The Tax Challenges of Accurately Identifying Customer Locations

For communications service providers, there's a lot on the line

All communications service providers (CSPs), from wireline to wireless to VoIP and from emerging companies to established corporations, face a similar set of challenges. There are regulatory fees to track, nexus requirements to determine and tax on tax calculations to get right.

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And then there's one of the most significant variables of all: location.

The billing components that seem so simple on the surface – a street name, a zip code, a phone number – are in fact riddled with complications. These location identifiers dictate which jurisdiction gets to tax each individual customer and what rates to apply at the local, state and federal levels. For this reason, pinpointing customer locations at a granular level is a critical component of compliance and profitability. Yet many of the most commonly used methods for identifying locations aren't very reliable for tax purposes.

While location accuracy is hard to achieve in any industry, CSPs face an especially difficult set of challenges. Historically, locations have been dictated by the physical or billing addresses typically placed at the top portion of paper bills. The nomadic nature of today's customers is causing a dramatic shift in how providers can, and should, identify customer locations for tax purposes.

This white paper explains the correlation between customer location IDs and profitability, explores current methods for obtaining locational data for taxation and outlines steps CSPs are taking to resolve common location issues.

Location Identification and Taxation

In the complex world of communications taxation, pinpointing a customer's precise location is one of the most critical components of tax compliance. Correctly identifying exact localities is important for several key reasons.

Accurate customer location identification:

Ensures accuracy. Properly identifying customer locations enables companies to confidently answer the question: "Which jurisdiction gets to tax the customer?" It also ensures that the correct taxing authority is collecting important surcharges such as fees to support 911 services, and that those taxes and charges are being accurately assessed and correctly calculated.

Impacts profitability. Each time a provider files the wrong jurisdiction in a customer's account, it risks overpaying and losing money. Additionally, incorrect location IDs can lead to customer confusion, complaints and drain support time.

Affects compliance. Inaccurate location IDs can also lead to miscalculations and tax underpayments, which in turn increase audit liabilities and the risk of penalties. What's more, taxing customers in the wrong jurisdictions can increase the potential for unwanted public attention and public class action issues—particularly for larger entities.

Sourcing Location IDs

In the pre-smartphone and video conferencing era of wired line calls, identifying the location of a sale for tax purposes (known as situsing) was based on a standard "two out of three" Goldberg rule established by the Supreme Court in 1989. For a state to be able to tax a long distance call, at least two of three variables had to be present within the state: origination, destination or a bill-to number.

When attempts to consistently apply this rule to cellular failed, the federal Mobile Telecommunications Sourcing Act (MTSA) was introduced. According to this act, wireless calls are taxed based on the customer's Place of Primary Use (PPU).Both of these processes are often riddled with complications such as:

- Incomplete addresses that fail to reflect counties, special tax districts and unincorporated areas

- Zip code databases that change constantly

- Placeholders (such as post office boxes and virtual phone numbers) that don't accurately reflect locations

These challenges tend to surface in several of the most common location identification methods and can increase risks of tax calculation errors.

5 Common Location ID Methods

Most of the common methods for sourcing call locations fall into one of five categories. These are ranked from least to most accurate and described below.

Method #1: Addresses

Physical addresses provide the most straightforward approach to identifying a customer's

location. Unfortunately, addresses do not always accurately reflect taxing jurisdictions. They don't provide the information needed to determine when a customer lives in a special purpose tax district or unincorporated area. And if a city spans multiple counties, as many do, the billing address will not tell you the county in which your customer is located.

Consideration #2: Zip Codes

Zip codes, and specifically zip +4, are more exacting than addresses alone. However, the zip code database changes constantly: There are more than 40,000 zip codes in the US and changes are made monthly. Like addresses, zip codes still may not tell you what counties your customers are located in, whether they live outside city limits or if they're in special tax districts.

Consideration #3: Phone Numbers

Phone numbers often have a more targeted footprint than zip codes and addresses. However, the North American Numbering Plan (NANP) database changes regularly and often doesn't indicate when a person lives outside city limits or in a special tax district. Further complicating matters are virtual phone numbers and "follow me" services that can make it incredibly difficult to determine where a customer truly is physically located.

Consideration #4: FIPS Codes

Federal Information Processing Standards, or FIPS, codes are used largely by federal government agencies and contractors to ensure uniform identification of states and counties. While these codes are more precise than addresses and phone numbers, they still may not reveal when a customer lives outside city limits or in a special tax district. They are also more difficult to maintain. Most customers are unaware of their codes in the FIPS database, which changes regularly.

Consideration #5: GIS Software

Geographic information systems use spatial technology to convert each physical location to a precise latitude-longitude pair. When used to identify customer locations, the boundaries of cities, counties and special purpose districts are immediately visible. GIS software also brings clarity to incorporated and unincorporated statuses through geo-coding.

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The Importance of Geo-Coding

Locating correct jurisdictions at the national, state and local levels–all the way down to special tax districts–is a job that requires geo-coding. 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.

Spatial data allows companies to identify the exact geographic coordinates of an address. For example, the Avalara AvaTax for Communications Geo module will take a customer's account and translate the billing address into an exact latitude and longitude pair. This type of GIS-based automation ensures true accuracy in a way other methods can't.

In communications taxation, accurate location identification is critical. When a company fails to properly identify customer jurisdictions, tax calculations are virtually guaranteed to be inaccurate. This can lead to overpayments or underpayments and increase audit liability. Failing to get locations right not only impacts profitability but can put a company in danger of unhappy customers, costly litigation or non-compliance fees and fines.

Fortunately, there is a simple way to reverse these risks. By adding a geo-coding component to tax automation software, communications service providers can identify customer locations with confidence.
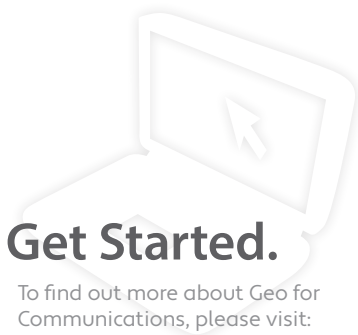
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