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**FOR INTERNAL PTA
DISCUSSION PURPOSES ONLY**

CONFIDENTIAL
ATTORNEY CLIENT PRIVILEGE

MEMORANDUM

TO: Steve Samara, PTA
FROM: Norm Kennard
DATE: March 23, 2010
RE: GRT and PA USF Charges

A. Introduction

This Memorandum discusses the Pennsylvania Gross Receipts Tax (“GRT”) and its application to Pennsylvania Universal Service Fund (“PA USF”) receipts and is a follow up to our earlier memorandum concerning the GRT and access charges, dated March 4, 2010. For convenience and brevity purposes, we incorporate herein the research, analyses, and discussions contained in that memorandum.

B. PA USF

The PA USF was established by the Pennsylvania Public Utility Commission (“PUC”) to reduce access charges and intraLATA toll rates for Pennsylvania telephone customers and to encourage greater toll competition while enabling carriers to preserve the affordability of local service rates in Pennsylvania. Incumbent local exchange carriers (“ILECs”), interexchange carriers (“IXCs”), and competitive local exchange carriers (“CLECs”) all contribute to the fund. Money from the fund is subsequently disbursed to ILECs to compensate for past revenue reductions.

C. Department of Revenue Decision

The Department of Revenue’s Board of Finance and Revenue recently concluded that receipts from PA USF charges are properly includable in a rural local exchange company’s (“RLEC”) taxable gross receipts. In reaching that decision, the Department took the position that because the RLEC

charged its customers for the PA USF and other services, such receipts were “related to the transmission of telephone messages” and, therefore, subject to GRT.

D. Analysis

We disagree with the Department’s conclusion and believe that receipts from PA USF charges should not be included in an RLEC’s taxable gross receipts. There are two lines of thought to this position.

First and foremost, it is our opinion that PA USF receipts do not constitute, nor are they related to, the transmission of “telephone messages.” Under the Tax Code, the general rule provides that “[e]very . . . telephone company, telegraph company or provider of mobile telecommunications services” is subject to a tax “upon each dollar of gross receipts” received from “telephone messages” transmitted both intrastate and interstate (*i.e.*, where the message originates or terminates in Pennsylvania and is billed to a Pennsylvania service address).¹ Accordingly, the dispositive issue with respect to the applicability of the GRT to PA USF receipts becomes whether receipts from the PAUSF are received from the “transmission of telephone messages.” It appears, however, the Department has broadened the GRT’s reach to include not only those receipts received from the actual transmission of telephone messages, but also receipts *related thereto*.

Receipts from the PA USF represent fixed amounts that are received from the PAUSF based upon a formula set by the PUC which is not dependent in any way upon whether messages are conveyed or not. This amount of USF receipts by the RLECs does not change and has no relationship to the actual carriage of any telephone messages. The number of messages transmitted in any given period is completely irrelevant for PA USF purposes. An RLEC receives PA USF receipts regardless of the number of messages that are carried on its network. Receipts are not calculated on a per message basis. With no nexus to the actual messages transmitted, PA USF receipts cannot be deemed to be received from the transmission of telephone messages.

Alternatively, an argument against the application of the GRT to PA USF receipts may be made based on the “sales for resale” exception to the general rule above. Under that exception, receipts derived from sales of telecommunications services for resale which are made to entities that are subject to the GRT when the service is resold are exempt from taxable gross receipts.² IXC’s, such as AT&T, Sprint, and Qwest, contribute money into the PA USF. By law, they are not permitted to implement a customer or end-user surcharge or any other direct or indirect charge to recover these contributions to the fund.³ These IXC’s have appeared before the PUC and testified that their contributions are recovered, however, in the rates charged to their customers. This sworn testimony suggests, then, that PA USF receipts should be treated as any other sale for resale and, thus, consistent with the treatment of access charges. Accordingly, PA USF receipts should be exempt from the GRT, to the extent such IXC’s are subject to the GRT. In support of this argument, the RLEC could obtain a list of PA USF contributing IXC’s and their Federal EINs and submit it to the Department for verification purposes.

¹ 72 P.S. § 8101(a)(2).

² See 72 P.S. § 81801(a)(2)(ii).

³ 52 Pa. Code § 63.170.

E. Disclaimer

The contents of this Memorandum are not intended to constitute tax advice to the PTA or any member company and may not be relied upon as such. The member companies should consult their tax advisors.