

**INTERNAL PTA
DISCUSSION PURPOSES ONLY**



**CONFIDENTIAL
ATTORNEY CLIENT PRIVILEGE**

TO: Steve Samara, PTA
FROM: Norm Kennard
DATE: March 4, 2010
RE: GRT and Access Charges (Final)

A. Gross Receipts Tax

“Every ... 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” both intrastate and interstate (where the message originates or terminates in Pennsylvania and is billed to a Pennsylvania service address). The original gross receipts tax (GRT) was implemented in 1971 and amended, inter alia, to recognize certain telephone exemptions in 2000. In 2003, the Tax Code was revised to add mobile and interstate messages. In Corporate Tax Bulletin 2005-001, the Department interpreted the phrase “in interstate commerce” to include international calling as well. Telephone companies that pay gross receipts tax in another state on messages and services that are also subject to Pennsylvania gross receipts tax are entitled to a credit.

An exception to the application of the tax is granted to gross receipts derived from the sales of access to the Internet and “sales for resale” made to entities that are subject to the gross receipt tax upon the resale transaction. Specific examples of resale are identified: “exchange access,” unbundled network elements and services that interconnect with wireless carriers.

B. Exchange Access

There is no definition in the Tax Code of the term “exchange access.” However, the term is well known in telecommunications parlance and is defined in federal regulations, with similar definitions used by the Pennsylvania Public Utility Commission. Under federal statute, the term “exchange access” means “the offering of access to telephone exchange services or facilities for the purpose of origination or termination of telephone toll services.”¹ Toll service is “telephone service between stations in different exchange areas” with charges in addition to those associated with local service.² The Pennsylvania Public Utility Commission administers access tariffs, where the rates, terms and conditions of intrastate exchange access are established. The Federal

¹ 47 U.S.C. § 153(16).

² 47 C.F.R. § 51.5.

Communications Commission does the same with respect to exchange access provided for interstate calling.

The rural local exchange companies' (RLEC) access services are provided to interexchange carriers (IXCs) and other similar carriers on both the terminating and originating sides of a toll call. On the originating end, the IXC typically has a retail business relationship with the (calling) end user for the provision of toll service and pays originating access charges. On the terminating side, the local exchange carriers charges access charges to the carrier delivering the call, which, most likely, is not the originating IXC (when intermediate carriers are involved in "least cost routing"). The originating IXC's toll charges cover the cost of both sides of the access charges, or at least should if the IXC wants to remain in business. The GRT PUC Code provisions recognize the IXC's relationship with the customer and expressly permits the carrier to include a separate line item on the customer's bill to collect the tax.

C. Analysis

Receipts from exchange access service are exempt from GRT, when received from entities that are "subject to the tax" when the access service is "resold" (i.e., as a completed toll call). The key then is whether the entity to whom access is sold is subject to the tax. This is clear on the originating side, when the RLEC sells access directly to the IXC that makes this retail sale. On the terminating side, where the call may have been handed off several times through a series of intermediate carriers, the entity to whom access is sold is once or more removed from the entity that makes the resale. It would seem reasonable in that situation, to the extent that the Department of Revenue (Department) raises it (we don't know that they have) to argue that the exemption flows through the intermediate carriers (who are also subject to the tax, unless they can use the reseller's exemption).

It is our opinion that, under the express terminology of the Tax Code, the taxpayer need only demonstrate that the entity making the resale is subject to the tax. Within the scope of the application of the GRT, exchange access is clearly input into a "telegraph or telephone message," the receipts for which are subject to the tax. Access charges are, by regulatory definition, for "the purpose of origination or termination of telephone toll services." There is no other use of which I am aware. This is unlike certain sales tax transactions where a product (lumber) is purchased by various types of users and subject to various uses (new house construction), such that a sales tax exemption certificate must be supplied. Exchange access is only used to provide telephone message connectivity and should be considered automatically exempt.

The Department has taken the position, however, that RLECs claiming the exemption "are required to provide the Name and Federal EIN of the Reseller along with the amount received from each entity."³ More recently, it appears that the Department has also been requiring local exchange carriers to identify whether the IXC is certificated by the Commission. In at least one instance, the Department has refused to grant the exemption, if the local exchange carrier could not identify the EIN or PA PUC utility code for the IXC or if the resale IXC did not pay GRT.

³ Instructions for RCT-111 Return.

Several thoughts. First, the regulatory status of the reseller is irrelevant. A utility certificate is not required for the tax to apply. The Commonwealth Court has previously held that gross receipt taxpayers are defined by the function they perform, without regard to whether they are regulated as a public utility.⁴ Thus, an unregulated electric generator and a natural gas producer were both found subject to the tax. Also, under the Electric Choice Act, although electric generation suppliers are excluded from the definition of public utility, they are still required to collect the tax as resellers.

Second, the RLEC should not be forced to pay if the resale entity (IXC) does not. Certainly the risk of collection is upon the Commonwealth and not the local exchange company. The sale for resale by the RLEC is exempt where the resale is subject to the tax, regardless of whether tax is actually collected by the Department. It is unreasonable and in excess of the statute to require the RLECs to either pursue the reseller for collection or hold the exemption hostage to actual receipt of the gross receipts tax from the reseller.

Finally, it may be arguable whether the RLEC is required to identify the reseller, but the Department may not be out of line in requesting the identity of the IXC to whom access services apply.⁵ Again, the resale entity to whom access service is sold must be subject to the tax for the exemption to apply. While access service, by definition, enables a customer message that is subject to the tax, it should not be surprising that the Department seeks some proof of the reseller's identity. At this point, the Department is not demanding that the RLECs prove that there is a resale subject to the tax, only the identity of the reseller.

D. Prospective Changes

One way to deal with the risk imposed by the Department is to require all originating and terminating access service customers to fill out a form certifying payment of gross receipts tax returns for the resale transaction and requiring indemnification if the Department does not grant the exemption. One such form currently in use is attached.

The carriers whom the RLECs send carrier access bills (CABs) could be advised that, if they do not sign the form, then gross receipts tax will be applied to their bill going forward. This way, in the next tax return, the RLEC will have either the exemption form or the cash to pay the tax on non-exempt sales. Research of the access tariff should be performed to determine whether this is consistent. The state tax adjustment surcharge (STAS) mechanism might also be available to recover the shortfall, although the STAS generally reflects changes in the tax rate, not in the tax base or exemptions.

⁴ *Hanley and Bird v. Commonwealth*, 590 A.2d 1382 (Pa. Cmwlth., 1991) and *Solar Turbines Inc. v. Commonwealth*, 816 A.2d 362 (Pa. Cmwlth., 2003).

⁵ The taxpayer bears the burden of demonstrating that the exemption applies. *Commonwealth v. Peters Orchard*, 511 Pa. 465, 515 A. 2d 550 (1986) and *Transcontinental Gas Pipe Line v. Com.*, 153 Pa. Cmwlth. 60, 620 A. 2d 614 (Pa. Cmwlth., 1993). In the later case, a certain portion of the gas sold at wholesale (i.e., sale for resale) was used in the reseller's operations or lost and the GRT was applied to that portion. Resale gas company statements were used to establish the amount of gas sold or lost.

NOTE: The contents of this memo 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 advisor.

Exemption from Pennsylvania Gross Receipts Tax only applies to resellers that file Pennsylvania Gross Receipt Tax Returns. In order to receive an exemption from collection of Pennsylvania Gross Receipts from your company, please complete the following form:

Legal Name of Entity (“Company”)_____

EIN Used on PA Gross Receipts Return Form, _____

Certification of Gross Receipts Return Filing:

I certify that the above company filed Pennsylvania Gross Receipts Tax Returns, Form RCT 111 for all periods during which exemption was claimed, and the Company continues to file PA Gross Receipt Returns. The above EIN was used in the filing of those Gross Receipts Returns.

It is agreed that in the event the State of Pennsylvania denies the Company a Gross Receipt Tax Exemption, the Company will cooperate fully with Frontier Communications in providing documentation to support the exemption claimed. If the Pa Department of Revenue denies efforts to support the exemption, Company will indemnify and reimburse Frontier for all taxes, interest and penalties assessed. This indemnity is in addition to and does not supersede the rights that Frontier has negotiated in the full contract with the Company.

Authorized Signatory_____

Printed Name_____

Business Telephone number_____