TC 12-01
Tax Type: Telecommunications Excise Tax
Issue: Telecommunications Excise Tax Owed

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS v. **ABC BUSINESS, LLC** **Taxpayer**	**Docket # XXXXXX** **IBT # XXXXXX** **NTL # XXXXXX**

RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Jeffrey A. Ryva of Husch Blackwell LLP for ABC Business, LLC

Synopsis:

The Department of Revenue ("Department") conducted an audit of ABC Business, LLC ("taxpayer") for the period of November 2005 through June 2010. At the conclusion of the audit, the Department issued twelve Notices of Tax Liability ("NTL's") to the taxpayer. The taxpayer timely protested the NTL's, and an evidentiary hearing was held. The NTL's assess additional tax, penalties, and interest pursuant to the Illinois Telecommunications Excise Tax Act ("Tax Act") (35 ILCS 630/1 *et seq*.). The taxpayer provides a telephone service known as Voice-over Internet Protocol ("VoIP"), which allows its customers to place and receive telephone calls over the internet wherever they can connect to a broadband network. The taxpayer contends that its services are not subject to the Tax Act because the Tax Act is

preempted by federal statute, federal case law, and authority from the Federal Communications Commission ("FCC"). The Department contends that the Tax Act is not preempted by federal law. In addition, the taxpayer argues that in the event that the Tax Act is not preempted and the tax applies, then the Department improperly calculated the tax on the total amount that the taxpayer charged to its customers, rather than only the amount that corresponded to the inbound and outbound local and long-distance calls. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer was organized in the State of Illinois in November 2005. The taxpayer provides a phone service known as Voice-over Internet Protocol ("VoIP"). The taxpayer is located in Anywhere, Illinois. (Dept. Ex. #1, pp. 96, 136-142; Taxpayer Ex. #1, pp. 1-2; Tr. p. 60)
2. VoIP technology allows customers to place and receive telephone calls through a broadband connection to the internet. The taxpayer provides its services to businesses in Illinois, and VoIP is the only service it provides. (Taxpayer Ex. #1, pp. 1, 2, 8; Tr. p. 127)
3. In order to use VoIP, a customer must obtain his or her own broadband internet connection. The taxpayer is not an internet service provider ("ISP") and does not provide the customer with access to the internet. (Taxpayer Ex. #1, p. 1; Tr. pp. 81-82, 120)
4. The customer may obtain internet access from his or her home through an ISP, or the customer may obtain access anywhere throughout the world where a broadband internet connection is available. (Taxpayer Ex. #1, p. 1; Tr. pp. 81-82)

5. In order to use VoIP, the customer must have equipment that allows voice communication to be transmitted over the internet. (Tr. pp. 82-83, 123-124; 47 C.F.R. §9.3)
6. There are many options for the type of equipment needed to use VoIP. The equipment may be an adapter that attaches to a regular telephone. The equipment may also be a box known as an Internet Access Device that converts an existing phone system to a VoIP system by connecting it to the internet. (Tr. pp. 82-83, 124)
7. The equipment may be a portable VoIP phone, which is sold by the taxpayer. (Taxpayer Ex. #5, p. 2; Tr. p. 123)
8. The equipment may be a computer that has a microphone and software to access VoIP so that the computer can be used as a phone. The equipment may also be a cell phone with VoIP capabilities. (Tr. pp. 71, 85)
9. Once the taxpayer's customer has VoIP equipment, the customer may call either a person who also has VoIP equipment (VoIP-to-VoIP communication) or a person who has a landline (VoIP-to-landline communication). A person who has a landline may call the taxpayer's customer who has VoIP equipment (landline-to-VoIP communication). (Tr. pp. 71-78)
10. VoIP-to-landline communications and landline-to-VoIP communications are known as "interconnected VoIP service." (47 C.F.R. §9.3)
11. For VoIP-to-VoIP communications, the initiating equipment converts the voice to "packets," which are transmitted over the internet to the receiving equipment, which converts the packets back to voice. (Tr. pp. 73-76, 118-119, 123-124)

12. For VoIP-to-VoIP communications, the call originates and terminates at an internet provider ("IP") address. The calls are transmitted solely over the internet, and the beginning and end points of VoIP-to-VoIP communications are in cyberspace. (Taxpayer Ex. #1, p. 2; Tr. pp. 71, 75-76, 79)
13. For VoIP-to-landline communications, the voice data is converted to packets that are transmitted over the internet. The packets are then "unbundled" and converted to analog voice, and the call "hops on" the Public Switched Telephone Network ("PSTN") where it is then received by a regular phone.[1] For landline-to-VoIP communications, the process is the same except in reverse. The beginning and end points of the landline portion of the interconnected VoIP service call can be geographically located. (Taxpayer Ex. #1, p. 1; Tr. pp. 74-80)
14. The taxpayer uses a company known as XYZ Business to complete its calls.[2] XYZ Business has "internet infrastructure or a footprint across the United States." If the call is VoIP-to-landline, XYZ Business unbundles the packets and "hands off" the call to a company that uses the PSTN, such as AT&T, where the call is then completed. (Tr. pp. 73-77)
15. If the call is VoIP-to-VoIP and the VoIP equipment is transportable so that it may be used wherever there is access to a broadband internet connection, the taxpayer's technology does not allow the taxpayer to determine the geographic location of either the person making the call or the person receiving the call. (Taxpayer Ex. #1, p. 4; Tr. p. 79)

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[1] The Public Switched Telephone Network ("PSTN") is "an international system of public circuit-switched telephone networks based on copper wires that carries analog voice data." Mayor and City Council of Baltimore v. Vonage America, Inc., 544 F. Supp. 2d 458, 462, f.n. 7 (D. Maryland 2008), *motion to reconsider denied*, 569 F. Supp. 2d 535. "Telephone service carried by the PSTN is often called 'Plain Old Telephone Service' ('POTS')." *Id*.

[2] The full extent of the taxpayer's relationship with XYZ Business is not clear, and the taxpayer did not provide a copy of its contract with XYZ Business.

16. The taxpayer "did not and could not track or break down calls between local and long distance, nor separate interstate from intrastate calls." (Taxpayer Ex. #1, p. 4)
17. "The ultimate carrier could" determine whether the VoIP portion of a call is intrastate or interstate. XYZ Business "might be able to tell whether [a call is] an intra or interstate call. Or Level 3 [which was not explained] could be able to do that." (Tr. p. 79)
18. The North American Numbering Plan ("NANP") is the numbering scheme that assigns numbers for the PSTN. The taxpayer's customers may "port" that number to a VoIP system.[3] XYZ Business ports numbers for the taxpayer. When making a VoIP call, the number from the NANP does not necessarily correspond to the user's geographic location. (Tr. pp. 83-86; 122)
19. Some of the phone features that the taxpayer offers include caller ID, three-way calling, call forwarding, voicemail, voicemail to email, individual simultaneous ring (home, office and cell phones can ring simultaneously), "on-the-fly" conferencing (spontaneously make a conference call), auto-attendant (automated receptionist), and remote office (access and use the features from anywhere in the world). (Dept. Ex. #1, pp. 139, 142)
20. During the audit period, the taxpayer "sold its service on a flat-rate basis per connection." (Taxpayer Ex. #1, p. 4)
21. The taxpayer's "hosted services are bundled, at a total service price of $39.95 per telephone per month." (Taxpayer Ex. #1, p. 5)

[3] According to the Communications Act, "number portability" means "the ability of users of telecommunications services to retain, at the same location, existing telecommunications numbers without impairment of quality, reliability, or convenience when switching from one telecommunications carrier to another." 47 U.S.C. §153(37); 47 C.F.R. §52.21(n). The FCC requires an interconnected VoIP provider to facilitate a customer's "valid number portability request." 47 C.F.R. §52.34.

22. The bundled services include four major components: (1) all local and long distance calls inbound and outbound, including interstate as well as intrastate; (2) all of the telephone equipment (which includes desk telephones, host router, and Power Over Ethernet switch if necessary); (3) full technical support and maintenance 24/7 for the internet phone service; and (4) all features licenses like voicemail, call forwarding, auto attendant, and speed dial. Each component is billed at $9.99. (Taxpayer Ex. #1, p. 6; Tr. pp. 93-94)
23. During the audit period, the taxpayer did not specifically break down on its customers' invoices $9.99 for each of the four components of the package. (Tr. pp. 91-92, 99-101, 111-113)
24. During the audit period, the Department concluded that the taxpayer "owed tax as to the entire amount of its billings, not the one-fourth that actually corresponded to inbound and outbound local and long-distance calls." (Taxpayer Ex. #1, p. 6)
25. The FCC regulates the taxpayer's E911 service. (Tr. pp. 114-115; 47 C.F.R. §9.1-9.7)
26. In order to provide E911 service, the taxpayer must obtain from each customer, prior to the initiation of service, the physical location at which the service will first be utilized. The most recent information obtained by the taxpayer that identifies the physical location of the customer is known as the Registered Location. (Tr. pp. 115-116; 47 C.F.R. §9.3, §9.5(d)(1))
27. The Registered Location that is associated with the taxpayer's service is necessary in order for the emergency response team to know where to go when the customer dials 911. (Tr. p. 116; 47 C.F.R. §9.5)

28. The taxpayer must provide its customers with one or more methods of updating their Registered Location. The methods must allow the customers to update their Registered Location at will and in a timely manner. (47 C.F.R. §9.5(d)(2))
29. For E911 service, the phone number for the taxpayer's customer is associated with a specific physical address for that customer. (Tr. p. 116)
30. When the taxpayer sends an invoice to its customer, it mails a hard copy of the invoice to the customer's billing address. The taxpayer maintains billing addresses for all of its customers. (Tr. pp. 116-118)
31. The Department conducted an audit of the taxpayer's business for the period of November 2005 through June 2010. (Dept. Ex. #1, pp. 96-97)
32. For all of the months of the audit period except November 2005, the taxpayer filed Form RT-10, Telecommunications Infrastructure Maintenance Fees Return, pursuant to the Illinois Telecommunications Infrastructure Maintenance Fee Act (35 ILCS 635/1 *et seq*.).[4] The taxpayer charged and collected this fee from its customers. According to the RT-10s, the first month that the taxpayer began receiving income was February 2006. (Dept. Ex. #1, pp. 215-269; Tr. p. 109)
33. During the audit period, the taxpayer did not file Form RT-2, Telecommunications Tax Return, pursuant to the Illinois Telecommunications Excise Tax Act (35 ILCS 630/1 *et seq*.). (Dept. Ex. #1, p. 97)
34. Both the telecommunications infrastructure maintenance fee ("TIMF") and the telecommunications excise tax are based on the taxpayer's gross charges and the customer's location. (Dept. Ex. #1, p. 97; 35 ILCS 630/3, 4; 635/15)

[4] This Act imposes an infrastructure maintenance fee on a telecommunications retailer in the amount of .5% of gross charges charged "to service addresses in this State for telecommunications, other than wireless telecommunications, originating or received in this State." 35 ILCS 635/15. The imposition of this fee is not at issue in this case.

35. During the audit, the taxpayer provided the auditor with copies of its RT-10s for the audit period. The auditor asked the taxpayer to provide information that would substantiate the gross charges on the RT-10s. The taxpayer did not give this information to the auditor. (Dept. Ex. #1, p. 97)
36. The auditor asked the taxpayer for copies of its customer listing in order to determine the billing addresses of the customers to properly calculate the tax. The taxpayer did not provide this information to the auditor. (Dept. Ex. #1, p. 97)
37. The taxpayer provided the auditor with a spreadsheet that showed the monthly charges that XYZ Business billed to the taxpayer for XYZ Business' services. The taxpayer asked the auditor to calculate the excise tax based on the gross charges that XYZ Business billed to the taxpayer. The auditor explained that the tax was not calculated on these gross charges. (Dept. Ex. #1, pp. 96-98; Tr. pp. 19-21, 112)
38. The auditor calculated the excise tax based on the gross charges that were reported on the taxpayer's RT-10s during the audit period. (Dept. Ex. #1, pp. 96-98; Tr. pp. 51-52)
39. After the auditor determined the tax, the taxpayer told the auditor it was willing to provide additional information to receive credit for some of the charges. The taxpayer gave the auditor its billing invoices for the month of June 2010. Some of the charges on the invoices were for 911 service, voicemail service, data maintenance, and equipment leases. The auditor eliminated those charges for the month of June 2010 and projected that amount over the remaining audit period to give the taxpayer credit for those charges. (Dept. Ex. #1, pp. 96-99; Tr. pp. 21-22, 25-26)
40. In late September or early October 2010, the taxpayer's president submitted additional documents to the Department that "included various invoices showing the break-down of

the four billing components of the bundled VoIP service. The Department rejected the submission of additional invoices for the reason that they were for billings outside the audit period. …" (Taxpayer Ex. #1, p. 7)

41. On November 16, 2010, the auditor prepared Form SC-10-K, Audit Correction and/or Determination of Tax Due, showing the total tax due, plus penalties and interest, for the audit period.[5] The SC-10-K was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1, pp. 76-77, 186-187)

CONCLUSIONS OF LAW:

Initially, the taxpayer has requested that all of the Department's responses to the taxpayer's Request to Admit be deemed admitted because the Department did not provide a specific sworn statement as to any of its denials or detailed reasons why it could not admit or deny certain requests. (Taxpayer Ex. #1) The Department's regulation concerning Requests for Admissions states, in relevant part, as follows:

> (1) A party may serve on any other party a written request for the admission by the latter of the truth of any specified relevant fact set forth in the request, and/or for the admission of the genuineness of any relevant documents described in the request. … Each of the matters concerning admission of fact, or the genuineness of each document for which admission of fact is requested, shall be admitted, unless, within 28 days after service of the request or such additional time as may be granted by the Administrative Law Judge, the person to whom the request is directed serves upon the requesting party either:
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> (A) *A sworn statement denying specifically the matter on which admission of fact is requested, or setting forth, in detail, the reason why he cannot truthfully admit or deny those matters.* A denial shall fairly meet the substance of the requested admission. If good faith requires that a party qualify his answer or deny only a part of an admission of fact, he shall specify so much of it as is true and deny or qualify the remainder. An answering person may not give lack of information or knowledge as a reason for failure to admit or deny

[5] A portion of the audit period included the time period during which tax liabilities qualified for the amnesty program (July 1, 2002 through June 30, 2009). (Dept. Ex. #1, pp. 96-99) Because this portion of the liability was not paid during the amnesty period (October 1, 2010 through November 8, 2010), the penalties and interest are double for this time period. See 86 Ill. Admin. Code §520.101; 520.105(i).

> unless he states that he has made reasonable inquiries and that the information known or regularly obtainable by him is insufficient to enable him to admit or deny said fact; *or*
>
> (B) *A written objection on the grounds that some or all of the requested admissions of fact are privileged or irrelevant.* An objection on the grounds of relevance may be noted by any party but it is not to be regarded as just cause for refusal to admit or deny. If written objections to a request are made, the remainder of the request shall be answered within the period designated in the request. A requesting party, upon receipt of any objection, may have such objection(s) heard and determined by the Administrative Law Judge upon prompt notice and motion directed thereto. (Emphasis added.) 86 Ill. Admin. Code §200.125(d)(1)(A), (B).
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> Any admission made by a party to a request under this rule is for the purpose of the pending action only. It does not constitute an admission by him for any other civil proceeding and may not be used against him in any other proceeding.

The Department expressly admitted most of the facts set forth in the taxpayer's Request to Admit. The Department objected to one of the requests (#44) on the basis that it was irrelevant and privileged information. (Taxpayer Ex. #1, p. 9) Written objections do not need to be sworn (Vision Point of Sale, Inc. v. Haas, 226 Ill. 2d 334, 355 (2007)), and this request is not deemed admitted by the Department.

For the remaining requests, however, the Department did not provide a sworn statement, and for the requests that the Department stated it could not admit or deny, the Department did not set forth, in detail, the reason why it could not truthfully be admitted or denied. The Department's attorney signed the response without verification.[6] Because the Department did not provide a sworn statement in compliance with section 200.125(d)(1)(A), these requests are deemed admitted by the Department. See Coleman v. Akpakpah, 402 Ill. App. 3d 822, 828-829 (1st Dist. 2010) (failure to comply with verification requirement for Request to Admit required facts to be deemed admitted). Of those facts deemed admitted, the relevant facts have been included in the Findings of Fact. (See Findings of Fact #1, 2, 3, 4, 12, 13, 15, 16, 19, 20, 21, 23,

[6] The verification requirement would have been met with language tracking section 1-109 of the Code of Civil Procedure (735 ILCS 5/1-109). See Vision Point, at 355-356.

39) Many of the admitted facts, however, are not relevant to deciding the issues in this case and have been excluded for that reason.[7]

The taxpayer contends that this case has nothing to do with numbers, and the taxpayer adamantly believes that the Tax Act simply does not apply to the taxpayer's services. Section 3 of the Tax Act, which concerns the imposition of the tax on intrastate telecommunications, provides, in relevant part, as follows:

> Beginning January 1, 1998, a tax is imposed upon the act or privilege of originating in this State or receiving in this State intrastate telecommunications by a person in this State at the rate of 7% of the gross charge for such telecommunications purchased at retail from a retailer by such person. *However, such tax is not imposed on the act or privilege to the extent such act or privilege may not, under the Constitution and statutes of the United States, be made the subject of taxation by the State….* (Emphasis added.) 35 ILCS 630/3.

Section 4 of the Tax Act, which concerns the imposition of the tax on interstate telecommunications, provides, in relevant part, as follows:

> Beginning January 1, 1998, a tax is imposed upon the act or privilege of originating in this State or receiving in this State interstate telecommunications by a person in this State at the rate of 7% of the gross charge for such telecommunications purchased at retail from a retailer by such person. To prevent actual multi-state taxation of the act or privilege that is subject to taxation under this paragraph, any taxpayer, upon proof that that taxpayer has paid a tax in another state on such event, shall be allowed a credit against the tax imposed in this Section 4 to the extent of the amount of such tax properly due and paid in such other state. *However, such tax is not imposed on the act or privilege to the extent such act or privilege may not, under the Constitution and statutes of the United States, be made the subject of taxation by the State….* (Emphasis added.) 35 ILCS 630/4.

Section 21 of the Tax Act also provides as follows:

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[7] One irrelevant fact is that at least one of the Department's representatives agreed with the taxpayer that the excise tax does not apply to VoIP services. (Taxpayer Ex. #1, p. 4) Whether the excise tax is preempted by federal law is a question for judicial determination; the opinion of a Department employee is not binding on this issue. See Craftmasters, Inc. v. Department of Revenue, 269 Ill. App. 3d 934, 940 (4th Dist. 1995) (auditor's opinion as to how exemption would apply is not binding upon a court).

> If Section 4 of this Article is declared unconstitutional or invalid, no part of this Article shall be effective. 35 ILCS 630/21.

The taxpayer argues that under federal authority, the act or privilege of providing VoIP services is not subject to taxation by the State of Illinois. According to the taxpayer, VoIP services fall squarely within the "savings clauses" of Sections 3 and 4 because the Federal Communications Act preempts all State laws that regulate or tax VoIP services.

Before discussing the preemption issue, it is worthwhile to explain why the taxpayer filed Form RT-10 for each month during the audit period. The taxpayer's president testified that, based on advice from an attorney, the taxpayer applied for and obtained status as a Competitive Local Exchange Carrier ("CLEC"). (Tr. pp. 60-61, 68) A CLEC is allowed to enter into a contractual agreement with a company, such as AT&T, for the use of its POTS lines (landlines). (Tr. pp. 62-63) The company will sell the lines to the CLEC wholesale, and the CLEC resells them. *Id*. The taxpayer decided to get the CLEC status because it thought that the status would increase the value of the taxpayer in the event that another company would be interested in buying it. (Tr. pp. 122-123) The taxpayer also considered offering a landline type of service along with its VoIP service, and it would need the CLEC status to do that.[8] *Id*. The taxpayer has CLEC status but never entered into an agreement with a company such as AT&T, and it does not actually lease the PSTN lines. (Tr. pp. 68, 122)

The taxpayer's president believed that because the taxpayer obtained CLEC status, the taxpayer was required to file Form RT-10, Telecommunications Infrastructure Maintenance Fees Return, pursuant to the Illinois Telecommunications Infrastructure Maintenance Fee Act. (Tr. pp. 64-65) He also believed that the taxpayer owed the TIMF but not the excise tax because of

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[8] XYZ Business handles the landline portion of the taxpayer's services. (Tr. pp. 73-74) A CLEC may port numbers from AT&T to another carrier, and the taxpayer has the ability to port numbers because of its CLEC status. (Tr. p. 122) The taxpayer, however, has XYZ Business port the numbers because XYZ Business is a CLEC. *Id.*

the term "infrastructure;" he thought the TIMF was a fee on the taxpayer's business and not its services. (Tr. pp. 68-69) He said that he never considered contesting that fee because it is only .5% of gross charges, and he thought the amount was not "big enough" to contest. (Tr. pp. 69-70) The taxpayer charges the TIMF to its customers.

Preemption

For preemption, the taxpayer notes that federal law is both supreme and controlling in all Illinois proceedings. The Supremacy Clause of the United States Constitution empowers Congress and federal agencies acting within the scope of their delegated authority to preempt state law. Louisiana Public Service Commission v. FCC, 476 U.S. 355, 368-369 (1986). Preemption occurs (1) when Congress, in enacting a federal statute, expresses a clear intent to preempt state law; (2) when there is outright or actual conflict between federal and state law; (3) where compliance with both federal and state law is in effect physically impossible; (4) where there is implicit in federal law a barrier to state regulation; (5) where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law; or (6) where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress. *Id*. The Illinois Supreme Court has held that when the question is whether a state law is preempted by federal authority, federal court decisions under federal statutes are binding throughout Illinois, even upon its highest court. See *e.g.*, U.S. Bank National Association v. Clark, 216 Ill. 2d 334 (2005); Busch v. Graphic Color Corp., 169 Ill. 2d 325 (1996).

The taxpayer argues that the Federal Communications Act of 1934, as amended, 47 U.S.C. §§151 *et seq*. ("Communications Act") preempts State taxation of VoIP services for two reasons: (1) VoIP services are "information services" within the meaning of the

Communications Act (47 U.S.C. §153) and may not be regulated or taxed by the State; and (2) VoIP services fall within the "impossibility exception" for preemption. Unfortunately, the taxpayer misunderstands Congress' intent under the amendments to the Communications Act.

With respect to the taxpayer's first contention, the taxpayer refers to Vonage Holdings Corporation v. Minnesota Public Utilities Commission ("MPUC I"), 290 F. Supp. 2d 993 (D. Minn. 2003), *aff'd*, 394 F. 3d 568 (8th Cir. 2004), where the court found there was a direct conflict between the Communications Act and a Minnesota law as it was applied to Vonage's VoIP services.[9] The court noted that Congress intended to leave the internet unregulated. *Id*. at 997 (citing 47 U.S.C. §230(b)). Under the Communications Act, Congress differentiated between "telecommunications services," which may be regulated, and "information services," which, like the internet, may not. The court stated that the internet was the backbone of Vonage's VoIP services, and the services were "information services" within the meaning of that term as defined by the Communications Act, rather than "telecommunications" or "telecommunications services."[10] The court found that because Congress clearly defined information services separately from telecommunications services, "Congress intended to keep the Internet and information services unregulated." *Id*. at 1001. The court concluded that there was a direct conflict between the Communications Act and the state law that was enforced by the MPUC, and preemption was necessary. *Id*. at 1001-1002.

The taxpayer notes that the court's decision in MPUC I has been followed by subsequent federal cases. See Paetec Communications, Inc. v. XYZ Business, LLC, 2010 WL 1767193 (D.

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[9] The Minnesota law required telephone companies to obtain certification authorizing them to provide telephone service. *Id*. at 996-997.

[10] At the time of the decision, the definition for "information services" was found at 47 U.S.C. §153(20), and the same definition is currently found at 47 U.S.C. §153(24). The definitions for "telecommunications" and "telecommunications services" were previously found at 47 U.S.C. §153(43) and (46) respectively. The same definitions are currently found at 47 U.S.C. §153(50) and (53) respectively.

D.C.) (VoIP services at issue were information services and not subject to "access charge" regime of the Communications Act); Southwestern Bell Telephone, L.P. v. Missouri Public Service Commission, 461 F. Supp. 2d 1055 (E.D. Mo. 2006) (VoIP services at issue were information services and not subject to "access charge" regime of the Communications Act); Vonage Holdings Corporation v. New York State Public Service Commission, 2005 WL 3440708 (S.D. N.Y.) (New York State Public Service Commission prohibited from enforcing its regulatory regime for "telephone corporations" to Vonage's VoIP services).

These cases cited by the taxpayer that distinguish "information" from "telecommunications" services are not applicable to the present case because these cases concern regulation, not taxation, of VoIP services, and a separate provision of the Communications Act expressly allows States to tax VoIP services. When determining whether the Tax Act is preempted, the "ultimate touchstone" of preemption analysis is the intent of Congress. City of Chicago v. Comcast Cable Holdings, LLC, 231 Ill. 2d 399, 405 (2008), citing Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516 (1992). Despite the taxpayer's reliance on these federal cases, the clear intent of Congress under the Communications Act is to allow States to tax VoIP services.

Congress amended the Communications Act by passing the Internet Tax Freedom Act ("ITFA"), Pub. L. No. 105-277, §§ 1100 *et seq*., 112 Stat. 2681, 47 U.S.C. §151 note (1998) ("Pub. L. No. 105-277"). Under the latest amendments to the ITFA, Congress has specifically allowed States to tax VoIP services. See Pub. L. No. 110-108, §1105(5), 121 Stat. 1024, 47 U.S.C. §151 note (2007) ("Pub. L. No. 110-108"); Pub. L. No. 108-435, 118 Stat. 2615, 47 U.S.C §151 note (2004) ("Pub. L. No. 108-435"). See also 47 U.S.C. §609 note (2007).

The ITFA was initially passed in 1998 and prohibits States from imposing taxes on "Internet access."[11] The ITFA is reproduced as a note to section 151 of the Communications Act. In 2004, Congress amended the ITFA and included the following in section 1108:

> EXCEPTION FOR VOICE SERVICES OVER THE INTERNET.
>
> Nothing in this Act shall be construed to affect the imposition of tax on a charge for voice or similar service utilizing Internet Protocol or any successor protocol. This section shall not apply to any services that are incidental to Internet access, such as voice-capable email or instant messaging. Pub. L. No. 108-435.

Under this provision, an exception to the moratorium was made for voice services that use Internet Protocol, *i.e.*, VoIP services. This amendment was effective November 1, 2003, and therefore, from the beginning of the audit period in this case, States were allowed to tax VoIP services.

Congress subsequently amended the ITFA again to specifically exclude VoIP services from the definition of "internet access." The latest amendment is the Internet Tax Freedom Act Amendments Act of 2007, which became effective on November 1, 2007 and includes the following definition of internet access in section 1105:

> **(5) Internet access.**--The term 'Internet access'—
>
> **(A)** means a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet;
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> **(B)** includes the purchase, use or sale of telecommunications by a provider of a service described in subparagraph (A) to the extent such telecommunications are purchased, used or sold.—
>
> **(i)** to provide such service; or

[11] Section 1101(a)(1) of the ITFA states as follows: "Moratorium – No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending 3 years after the date of the enactment of this Act – (1) taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998." Pub. L. No. 105-277. Congress subsequently extended the sunset provision of the ITFA. See Internet Tax Nondiscrimination Act, Pub. L. No. 107-75, 115 Stat. 703, 47 U.S.C §151 note (2001) (extending ITFA to November 1, 2003); Internet Tax Nondiscrimination Act, Pub. L. No. 108-435 (extending ITFA to November 1, 2007); Internet Tax Freedom Act Amendments Act of 2007, Pub. L. No. 110-108 (extending ITFA to November 1, 2014).

(ii) to otherwise enable users to access content, information or other services offered over the Internet;

(C) includes services that are incidental to the provision of the service described in subparagraph (A) when furnished to users as part of such service, such as a home page, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity;

(D) *does not include voice*, audio or video programming, or other products and *services* (except services described in subparagraph (A), (B), (C), or (E)) *that utilize Internet protocol or any successor protocol and for which there is a charge, regardless of whether such charge is separately stated or aggregated with the charge for services described in subparagraph (A), (B), (C), or (E)*; and

(E) includes a homepage, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity, that are provided independently or not packaged with Internet access. (*Emphasis added*.) Pub. L. No. 110-108, §1105(5).

The taxpayer charges its customers for its services, which, again, are voice services that use Internet Protocol. Under section 1105(5)(D), Congress clearly excluded these services from the term "Internet access," and, therefore, States are currently allowed to tax these services.

In short, in the seminal case relied upon by the taxpayer, MPUC I, *supra*, the court found there was a direct conflict between the Communications Act and Minnesota's regulations, and Minnesota, therefore, could not regulate VoIP services. In the present case, with the current amendments to the ITFA, the Communications Act specifically allows States to tax VoIP services. Unlike Minnesota's regulations, the Illinois excise tax does not conflict with federal law; federal law actually allows it.

In addition, section 152 of the Communications Act, which concerns the FCC's jurisdiction, includes the following in a note:

Applicability of Consent Decrees and Other Law …

(c) Federal, State, and local law. –

(1) **No implied effect. –** This Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State, or local law unless expressly so provided in such Act or amendments.

(2) **State tax savings provision. –** Notwithstanding paragraph (1), nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede, or authorize the modification, impairment, or supersession of, any State or local law pertaining to taxation, except as provided in sections 622 and 653(c) of the Communications Act of 1934 [sections 542 and 573(c) of this title] and section 602 of this Act [set out as a note under this section]. (Emphasis in original.) Pub. L. 104-104, Title VI, §601, 110 Stat. 143, 47 U.S.C. §152 note (1996) ("Pub. L. 104-104").

Section 542 of title 47 concerns franchise fees, section 573(c) concerns reduced regulatory burdens for open video systems, and section 602 of the Communications Act concerns preemption of local taxation with respect to direct-to-home satellite services. See 47 U.S.C. §§542, 573(c); Pub.L. 104-104. This note to section 152, therefore, specifically indicates that nothing in the Act shall be construed to modify, impair, or supersede a State's right to tax VoIP services, and as previously stated, the ITFA, which is part of the Communications Act, expressly allows States to tax VoIP services.

The taxpayer contends that the ITFA "is of no importance in this case." (Taxpayer's Reply Brief, p. 19) The taxpayer simply states that it is not arguing that it offers internet access or that it is an internet service provider. Instead, the taxpayer argues that the courts have distinguished "information" services that *use* the internet from "telecommunications" services. The taxpayer claims that the Department does not realize that distinction and the importance of *using* rather than *providing* internet service. The taxpayer believes that the crucial policy running through this area of the law is to protect the internet users, which include VoIP providers.

The taxpayer's arguments are without merit and do not specifically address the amendments to the ITFA, which show that Congress clearly intends to allow States to tax VoIP services. As the taxpayer indicates, it is not offering internet access, and under the ITFA, VoIP services are specifically excluded from the definition of internet access. The taxpayer's services, therefore, are not exempt from taxes on that basis.

Although the taxpayer claims that it *uses* rather than *provides* internet services, Congress has determined that the taxpayer's specific use of the internet, providing VoIP services, is a use that States or local governments may tax. The State of Washington has upheld a telephone utility tax assessed by the City of Seattle on VoIP services (Vonage America, Inc. v. City of Seattle, 152 Wash. App. 12 (2009)), and a federal court has upheld a telecommunications tax assessed by the City of Baltimore on VoIP services (Mayor and City Council of Baltimore v. Vonage America, Inc., *supra*). The current federal policy, based on the clear language of the ITFA, is to allow States to tax VoIP services.[12]

Next, with respect to the taxpayer's contention that Illinois' authority to tax VoIP services is preempted by the "impossibility exception," the taxpayer first cites In re Vonage Holdings Corp., 19 F.C.C.R. 22404 (2004) ("Vonage Preemption Order"), *aff'd sub nom.* Minnesota Public Utilities Commission v. Federal Communications Commission ("MPUC II") 483 F. 3d 570 (8th Cir. 2007), which is an order by the FCC preempting the MPUC from applying its traditional "telephone company" regulations to Vonage's VoIP services. In the order, the FCC first noted as follows:

[12] States other than Illinois also tax VoIP services. See *e.g.* Minnesota Department of Revenue, Modification of Revenue Notice # 05-03 (April 13, 2009); Colorado Department of Revenue, GIL 2009-030 (June 30, 2009); New York State Department of Taxation and Finance, NYT-G-07(2)C (June 20, 2007) and NYT-G-07(3)C (June 21, 2007); South Carolina Department of Revenue, Rev. Rul. No. 06-8 (November 16, 2006); Pennsylvania Department of Revenue, Sales Tax Bulletin 2005-02 (January 28, 2005).

> We express no opinion here on the applicability to Vonage of Minnesota's general laws governing entities conducting business within the state, such as laws concerning taxation; fraud; general commercial dealings; and marketing, advertising, and other business practices. *Id*. at 22405.

Also in the order, the FCC noted the differences between Vonage's VoIP services and services provided by the PSTN.[13] The FCC determined that it had jurisdiction over Vonage's VoIP services because, first of all, the services are "mixed-use" services, which are capable of communications between both intrastate and interstate end points. *Id*. at 22413. Mixed-use services are generally subject to dual federal/state jurisdiction. *Id*. There is an exception to this rule, however, when "it is impossible or impractical to separate the service's intrastate from interstate components and the state regulation of the intrastate component interferes with valid federal rules or policies." *Id*. The FCC found that VoIP services are not purely intrastate services; they are jurisdictionally mixed (subject also to federal jurisdiction). Because the services are jurisdictionally mixed, the FCC has exclusive jurisdiction under the Communications Act to determine the policies and rules, if any, that govern the interstate aspect of Vonage's VoIP services. *Id*. at 22414.

The FCC found that under existing Commission precedent, unless the intrastate component could be separated, Minnesota's regulations directly conflicted with FCC rules and policies for services such as Vonage's VoIP.[14] The FCC examined whether there was any plausible approach to separating Vonage's VoIP services into interstate and intrastate components and found that there was none. *Id*. at 22418-22424. The FCC concluded that because it is impractical, if not impossible, to separate the interstate and intrastate components

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[13] The differences for VoIP services may be summarized as follows: (1) customers must have access to a broadband internet connection; (2) customers must have "specialized" equipment; (3) customers are offered various features, such as receiving voicemails through email, that are not available through PSTN services; and (4) the NANP numbers that the VoIP service uses are not necessarily tied to the user's physical location. *Id*. at 22406-22408.

[14] The FCC specifically declined to decide whether Vonage's VoIP services were "information" or "telecommunications" services under the Communications Act. *Id*. at 22411.

for purposes of enabling dual federal and state regulations to coexist without "negating" federal policy and rules, Minnesota's regulations must be preempted because they conflict with federal rules and policies governing Vonage's interstate VoIP communications. *Id*. Without a practical means of separating the service, Minnesota's regulations reach the interstate components of Vonage's VoIP services that are subject to exclusive federal jurisdiction. *Id*. at 22418.

The Vonage Preemption Order was challenged in federal court, and the FCC's decision was upheld in MPUC II, *supra*.[15] The court stated that the "impossibility exception" of the Communications Act, 47 U.S.C. §152(b), allows the FCC to preempt state regulation of a service which would otherwise be subject to dual federal and state regulation where it is (1) impossible or impractical to separate the service's intrastate and interstate components, and (2) the state regulation interferes with valid federal rules and policies. *Id*. at 576. The court stated that "the issue of whether VoIP services can be separated into interstate and intrastate components is a largely fact-driven inquiry requiring a high level of technical expertise." *Id*. at 579. The court concluded that the FCC did not arbitrarily or capriciously determine that it was impractical or impossible to separate the intrastate components of Vonage's VoIP service from its interstate components. *Id*. The court stated that its review was limited to the issue of whether the FCC's determination was reasonable based on the record existing before it at the time. *Id*. at 580. "If, in the future, advances in technology undermine the central rationale of the FCC's decision, its preemptive effect may be reexamined." *Id*. The court also concluded that the FCC did not arbitrarily or capriciously determine that the state regulation would interfere with valid federal rules or policies. *Id*. at 581.

[15] The court in MPUC II noted the difference between "fixed" and "nomadic" VoIP services. Fixed VoIP services are used from a fixed location; for example, VoIP service provided by a cable television company that uses the cable running to and from the customer's residence has a fixed geographic location. *Id*. at 575. Nomadic service can be used "nomadically" by connecting with a broadband internet connection anywhere in the world. *Id*.

In Vonage Holdings Corp. v. Nebraska Public Service Commission, 564 F. 3d 900, (8th Cir. 2009), the Eighth Circuit addressed "whether nomadic interconnected VoIP service providers may be subjected to a state regulation requiring them to collect a universal service fund surcharge." *Id*. at 903. Relying on the analysis in the Vonage Preemption Order and MPUC II, the court upheld the district court's finding that the state regulation was preempted. "[T]he FCC has made clear it, and not state commissions, has the responsibility to decide if such regulations will be applied." Nebraska Public Service Commission, at 905. In New Mexico Public Regulation Commission v. Vontage Holdings Corp., 640 F. Supp. 2d 1359 (D. N.M. 2009), the Court followed the reasoning in Nebraska Public Service Commission and MPUC II and found that New Mexico could not require a VoIP provider to collect a state universal service fee.

These cases concerning the impossibility exception are distinguishable from the present case. As the FCC noted in the Vonage Preemption Order, the cases do not concern taxation; they concern the FCC's regulatory authority and whether State commissions may enforce State regulations. The instant case does not concern regulations imposed by the Illinois Commerce Commission on VoIP services; it does not concern an Illinois law that would conflict with the FCC's regulatory authority. This case concerns the Department's assessment of the telecommunications excise tax on the taxpayer's VoIP services, and a tax on VoIP services is expressly allowed by Congress.

Furthermore, the taxpayer in the present case has not clearly established that the elements of the impossibility exception have been met. The taxpayer must show that compliance with both federal and state law is in effect physically impossible. Louisiana Public Service Commission, *supra*. In MPUC II, *supra*, the court stated that this exception is found in section 152(b) of the Communications Act and requires preemption where it is (1) impossible or

impractical to separate the service's intrastate and interstate components, and (2) the state regulation interferes with valid federal rules and policies. *Id*. at 576. In the cases cited by the taxpayer, the exception was met because the courts found that it was impossible to separate the intrastate and interstate components of VoIP service, and the regulations that were enforced by State commissions interfered with the FCC's jurisdiction. See Vonage Preemption Order, *supra*; MPUC II, *supra*; Nebraska Public Service Commission, *supra*; New Mexico Public Regulation Commission, *supra*.

Since those cases were decided, the technology has apparently improved because the testimony in the present case does not clearly establish that it is impossible or impractical to separate the taxpayer's VoIP services into intrastate and interstate components. As the court stated in MPUC II, *supra*, this is "a largely fact-driven inquiry requiring a high level of technical expertise." *Id*. at 579. "If, in the future, advances in technology undermine the central rationale of the FCC's decision, its preemptive effect may be reexamined." *Id*. at 580.

The current state of the technology is not clear from the record in this case. The taxpayer's president testified that the taxpayer's technology does not allow it to determine whether the VoIP portion of the call is interstate or intrastate. As previously stated, however, he testified that "the ultimate carrier could" make that determination. (Tr. p. 79) He said XYZ Business "might be able to" do it, or Level 3 (which was not explained) "would be able to do that." *Id*. He then stated as follows:

> We can't tell because we don't buy the service [as a CLEC]. When we buy the service and resell it, we will buy the service based upon connections. Okay? We don't know. We don't care whether we call intrastate or interstate. And we don't care whether they are local, in Springfield or long distance, okay, calls. The only thing that we can get broken down from our major carriers are the international calls, okay, because there are charges on a permitted basis on international calls. (Tr. pp. 79-80)

When subsequently asked whether anyone could actually separate interstate versus intrastate calls, the taxpayer's president responded, "ABC Business cannot do that." (Tr. p. 81) No further explanation was provided concerning the ability to determine whether calls are intrastate, interstate, or international.

Certainly this testimony does not allow a conclusion that it is impossible to separate intrastate and interstate components. This testimony does reflect that this taxpayer is not concerned with receiving this information. In fact, major carriers determine whether the call is international or not, and the taxpayer receives a breakdown from them for those calls. Based on the evidence provided by the taxpayer, the current state of the technology concerning the separation of the interstate and intrastate components moots the factual basis of MPUC II, *supra*, and the other cases upon which the taxpayer relies.

Furthermore, even if it is assumed that it is impossible or impractical to separate the interstate and intrastate components, the taxpayer has not established that the Tax Act interferes with federal rules and policies. As already mentioned, the current federal policy as expressed in the Communications Act is to allow States to tax VoIP services. Other than the Communications Act, the taxpayer has not cited a specific federal law or rule with which the excise tax would interfere. Under the Tax Act, the same rate of 7% applies to both interstate and intrastate telecommunications. 35 ILCS 630/3, 4. The taxpayer does not bill its customers separately for interstate or intrastate calls; the taxpayer charges one flat bundled fee that includes everything. Pursuant to the above, the taxpayer has failed to show that compliance with both federal and state law is in effect physically impossible, and the taxpayer has failed to establish that during the audit period in this case, federal law preempted Illinois' right to impose a tax on VoIP services.

It is worth noting that in Goldberg v. Sweet, 488 U.S. 252 (1989), the Supreme Court held that the Tax Act did not violate the Commerce Clause with respect to wired telecommunications. The court applied the four-pronged test originated in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), which found that a state tax will withstand scrutiny under the Commerce Clause if "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id*. at 279. In Goldberg, *supra*, the parties agreed that the tax satisfied the first prong, *i.e.*, it was applied to an activity having a substantial nexus with Illinois. *Id*. at 258, f.n. 9. The court then found that the tax imposed by the Tax Act met the other three prongs of the test and was consistent with the Commerce Clause. *Id*. at 267-268.

As the Supreme Court indicated, the Tax Act imposes a tax on the gross charge of interstate or intrastate telecommunications that originate or terminate in Illinois (35 ILCS 630/3, 4), and are charged to an Illinois service address (35 ILCS 630/2(a), (b)). The Supreme Court noted that at the time of the decision, the Tax Act did not define the term "service address." Goldberg, at 256, f.n. 6. The court stated that it understood the term to mean the "address where the telephone equipment is located and to which the telephone number is assigned." *Id*. The legislature has since amended the Tax Act to include the following definition of "service address" in section 2:

> (n) "Service address" means the location of telecommunications equipment from which the 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, maritime systems, service address means the customer's place of primary use as defined in the Mobile Telecommunications Sourcing

> Conformity Act.[16] 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).

One of the Department's regulations for the Tax Act is titled "Mobile Operations Reporting Option" and states, in relevant part, as follows:

> Retailers of telecommunications who provide … other services where the customer's service address is in fact not a fixed site, but rather a motor vehicle or other mobile location, shall use the location of the customer's primary use of the telecommunications equipment, as defined by telephone number, authorization code, or location in Illinois where bills are sent, as the service address for the purpose of determining whether tax is due on services charged to the customer. … 86 Ill. Admin. Code §495.120(a).

Thus, for services such as the taxpayer's nomadic VoIP, the location in Illinois where the bills are sent is the service address for purposes of calculating the tax. In Mayor and City Council of Baltimore, *supra*, the court found that "in the context of Vonage's nomadic VoIP, the presence of a billing address in the taxing locality is sufficient to constitute a 'substantial nexus'" under the Commerce Clause. Mayor and City Council of Baltimore, 569 F. Supp. 2d at 538. When applied to the taxpayer's VoIP services, therefore, the billing address constitutes substantial nexus, and the Tax Act continues to be consistent with the Commerce Clause.

Telecommunications Excise Tax

Because federal law does not preempt the Tax Act, it must be determined whether the Tax Act applies to the taxpayer's services. As previously stated, the tax is imposed upon intrastate or interstate telecommunications at the rate of 7% of the gross charge for such telecommunications. 35 ILCS 630/3, 4. The definition of "telecommunications" is provided in section 2(c) of the Tax Act as follows:

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[16] 35 ILCS 638/1 *et seq*. This Act 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. 35 ILCS 638/10.

> ‘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. As used in this Act, ‘private line’ means a dedicated non-traffic sensitive service for a single customer, that entitles the customer to exclusive or priority use of a communications channel or group of channels, from one or more specified locations to one or more other specified locations. The definition of ‘telecommunications’ shall not include value added services in which computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission. ‘Telecommunications’ shall not include purchases of telecommunications by a telecommunications service provider for use as a component part of the service provided by him to the ultimate retail consumer who originates or terminates the taxable end-to-end communications. Carrier access charges, right of access charges, charges for use of inter-company facilities, and all telecommunications resold in the subsequent provision of, used as a component of, or integrated into end-to-end telecommunications service shall be non-taxable as sales for resale. 35 ILCS 630/2(c).

Not only do the taxpayer’s VoIP services transmit messages or information through the use of computer exchange services (tr. p. 119), the taxpayer’s interconnected VoIP services use the PSTN. The taxpayer’s services clearly fall within this broad definition of telecommunications, and the taxpayer has not argued otherwise. See ST 05-0008-GIL, 1/12/05 (definition of telecommunications is very broad and encompasses VoIP).

The taxpayer does argue that even if the Tax Act applies to its services, the tax should only be assessed on the portion of its invoices that are for the local and long distance calls. The taxpayer contends that the tax should not have been assessed on the total gross charges. The taxpayer admitted, however, that it did not breakdown the four components of its services on the customers’ invoices because the taxpayer believed that the excise tax did not apply to its

services. (Tr. p. 91-92) The taxpayer contends that assessing the tax on the total gross charges is unfair because the taxpayer would have had to anticipate the imposition of the tax.

Section 9 of the Tax Act incorporates by reference section 5 of the Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*), which provides that if the taxpayer fails to file a return, the Department "shall determine the amount of tax due … according to its best judgment and information." 35 ILCS 630/9; 120/5. If a certified copy of the Department's determination of the amount of tax due is offered at any hearing before the Department, the certified copy "shall, without further proof, be admitted into evidence before the Department … and shall be *prima facie* proof of the correctness of the amount of tax due, as shown therein." *Id*.

Once the Department has established its *prima facie* case, the burden shifts to the taxpayer to overcome this presumption of validity. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 156-157 (1968); JM Aviation, Inc. v. Department of Revenue, 341 Ill. App. 3d 1, 11 (1st Dist. 2003); Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1st Dist. 1991); Sprague v. Johnson, 195 Ill. App. 3d 798, 803-804 (4th Dist. 1990); A.R. Barnes & Company v. Department of Revenue, 173 Ill. App. 3d 826, 832 (1st Dist. 1988). To rebut the Department's *prima facie* case, the taxpayer must present more than oral testimony denying the Department's assessment. *Id*. The taxpayer must present sufficient documentary evidence to support its claim. *Id*.

The Department's *prima facie* case was established with the admission of Form SC-10-K, Audit Correction and/or Determination of Tax Due, which was admitted under the certificate of the Director of the Department. The burden then shifted to the taxpayer to present competent evidence, identified with its books and records, to establish that the Department's determination is incorrect. Mel-Park Drugs, *supra*. When the taxpayer's evidence "is not so inconsistent or

improbable in itself as to be unworthy of belief, the burden then shifts to the Department, which is required to prove its case by competent evidence." *Id*. at 217. The taxpayer believes that its evidence was competent, and the Department now bears the burden of proof on all issues, including the taxpayer's argument that at most it only owes one-fourth of the amount claimed due. (Taxpayer's Reply Brief, p. 6)

The taxpayer is mistaken regarding the burden of proof. The burden has not shifted back to the Department. After the Department established its *prima facie* case, the taxpayer failed to present competent evidence, identified with its books and records, to establish that the Department's determination is incorrect. The only exhibits admitted into evidence for the taxpayer were the Department's responses to the taxpayer's Request to Admit and an advertisement for the taxpayer's services. The taxpayer's RT-10s were admitted as part of the Department's exhibit (Dept. Ex. #1, pp. 215-269). The taxpayer did not offer a single invoice or document related to its books and records to prove that it does not owe the amount assessed by the Department.[17] Without documentary evidence that shows that the assessment was incorrect, it cannot be found that the taxpayer has overcome the Department's *prima facie* case, and the assessment must be upheld on this basis.

Furthermore, even if the taxpayer had presented evidence identified with its books and records, the testimony indicated that the invoices during the audit period did not disaggregate and separate the four components that were included in the $39.95 monthly charge to the

[17] During the audit, the taxpayer did not provide the documents that the auditor requested. The taxpayer provided the auditor with the following: (1) RT-10 returns; (2) billing invoices for June 2010; and (3) a spreadsheet of amounts that XYZ Business charged to the taxpayer. (Dept. Ex. #1, p. 96) Because the taxpayer adamantly believes that VoIP services are not subject to the telecommunications excise tax, the taxpayer was "not willing to provide any additional information to conduct the audit." *Id*. at 97. The auditor asked for a customer listing to determine the billing addresses for the customers, and the taxpayer did not provide it. *Id*. The taxpayer also did not provide backup information for the total charges billed to its customers that was shown on the RT-10s. *Id*. The auditor calculated the liability based on those charges. *Id*. at 98.

customers. As stated previously, the relevant section of the ITFA that became effective on November 1, 2007 states that internet access does not include the following:

> [V]oice, audio or video programming, or other products and services (except services described in subparagraph (A), (B), (C), or (E)) that utilize Internet protocol or any successor protocol and for which there is a charge, *regardless of whether such charge is separately stated or aggregated with the charge for services described in subparagraph (A), (B), (C), or (E)*. (Emphasis added.) Pub. L. No. 110-108.

Thus, VoIP services are taxable regardless of whether the charge is aggregated with other charges. The excise tax is a percentage of the "gross charge" for telecommunications. 35 ILCS 630/3, 4. Section 2(a) defines "gross charge," in relevant part, as follows:

> "Gross charge" 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. … However, "gross charges" shall not include any of the following:
>
> (1) Any amounts added to a purchaser's bill because of a charge made pursuant to (i) the tax imposed by this Article; … (iv) 911 surcharges …
>
> (4) *Charges for customer equipment*, including such equipment that is leased or rented by the customer from any source, *wherein such charges are disaggregated and separately identified from other charges*. …
>
> (9) Amounts paid by telecommunications retailers under the Telecommunications Municipal Infrastructure Maintenance Fee Act.
>
> (10) *Charges for nontaxable services or telecommunications if* (i) those charges are aggregated with other charges for telecommunications that are taxable, (ii) those charges are not separately stated on the customer bill or invoice, *and* (iii) *the retailer can reasonably identify the nontaxable charges on the retailer's books and records kept in the regular course of business. If the nontaxable charges cannot reasonably be identified, the gross charge from the sale of both taxable and nontaxable services or telecommunications*

> *billed on a combined basis shall be attributed to the taxable services or telecommunications. The burden of proving nontaxable charges shall be on the retailer of the telecommunications*. (Emphasis added.) 35 ILCS 630/2(a).

Under this definition in the statute, the taxpayer clearly has the burden of proving and identifying the nontaxable charges through its books and records that are kept in the regular course of its business. In addition, the Department's regulation concerning the meaning of "gross charges" reiterates the need to separately identify the nontaxable charges and includes the following:

> A retailer may provide services to customers that are not provided in connection with originating or receiving telecommunications. If such services are not necessary for or directly related to the retailer's provision of telecommunications to customers *and the charges for such services are disaggregated and separately identified from other charges*, the charges need not be included in "Gross charges". (Emphasis added.) 86 Ill. Admin. Code §495.100(a).

The following concerning customer equipment is also included in the regulation:

> To be exempt, the charges for customer equipment must be *disaggregated and separately identified from other charges in the books and records of the retailer*. (Emphasis added.) 86 Ill. Admin. Code §495.100(b).

All of these provisions clearly indicate that in order for the taxpayer to owe only one-fourth of the amount assessed, it must prove through its books and records that the charges for the equipment and the charges for nontaxable services were disaggregated and separately identified from the other charges. The taxpayer has simply failed to meet this burden. Because the taxpayer did not break down the four components of its services that it sold to its customers, and the taxpayer failed to produce books and records to show otherwise, the assessment must be upheld in its entirety. See *e.g.* Sprague, *supra*, (hauling charges that were not separately itemized on taxpayer's sales invoices were taxed under ROTA).

As a final note, for the time period before November 1, 2007, the previous amendment to the ITFA that was effective on November 1, 2003 stated that services that are incidental to

internet access, such as voice-capable email or instant messaging, are covered by the moratorium and not taxable. This provision did not provide that the services had to be separately identified. The taxpayer, however, did not provide any documentation for the time period prior to November 1, 2007 to show what portion of the assessed charges was for incidental services. Although the testimony indicated that each component of the package is billed at $9.99, the testimony also indicated that occasionally the taxpayer would sell services to a customer outside of the package. (Tr. p. 97) Because the gross charges were not always for the package rate, determining the amount attributable to incidental services is not as easy as calculating one-fourth of the assessed charges. Without documentation, such as invoices, that would substantiate the gross charges, it cannot be determined what amounts prior to November 1, 2007 were attributable to incidental charges. Furthermore, the auditor gave the taxpayer credit for certain charges that included voicemail service. (See Findings of Fact #39) Without invoices, it is impossible to determine whether the taxpayer is entitled to additional credit. The incidental charges, therefore, must be included in the tax.

Recommendation:

For the foregoing reasons, it is recommended that this matter be resolved in favor of the Department.

Linda Olivero
Administrative Law Judge

Enter: February 3, 2012