocoding component to tax automation software, communications service providers can identify customer locations with confidence.

CHALLENGE #4

APPLYING THE RIGHT RATES TO BUNDLED PRICING



SURVIVAL TACTIC

Meticulous records and communications tax expertise

The implications of continually changing rates and rules are especially acute as it relates to bundled pricing. As soon as nontaxable services are packaged together with taxable ones, the entire bundle potentially becomes subject to communications taxes and regulatory fees. But, there are effective strategies to unbundle or allocate taxes across services with lower risk. For example, a company might separate out each component of a bundle on the invoice – as though it was sold à la carte – and apply the appropriate communications taxes to each item on the bill.

With proper preparation, the CSP may be able to charge one consistent price on the bills sent to customers while internally separating out each piece for taxation purposes.

Whether a provider chooses one of these options or pays full tax on the entire bundle, compliance will require constant research, validation, and updating of tax rates across states – and, of course, maintaining meticulous usage records to justify unbundling methods to an auditor. If the CSP does unbundle the bundle for tax purposes, they'll be faced with the delicate matter of accurately identifying the value of each unbundled component.

And if that weren't involved enough, tax managers will need to keep tabs on what's allowed in each state. While many states allow unbundling for taxation, some are stricter.

And even when a state does allow unbundling, applying the correct percentages based on that particular state's rules can be the difference between compliance and hefty penalties.

The best method for ensuring more accurate tax rates on bundles is to use a specialized tax automation solution that supports unbundling and monitors relevant rate changes as they evolve.

For the provider that offers many different package options in a wide range of states, it may be necessary to add a specialized professional service to help determine which practices to use in each state.

A STREAMLINED SOLUTION

The communications industry changes constantly, and the pace seems to be increasing. As federal, state, and local jurisdictions work to align tax laws with new communications technologies and innovations, providers should remain vigilant of the many challenges that arise as a result.

At Avalara, many of these challenges are made nonissues through a variety of capabilities – including specialized compliance experts; professional services; an automation platform that supports geocoding, unbundling, and more – designed specifically to keep providers updated regularly on the latest rules, rates, and filing requirements across tens of thousands of tax jurisdictions.

Automating with Avalara makes compliance easier

The Avalara for Communications suite is designed to meet the compliance needs of businesses of all sizes in all industries so you can focus on daily operations. Tax rates, rules, and regulations change frequently. Although we hope you'll find this information helpful, this guide is for informational purposes only and does not provide legal or tax advice.

To learn more about any of these Avalara products or services, please contact your account manager or call 844-725-7278 to discuss how our team can help.