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What's the Hang Up? The Future of VoIP Regulation and Taxation in New Hampshire

KATIE WINSTANLEY*

I. INTRODUCTION

The rise of Voice over Internet Protocol (“VoIP”) services “means nothing less than the death of the traditional telephone business,”¹ as the ability to make free calls over a high-speed Internet connection in the future “undermines the existing pricing model for telephony.”² This disruptive, convergent technology is blurring the boundary between Internet services and telephone services because VoIP functions like the traditional telephone system, but travels as ones and zeros through a broadband Internet connection. As a result, the Federal Communications Commission (“FCC”) has questioned whether to classify VoIP as an information service, generally free from FCC regulation under the Telecommunications Act of 1996,³ or as a telecommunication service, subject to a comprehensive regulatory regime and common carrier obligations.⁴

While the FCC is struggling to classify various types of VoIP services within its regulatory framework established in the Telecommunications Act of 1996, the rest of the nation is debating whether states have the authority to regulate or to tax VoIP providers. In *Vonage Holdings Corp. v. Minnesota Public Utilities Commission*,⁵ the FCC and the United States District Court of Minnesota recently recognized that Vonage’s VoIP service is an information service, and as such, cannot be regulated by the states.⁶ The court in *Vonage*, however, did not decide whether states have the authority to tax VoIP services.⁷ Furthermore, the enactment of and

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1. *How The Internet Killed the Phone Business*, *The Economist* 950 (Sept. 17, 2005) (available at 2005 WLNR 14631449).

2. *Id.*

3. 47 U.S.C. § 153 (2006).

4. *Id.*

5. 290 F. Supp. 2d 993, 1003 (D. Minn. 2003).

6. *Id.*

7. *Id.*

amendments to the Internet Tax Nondiscrimination Act (“ITNA”) have left state and local governments questioning whether they may classify VoIP as an Internet access service, and thus whether they are barred from taxing VoIP under the Internet tax moratorium.⁸ Due to this confusion of how various VoIP services may be taxed, this note will attempt to clarify state taxation of Internet access and whether VoIP may be included under such a tax. More specifically, this note explores whether VoIP may be taxed separately under the seven percent New Hampshire communications services tax (“CST”) or whether it may be considered a part of a bundled Internet access service and therefore exempt from state taxation.⁹

States have a distinct interest in taxing telecommunications services, as they rely on receiving taxes from telecommunications services to fund universal services such as 911 calling, universal access, and services for the hearing or sight impaired.¹⁰ In fact, the Congressional Budget Office (“CBO”) estimates that by 2007, eighty million dollars in state and local government tax revenues annually will be at stake in this VoIP taxation debate.¹¹ To ensure that these services will not lose state funding while the governments decide how best to approach VoIP, this note proposes that a minimal federal flat tax be enacted to support those universal services that both telecommunications services and some VoIP services utilize.

Whether New Hampshire should tax certain VoIP services and how the State may do so is still undecided.¹² While New Hampshire Senator John

8. U.S. Gen. Acctg. Off., *Internet Access Tax Moratorium: Revenue Impacts Will Vary by State* 17, <http://www.gao.gov/new.items/d06273.pdf> (Jan. 2006) [hereinafter *GAO Report*]. While the 2004 amendments to the ITNA state that nothing in the ITNA will be “construed to affect the imposition of tax on a charge for voice or similar service utilizing Internet Protocol or any successor protocol,” such as VoIP, the act still leaves the issue of whether VoIP should be taxed at the federal or state level up in the air. 47 U.S.C. § 151. “When questioned about the impact of the moratorium on his state’s financial situation, one official noted that the state was more concerned about what will happen with VoIP than about the current provisions of the 2004 amendments.” *GAO Report, supra* n. 8, at 17.

9. New Hampshire’s CST imposes a tax on consumers who use two-way communications services and defines what constitutes taxable communications services. N.H. Rev. Stat. Ann. § 82-A (2005).

10. Konrad L. Trope, *Voiceover Internet Protocol: The Revolution in America’s Telecommunications Restructuring Infrastructure*, 823 PLI/Pat 55, 65 (Mar. 2005).

11. Cong. Budget Off., *S.150 Internet Tax Nondiscrimination Act*, <http://www.cbo.gov/showdoc.cfm?index=4544&sequence=0> (Sept. 9, 2003) [hereinafter *CBO Cost Estimate*]. According to the CBO, eighty million dollars per year would be lost by some states and local governments if the 1998 grandfather clause in the Internet Tax Freedom Act were repealed and all state and local governments were barred from taxing Internet access. *Id.*

12. TechWeb News, *New Hampshire Divided Over VoIP Taxes* <http://internetweek.cmp.com/showArticle.jhtml?articleID=23900780> (July 14, 2004) [hereinafter *New Hampshire Divided*]. While *New Hampshire Divided* claims that New Hampshire is one of only twelve states currently taxing VoIP, the New Hampshire Department of Revenue Administration asserts that it has not yet decided how to approach the possible taxation of VoIP. Interview with G. Phillip Blastos, Commr. of the N.H. Dept. of Revenue Administration (Feb. 17, 2006) (on file with the *Pierce Law Review*). This confusion needs to be resolved, as New Hampshire consumers and businesses have a right to know what those deductions are on their monthly bills.

Sununu is pushing to ensure that VoIP is “not saddled with undue regulatory burdens at either the federal or state level,”¹³ the New Hampshire Department of Revenue Administration proposed a tax on Internet and telephone services at the rate of seven percent.¹⁴ Furthermore, while New Hampshire has a long tradition of not levying taxes, local authorities are pushing to tax Internet services such as VoIP.¹⁵ Most interestingly, New Hampshire is currently taxing Internet access,¹⁶ though it is not clear whether New Hampshire is authorized to do so under the grandfather clause in the ITNA.¹⁷ If the state is legally able to tax Internet access as well as telephone communications services, and VoIP straddles both technologies, it is more likely that New Hampshire can and will tax VoIP services. The Granite State’s precarious relationship to the ITNA makes it a particularly interesting focal point during the ongoing VoIP debate.

This note discusses why most VoIP services, with the exception of phone-to-phone Internet Protocol (“IP”) telephony, should be classified as information services and, as such, should remain free from state taxation – focusing specifically on the taxation in New Hampshire. Part II focuses on the technology of VoIP and how it differs from traditional telephony. Part III discusses the distinction between information and telecommunication services in the Telecommunications Act of 1996, whether VoIP may qualify as Internet access in light of the Internet Tax Freedom Act (“ITFA”) of 1998, and the federal regulation of VoIP. Finally, Part IV addresses the debate over taxation of VoIP in New Hampshire and discusses why VoIP services should not yet be taxed by the New Hampshire Department of Revenue Administration in light of federal law and the best interests of local businesses and consumers.

II. BACKGROUND

Alice in Austria wishes to call her friend Bob in Boston, using a Boston area code to avoid charges for an international call. Using VoIP, Alice may initiate her call from any location in Austria where she may find

13. Ltr. from John E. Sununu, Sen., N.H., to Michael K. Powell, Chairman, F.C.C., *Forum to Discuss Voice over Internet Protocol 1*, <http://www.fcc.gov/voip/comments/JohnSununu.pdf> (Nov. 26, 2003).

14. *New Hampshire Divided*, *supra* n. 12.

15. *Id.*

16. Interview with G. Phillip Blastos, *supra* n. 12.

17. H.R. Rpt. 107-240 § 2 (Oct. 16, 2001); Cong. Research Serv., *RL30667: Internet Tax Legislation: Distinguishing Issues*, http://digital.library.unt.edu/govdocs/crs//data/2001/upl-meta-crs-1975/RL30667_2001Jan11.pdf?PHPSESSID=802145b70685d095542caff5b2579370 (Jan. 11, 2001). The ITNA is an extension of the Internet Tax Freedom Act, and imposes a moratorium on multiple and discriminatory taxation on electronic commerce until November 2007. *Id.*

Internet access. Once Alice connects to the Internet, she can transmit her call with the aid of a VoIP service provider, such as Skype. In order to hear and communicate with Bob, Alice can rely on a microphone and a headset that she can plug into her computer. Through VoIP, not only may Alice carry on a telephone conversation, but most service providers also allow her to record conversations and manage other information, such as voice mail.¹⁸

A. *Traditional Means of Telephony: Public Switched Telephone Networks*

When Alice dials a local pizza place from the phone in her kitchen, she is accessing the public switched telephone network (“PSTN”).¹⁹ The PSTN uses circuit switching to create a physical connection between the caller and the person receiving the phone call throughout the duration of the phone call.²⁰ Call quality is extremely high because a dedicated line is devoted to that call alone.²¹ By the same token, because a dedicated line is being devoted to that call alone, the PSTN is expensive and inefficient. The PSTN requires considerable capacity in the network while most of the time much of the capacity is not being used.²² Furthermore, the unidirectional nature of the PSTN results in slower data transmission.²³ While one side of the connection is busy sending information, the other side of the connection is locked up, waiting to receive the information.²⁴

B. *Packet Switching and the Internet*

Most activity that takes place on the Internet revolves around packet switching. Through packet switching, “data is divided up into small packets which are given identifying information” written in the language of the Internet – the Transmission Control Protocol/Internet Protocol (“TCP/IP”) – and then packets are “sent over the network by a variety of different routes, before being reassembled at the end into the format of the original message.”²⁵ Packets are delivered through Internet Service Providers (“ISPs”), who send the user’s packets to a backbone network, where traffic

18. Federal Communications Commission, *FCC Consumer Facts: VoIP/Internet Voice*, <http://www.fcc.gov/cgb/consumerfacts/voip.pdf> (accessed May 22, 2006) [hereinafter *FCC Consumer Facts*].

19. Roger Darlington, *A Guide to Voice Over Internet Protocol*, <http://www.rogerdarlington.co.uk/VoIP.html> (accessed May 22, 2006).

20. *Id.*

21. *Id.*

22. *Id.*

23. Trope, *supra* n. 10, at 64.

24. *Id.*

25. Darlington, *supra* n. 19.

is connected to other backbone networks and carried over long distances.”²⁶ By breaking up email messages and web pages into smaller packets of information and sending them over the backbone networks by the best available route, the Internet is able to work efficiently, routing packets around equipment failures and balancing traffic on networks.²⁷

C. Packet Switching and VoIP

Until recently, packet switching was inappropriate for transmitting voice communications, as “the breaking up and reassembly of the packets would cause an unacceptable deterioration in quality, notably because of the variable delay in the [reconstruction of the] packets.”²⁸ With the advent of high speed Internet connections, voice is now able to travel as data (packets) across computer networks through broadband.²⁹ While a call made over the PSTN occupies a single circuit over the duration of the call, VoIP packet switching “optimizes the Internet by finding the fastest route for each packet[,] and also by allowing simultaneous transmission in both directions of data and voice pursuant to the software protocol of the Internet (TCP/IP).”³⁰

VoIP uses packet switching by converting the “voice signal from your telephone into a digital signal that travels over the Internet.”³¹ The signal is then converted back into an audible signal at the other end of the network.³² VoIP services mainly operate in three ways: (1) computer-to-computer, where both the caller and recipient use headsets connected to their computers; (2) computer-to-phone, where the caller uses a headset and the recipient uses a normal telephone; and (3) phone-to-phone, where the caller requires a special analog telephone adaptor (“ATA”) to convert the analog voice signal into a digital signal.³³ While some VoIP services

26. GAO Report, *supra* n. 8, at 17.

27. HowStuffWorks, *What is a packet?*, <http://computer.howstuffworks.com/question525.htm> (accessed May 22, 2006).

28. Darlington, *supra* n. 19.

29. *Id.* Broadband “refers to high-speed Internet connections that allow for transfers of information at rates far faster than those of dial-up modems.” Center for Digital Democracy, *Broadband Primer*, <http://www.democraticmedia.org/primer.html> (accessed May 22, 2006).

30. Trope, *supra* n. 10, at 59.

31. FCC Consumer Facts, *supra* n. 18.

32. *Id.*

33. Darlington, *supra* n. 19. In phone-to-phone VoIP communications, the call is generally transmitted over broadband rather than over the PSTN with the assistance of an ATA. VoIP providers often package ATAs with their service; the ATAs allow the consumer to plug a normal telephone into the adaptor, which in turn connects to a computer. HowStuffWorks, *What is a packet?*, *supra* n. 27, at <http://computer.howstuffworks.com/ip-telephony3.htm>. The ATA converts the voice signal into a data signal to travel over broadband, where the data signal is received by the other caller’s ATA phone and converted into an audible signal. *Id.* IP phones are also available; these phones resemble normal

allow customers to call only other VoIP subscribers,³⁴ other services allow customers to call anyone with a regular telephone number on the PSTN.³⁵ When a VoIP call is made from a computer to a regular telephone number on the PSTN, the PSTN system is merely considered an access pathway;³⁶ the VoIP service *uses*, rather than *provides*, telecommunications on the PSTN.³⁷ As this note discusses in Part III,³⁸ this distinction is important in determining which VoIP services operate as information services, and thus which may be exempt from state regulation and taxation.

VoIP service is efficient and cost-effective, as “[o]ne infrastructure carrying both data and voice, provided by one supplier, can be managed, maintained, and upgraded much more efficiently than two separate networks for voice and data.”³⁹ Due to its digital nature, VoIP is “seamlessly integrated [into other technologies] to create a more interactive experience in other arenas,”⁴⁰ which makes it convenient for both businesses and consumers. Furthermore, most VoIP providers allow customers to choose their own area code,⁴¹ enabling consumers to bypass expensive long distance charges and providing service anywhere in the world where one may find an Internet connection.⁴² With twenty-nine percent of North American households already connected to the Internet via broadband connections as of 2004, it will not be long until many American consumers begin to make the switch from their PSTN services to VoIP services.⁴³ In fact, the Boston, Massachusetts-based TeleGeography research group reported that as of 2004, there are 2.7 million VoIP subscribers nationwide, compared with just 440,000 customers one year earlier.⁴⁴ By the end of 2006, the Forrester Research Group forecasts that nearly five million United States households will have purchased VoIP phone service.⁴⁵

telephones, but have an Ethernet connector and connect directly to a router, which is used to direct Internet traffic. The N.H. Off. of Consumer Advoc., *VoIP/Internet Voice*, 5 The N.H. Rate Watcher (It's Your Money) 1 (Summer 2005) [hereinafter *N.H. Rate Watcher*].

34. Services such as Pulver.com's Free World Dialup enable customers to become members of the pulver community, and as such may only communicate with other Pulver members. Free World Dialup, *FWD Home*, <http://www.freeworlddialup.com> (accessed May 22, 2006).

35. *N.H. Rate Watcher*, *supra* n. 33, at 2. The receiver of a VoIP to PSTN call does not need any special equipment to complete the call. *Id.*

36. Trope, *supra* n. 10, at 73.

37. *Vonage*, 290 F. Supp. 2d at 999.

38. *Infra* pt. III(B)(2).

39. Darlington, *supra* n. 19, at 3.

40. Denis Paiste, *Voice OVER; Internet Phone Customers Reach 2.7 Million*, The Union Leader C1 (Aug. 22, 2005).

41. *FCC Consumer Facts*, *supra* n. 18.

42. John Nemeth & Randall Janiczek, *Should VoIP be Taxed?* 36 Tax Adviser (May 1, 2005) (available at 2005 WLNR 7361111).

43. Paiste, *supra* n. 40.

44. *Id.*

45. Howstuffworks, *What is a packet?*, *supra* n. 27.

Some skeptics believe that consumers are more likely to switch from their PSTN carrier to a cellular carrier as opposed to a VoIP service provider,⁴⁶ as they have concerns as to “whether or not VoIP has the quality and reliability to completely replace [PSTN] services.”⁴⁷ For instance, some VoIP services do not offer emergency 911 services,⁴⁸ and some VoIP services may not work during power outages because providers may not offer backup power.⁴⁹ Furthermore, looking up the numbers of VoIP customers may prove to be difficult, as some VoIP providers may not offer directory assistance or white page listings.⁵⁰ Despite the different forecasts regarding the growth rate of VoIP, the adoption of VoIP by American consumers is imminent, and thus federal and state governments should decide whether and how to tax such services without stifling communications technology.

III. FEDERAL REGULATION OF VOIP

In *Vonage*, the United States District Court of Minnesota proclaimed that “[i]t is the policy of the United States . . . to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation.”⁵¹ Since the beginning of the digital revolution, Congress has feared that taxation and regulation directed at Internet services might “impede technological advancements and reduce the number of users who could afford Internet access.”⁵² As a result, Congress has passed a number of regulatory acts to prevent states from exercising regulatory authority over new Internet services,⁵³ giving the FCC jurisdiction over new services such as VoIP.⁵⁴

46. Paiste, *supra* n. 40.

47. Trope, *supra* n. 10, at 66.

48. Because lack of emergency 911 services is a rather significant threat to VoIP consumers, “the FCC adopted rules requiring providers of interconnected VoIP services to supply 911 emergency calling capabilities to their customers as a mandatory feature of the service by November 28, 2005.” Federal Communications Commission, *VoIP and 911 Services*, <http://www.voip911.gov> (accessed May 22, 2006). This order only applies to VoIP providers connected to the PSTN, and thus computer-to-computer VoIP providers may not offer emergency 911 services. *N.H. Rate Watcher*, *supra* n. 33, at 1-2.

49. *FCC Consumer Facts*, *supra* n. 18.

50. *Id.*

51. *Vonage*, 290 F. Supp. 2d at 997 (quoting 47 U.S.C. § 230(b)).

52. Nemeth & Janiczek, *supra* n. 42.

53. *See e.g.* Pub. L. No. 105-255, § 1101, 112 Stat. 2681, 2681-719 (1998) (The ITFA imposes a three-year moratorium for state taxes on Internet access or multiple or discriminatory taxes on electronic commerce.).

54. 47 U.S.C. § 151. Congress granted the FCC the authority to regulate “interstate and foreign commerce in communication by wire and radio so as to make available . . . a rapid, efficient, Nation-

Much of the legislation that may be relevant to VoIP regulation and taxation is directed toward Internet access or information services, and was drafted before the rise of VoIP. In fact, the VoIP Regulatory Freedom Act is the only proposed federal legislation to date that specifically addresses VoIP services. As a result, the arguments regarding VoIP regulation and taxation have a common thread: whether or not VoIP qualifies as Internet access or an information service under each particular piece of legislation. This section will unravel those arguments as applied to the most relevant pieces of legislation, FCC orders, and the *Vonage* case to illustrate that most VoIP services should be classified as information services and thus free from state taxation.

A. *The Telecommunications Act of 1996: The distinction between information services and telecommunications services*

Due to a lack of federal statutory authority addressing the regulation and taxation of VoIP, the FCC has turned to the Telecommunications Act of 1996 (“Telecom Act”) to govern its treatment of VoIP services. The purpose of the Telecom Act is to “create a ‘pro-competitive, deregulatory national policy framework’ with the intent of promoting the ‘deployment of advanced telecommunication and information technologies to all Americans by opening all telecommunication markets to competition.’”⁵⁵ As Congress has intended to keep Internet-related services free from any regulatory burdens, the Telecom Act provides for different levels of regulation by differentiating between telecommunication services and information services.⁵⁶

A telecommunication service is defined as “the offering of telecommunications for a fee directly to the public, or to such classes or users as to be effectively available directly to the public, regardless of the facilities used.”⁵⁷ Telecommunications are the transmission of the user’s information without changing the form or content of the original message.⁵⁸ PSTN providers have been classified as telecommunication services, and as such, have been subject to a comprehensive regulatory regime under Title II of the Telecom Act.⁵⁹ The extensive requirements that common carriers must meet under Title II include: requiring carriers to provide service on just,

wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges.” *Id.*

55. Trope, *supra* n. 10, at 75.

56. 47 U.S.C. § 151.

57. *Id.* at § 153.

58. *Id.*

59. Cheryl A. Tritt, *Telecommunications Future*, 813 PLI/Pat 245, 254 (Dec. 2004).

reasonable, and nondiscriminatory rates and terms; complying with tariffing requirements; meeting certain certification requirements; complying with interconnection obligations; contributing to the universal service fund; providing access to law enforcement for authorized wiretapping; complying with disability requirements; and complying with privacy requirements.⁶⁰

Unlike a telecommunication service, an information service is “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing or making available information via telecommunications.”⁶¹ Information services include “electronic publishing, but [do] not include any use of any such capability for the management, control, or operation of a telecommunication system or the management of a telecommunications service;”⁶² information services provide capabilities that extend beyond pure management of a preexisting system.⁶³ Furthermore, information services offer greater flexibility and more options than telecommunication services, as they not only transmit information, but also provide the capability for the consumer to manipulate and control information.⁶⁴ ISPs are a common example of information services, as they not only allow consumers to send information via broadband, but also enable consumers to process and store the data in various ways.⁶⁵ While telecommunication services are subject to federal, state, and local government regulation and taxation, information services fall under Title I of the Telecom Act and are largely free from FCC regulation.⁶⁶

B. FCC Regulation under the Telecom Act

Unfortunately, the definitions in the Telecom Act did not anticipate convergence technologies such as VoIP, and thus it is not clear whether VoIP is subject to common carrier obligations as a telecommunications service under Title II of the Telecom Act, or whether VoIP is largely free from federal regulation as an information service under Title I.⁶⁷ Where the Telecom Act does not prescribe a particular regulatory treatment, as in the case of VoIP, the FCC may have authority to impose requirements under Title I; possible federal VoIP regulation and taxation have therefore

60. *In re IP-Enabled Services*, 19 F.C.C.R. 4863, 4867 (2004).

61. 47 U.S.C. § 153.

62. *Id.*

63. *In re AT&T*, 19 F.C.C.R. 7457, 7465 (2004).

64. 47 U.S.C. § 153.

65. Tritt, *supra* n. 59, at 254.

66. *Id.* at 254-55.

67. Trope, *supra* n. 10, at 77.

become ongoing concerns for the FCC.⁶⁸ Since VoIP has entered the FCC's radar, the FCC has issued several declaratory rulings on various VoIP services and has made several reports to Congress regarding the classification of different varieties of VoIP services.⁶⁹ Through these reports and rulings, the FCC "clarified the regulatory status of only a limited segment of the broad range of services using VoIP technology, leaving the great bulk of these services in regulatory limbo."⁷⁰

This confusion and individualized treatment of services is largely due to the fact that VoIP services may greatly differ from each other. On one end of the spectrum, they may resemble telecommunications services, such as phone-to-phone IP communications. On the other end of the spectrum, they may be classified as information services, such as computer-to-computer digital voice communications. As a result of this expansive spectrum of services, the FCC is rightly hesitant to impose any broad, sweeping regulations, for not all VoIP services should be treated equally.⁷¹ In approaching VoIP taxation and regulation, the FCC and the federal government should focus on areas where VoIP services behave similarly, such as universal access services. A majority of VoIP services should provide emergency 911 calling and other similar services that are subsidized by the universal service fund,⁷² and thus it seems fair that VoIP services should be required to pay a federal flat tax in order to support these services that VoIP consumers use.

68. *In re IP-Enabled Services*, 19 F.C.C.R. at 4881.

69. It is noteworthy that the FCC considered the application of existing federal law to VoIP services in one large wave of FCC orders, dealing with Pulver.com's declaratory ruling and requesting comments on IP-enabled services on February 12, 2004. The order regarding AT&T's phone-to-phone telephony service was issued shortly thereafter on April 14, 2004. Since these orders were released, the FCC has not taken much action regarding VoIP, and has refrained from establishing clear cut regulations and policies.

70. Tritt, *supra* n. 59, at 253.

71. Because there are various types of VoIP services that behave more like the telephone and others that behave more like Internet communications, the FCC should not categorize and regulate these differing services as VoIP in general. Phone-to-phone IP telephony, for instance, may use the local exchange facilities that telecommunications companies pay to maintain, and thus should not be able to get a free ride from the investments of telecommunications companies. See *infra* pt. III(B)(2). Other VoIP services may occur completely over the Internet using an interface application such as Pulver.com's Free World Dialup, and thus should not be charged for maintenance of telecommunication equipment. See *infra* pt. III(C)(2). As a result, broad regulations treating all VoIP services alike may either give telecommunications companies a windfall or allow some VoIP services to use their equipment without paying for it, which in turn could substantially effect the communications market.

72. In May of 2005, the FCC "ordered certain VoIP providers (i.e., those connected to the public switched telephone network) to supply, within 120 days of the order, enhanced 911 services as a mandatory feature of service." *N.H. Rate Watcher*, *supra* n. 33, at 2.

1. *IP-Enabled Services in general*

Due to the increasing growth of convergence communications technologies, the FCC issued an order to discuss “whether [it] can best meet its role of safeguarding the public interest by continuing its established policy of minimal regulation of the Internet and the services provided over it,” which include VoIP.⁷³ While the order posed some interesting questions and discussed several relevant pieces of legislation regarding VoIP, the effect of the order was to seek comments from consumers, the industry, and regulating bodies; the FCC said it would only rule on specific issues presented in individual petitions at this point in time.⁷⁴

The FCC did, however, attempt to draw boundaries with regard to the extent of deregulation, as it clarified that:

[F]encing off IP platforms from economic regulation traditionally applied to legacy telecommunications services would not put them beyond the reach of regulations designed to promote public safety and consumer protection (such as emergency 911) or other important public policy concerns.⁷⁵

As echoed in the proposed VoIP Regulatory Freedom Act, VoIP providers should be required to contribute to universal service because currently only telecommunication services contribute to the fund, which benefits both telecommunications and VoIP consumers.⁷⁶

The technological nature of VoIP does not make providers and consumers exempt from contributing to and providing for disability access, consumer protection mechanisms (such as tech support), consumer privacy mechanisms, law enforcement access for authorized wiretapping purposes, and emergency 911 service. On the other hand, the FCC also expressed concern over the right amount of deregulation, referring to the “‘virtuous circle’ in which competition begets innovation, which in turn begets more competition.”⁷⁷ How much regulatory freedom do VoIP providers need in order to promote competition, further innovation, and increase the variety of VoIP services available to consumers? The FCC also mentioned that rural carriers must be considered within the scope of this question, as they

73. *In re IP-Enabled Services*, 19 F.C.C.R. at 4865.

74. *Id.* at 4864.

75. *Id.* at 4868.

76. H.R. 4129, 108th Cong. (Apr. 2, 2004) (as introduced); Sen. 2281, 108th Cong. (Apr. 5, 2004) (as introduced).

77. *In re IP-Enabled Services*, 19 F.C.C.R. at 4879.

generally have higher operating and equipment costs, fewer subscribers, and lack economies of scale.⁷⁸

Whatever the fate of VoIP regulation, the FCC established that one major policy consideration must always be kept in mind: “Any service provider that sends traffic to the PSTN should be subject to similar compensation obligations, irrespective of whether the traffic originates on the PSTN, on an IP network, or on a cable network.”⁷⁹ While many VoIP services utilize broadband during the course of the entire transaction, steering clear of the PSTN, others may utilize the PSTN to initiate a call or transmit a call to the receiving consumer. The FCC attempted to distinguish amongst VoIP services that take advantage of the PSTN in its AT&T Phone-to-Phone IP ruling, and will have to take into account similar discrepancies in VoIP functionality in crafting future regulations.⁸⁰

2. *Phone-to-Phone telephony is declared a telecommunications service*

In a separate order, the FCC determined that AT&T’s Phone-to-Phone IP telephony service is a telecommunications service, and as such, it is subject to interstate access charges.⁸¹ Under AT&T’s service: (1) a call is initiated like a traditional phone call over the PSTN; (2) is converted into an IP format when it enters AT&T’s network and travels over AT&T’s Internet backbone; and (3) is again converted back to the circuit-switched format so the call can be terminated over the PSTN.⁸² AT&T argues that applying access charges to this type of service would constitute a tax on the Internet, which is violative of the ITNA and section 230(b)(2) of the Telecom Act.⁸³

The AT&T ruling is helpful in distinguishing between telecommunications and information services, or basic and enhanced services, as the FCC calls them.⁸⁴ A basic service, like a telecommunication service, provides “transmission capacity for the movement of information without net change in form or content.”⁸⁵ An enhanced service, or information service, on the other hand, “contains a basic service component but also involves some degree of data processing that changes the form *or* content of the

78. *Id.* at 4913-14.

79. *Id.* at 4885.

80. *In re AT&T*, 19 F.C.C.R. at 7469.

81. *Id.* at 7457. Access charges are assessed on interexchange carriers that use local exchange switching facilities for the provision of interstate or foreign telecommunications services. *Id.*

82. *Id.*

83. *Id.* at 7468.

84. *Id.* at 7459.

85. *Id.*

transmitted information.”⁸⁶ The FCC ruled that phone-to-phone telephony is a telecommunications service and must pay taxes and access charges because (1) it does not change the form *or* content of the information as sent and received; (2) it offers telecommunications for a fee directly to the public; (3) it does not offer customers a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information (as information services do); and (4) customers do not order a different service or pay different rates; they believe that they are receiving AT&T’s traditional long distance service.⁸⁷

AT&T’s Phone-to-Phone IP telephony may fall under the FCC’s definition of an enhanced service because the definition contains a disjunctive “or.” An enhanced service necessarily has a service component, but it may involve data processing that changes the *form* of the communication, or it may involve data processing that changes the *content* of the communication.⁸⁸ Because AT&T’s Phone-to-Phone IP telephony changes the form of the communication upon entering and exiting AT&T’s network from a voice signal to a digital signal, one may argue that the service is in fact an enhanced service. This tragic flaw in the definition of enhanced services demonstrates that a greater distinction between enhanced and basic services, or information and telecommunication services, is required to achieve a greater degree of regulatory certainty.

Essentially, the FCC may have deemed AT&T’s service a telecommunications service because the service converts from circuit-switched to packet-switched networks for the sole purpose of managing information; “[t]o allow a carrier to avoid regulatory obligations simply by dropping a little IP in the network would merely sanction regulatory arbitrage and would collapse the universal service system virtually overnight.”⁸⁹ Furthermore, unlike AT&T’s Phone-to-Phone IP telephony service customers, VoIP customers actually receive the benefit of the voice-to-digital signal conversion, as they are able to store and manipulate the information that is sent through the VoIP service. The customers’ control over the information sent and received over VoIP, in addition to the means by which that information is transformed and sent over the network, is one of the main features that separates VoIP, an information service, from telecommunication services.

86. *Id.*

87. *Id.* 7457-58, 7465.

88. *Id.* at 7459.

89. *Id.* at 7475.

3. VoIP Internet applications are declared information services

Unlike AT&T's Phone-to-Phone IP telephony services, the FCC declared Pulver.com's Free World Dialup ("FWD") service to be an unregulated information service in an attempt to "bring a measure of regulatory stability to the marketplace and therefore remove barriers to investment and deployment of Internet applications and services."⁹⁰ In essence, FWD is a free Internet application that allows members to obtain a Pulver-assigned five- or six-digit number and use the Internet anywhere in the world to call other FWD members.⁹¹ Because FWD is simply an application, members must have existing broadband Internet access in order to register, and can provide up to twenty-five different geographic locations where they can receive calls.⁹² The FWD application informs members when other members are online and can receive a call, and also provides a directory service, allowing members to find the assigned number necessary to reach other members.⁹³

Pulver.com, however, does not have the ability to determine the geographic location of FWD members when making or receiving calls, and thus, has no way of determining which calls are intrastate, interstate, or international.⁹⁴ Under the Telecom Act, states have jurisdiction over intrastate communications,⁹⁵ while the FCC has exclusive jurisdiction over interstate communications such as FWD.⁹⁶

To determine whether the FCC has jurisdiction over certain communication services, the Commission has traditionally applied two tests, (1) an end-to-end analysis and (2) the mixed use doctrine.⁹⁷ Under the end-to-end analysis, the FCC looks at the end points of a communication to determine the jurisdictional nature of any given service.⁹⁸ This approach appears to be relevant only to a circuit-switched network and should not apply when analyzing VoIP services, as the means of the communication, not the ends, is the essence and advantage of VoIP services.⁹⁹ The means of the communication enable a voice signal to be converted to a digital signal and empower consumers to control and store information, adding great flexibil-

90. *In re Pulver.com*, 19 F.C.C.R. 3307, 3307 (2004).

91. *Id.* at 3309-10.

92. *Id.* at 3310.

93. *Id.*

94. *Id.*

95. 47 U.S.C. § 152(b).

96. *Id.* at § 152(a).

97. *In re Pulver.com*, 19 F.C.C.R. at 3321-22.

98. *Id.* at 3321.

99. *Id.*

ity to the everyday task of communication.¹⁰⁰ The end points of a communication, however, may not even be known to the VoIP provider, as in FWD.¹⁰¹

The more practical approach to analyzing the jurisdictional nature of VoIP is the mixed use doctrine, which holds that “where separating interstate traffic from intrastate traffic is impossible or impractical, the FCC has declared such traffic to be interstate in nature.”¹⁰² Because VoIP calls can be placed from anywhere one has Internet access, and are often unable to be traced to geographic locations, VoIP services are interstate in nature and should be subject to FCC regulation.¹⁰³ As a result, “any state regulations that seek to treat FWD as a telecommunications service or otherwise subject it to public-utility type regulation would almost certainly pose a conflict” with the FCC’s hands-off regulatory policy regarding the Internet as well as the Telecom Act.¹⁰⁴ Furthermore, according to *California v. Federal Communications Commission*,¹⁰⁵ the FCC may preempt state regulations when the regulations would negate national policy.

If FWD and similar VoIP services were to fall under state jurisdiction and were subjected to state regulation, such services would have to satisfy the requirements of all fifty states, including more than fifty certification, taxation, and other various obligations.¹⁰⁶ The barriers to enter the VoIP market would rise significantly due to the expenses associated with complying with a myriad of differing regulations and taxes, decreasing competition, consumer choice in services, and innovation in packet-switched communications. In order to remain free from multiple and discriminatory state taxation, most VoIP services should be treated as information services and should remain free from state taxation. Because most VoIP services provide universal services to their customers, they should be subject to a federal flat tax that would help fund these services.

C. Vonage Holdings Corp. v. The Minnesota Public Utilities Commission

While the FCC orders attempted to classify phone-to-phone and computer-to-computer VoIP communications, *Vonage* examines the middle ground and holds that computer-to-phone VoIP services are information services. The United States District Court of Minnesota relied upon the

100. *Id.* at 3309-10.

101. *Id.* at 3310.

102. *Id.* at 3322.

103. *Id.* at 3320.

104. *Id.* at 3316.

105. 39 F.3d 919, 933 (9th Cir. 1994).

106. *In re Pulver.com*, 19 F.C.C.R. at 3323.

Telecom Act, the Commerce Clause,¹⁰⁷ and the Due Process Clause of the Fourteenth Amendment,¹⁰⁸ holding that “the VoIP service provided by Vonage constitutes an information service because it offers the ‘capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications.’”¹⁰⁹

Vonage’s DigitalVoice VoIP service allows Vonage’s customers to make computer-to-phone calls and receive phone-to-computer calls.¹¹⁰ The Minnesota Public Utilities Commission issued an order requiring Vonage to comply with Minnesota laws that regulate telephone companies, while the Minnesota Department of Commerce complained that Vonage failed to obtain proper certificate of authority as a telephone company, submit a required 911 service plan, pay 911 fees, and file a tariff.¹¹¹ Essentially, the case revolved around whether Vonage provides an information service or a telecommunication service, and thus, whether the states could regulate Vonage.¹¹²

The United States District Court of Minnesota decided that the Minnesota regulations that essentially regulate information services conflict with federal law, namely the Supremacy Clause of Article VI of the United States Constitution, and must be preempted because Congress intended to keep the Internet and information services unregulated.¹¹³ Most importantly, the court found that “[w]hen an entity offers transmission incorporating the capability for generating, acquiring, utilizing, or making available information, it does not offer telecommunications. Rather, it offers an information service *even though it uses telecommunications to do so.*”¹¹⁴ While Vonage’s VoIP service appears to be a telecommunication service to the normal user, as it utilizes telephones and the PSTN as a means to access the Internet, the broadband connection is the backbone of the service,

107. “Congress shall have the power . . . [t]o regulate Commerce . . . among the several States.” U.S. Const. art. I, § 8.

108. The Due Process Clause of the Fourteenth Amendment dictates that “[n]o State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.” U.S. Const. amend XIV, § 1.

109. *Vonage*, 290 F. Supp. 2d at 999. The court’s reasoning seems rather circular; essentially, the court is saying that Vonage’s VoIP service is an information service because it is an information service. This is yet another indication that what is meant by the term “information service” should be more precisely defined.

110. *Id.* at 995.

111. *Id.* at 995-96.

112. *Id.* at 996.

113. *Id.* at 1001-02.

114. *Id.* (quoting *In re Federal-State Joint Bd. on Universal Serv.*, 13 F.C.C.R. 11501, 11520 (1998)) (emphasis in original).

and ultimately converts the analog voice signal into a digital data transmission that can be stored and further controlled by the consumer.¹¹⁵

The court attempted to distinguish between computer-to-computer and computer-to-phone VoIP services, such as those provided by Vonage, and phone-to-phone VoIP services. The court clarified that phone-to-phone VoIP services “[lack] the characteristics that would render them information services within the meaning of the [Telecom Act], and instead bear the characteristics of telecommunications services.”¹¹⁶ In support of this argument, the court listed the four factors presented in the FCC’s AT&T Phone-to-Phone IP telephony ruling.¹¹⁷ The use of the same four AT&T factors in *Vonage* seems to reinforce that it is the use of a computer at either end of a VoIP transaction that enables the communication to be generated, controlled, stored, and retrieved by the user, and to differentiate computer-to-computer and computer-to-phone VoIP transactions from phone-to-phone and PSTN telecommunications services.¹¹⁸

D. *The Internet Tax Freedom Act*

The FCC orders and the *Vonage* holding indicate that computer-to-computer and computer-to-phone VoIP services are information services and, as such, are not subject to strict federal regulation because they equip the consumer with the ability to manipulate transmitted data and do not both begin and terminate on the PSTN.¹¹⁹ However, the aforementioned authority does not specifically address state authority to tax VoIP services. Unlike most telecommunications services, which are subject to state taxation, some information services, such as Internet access, may be exempt from state taxation.¹²⁰ Another way to analyze the taxation of VoIP is to compare VoIP services to Internet access and the bundled services that

115. *Id.* at 995.

116. *Id.* at 999.

117. *See supra* pt. III(B)(2). The AT&T factors are:

- (1) It does not change the form *or* content of the information as sent and received;
- (2) It offers telecommunications for a fee directly to the public;
- (3) It does not offer customers a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information (as information services do);
- (4) Customers do not order a different service or pay different rates; they believe that they are receiving AT&T’s traditional long distance service.

In re AT&T, 19 F.C.C.R. at 7457-58, 7465.

118. 290 F. Supp. 2d at 999-1000.

119. *Id.* at 1003; *In re Pulver.com*, 19 F.C.C.R. at 3307.

120. The tax exemption for Internet access services provided by the Internet Tax Nondiscrimination Act is only a temporary ban through November of 2007. Pub. L. No. 107-75, § 2, 115 Stat. 703 (2001).

accompany Internet access, such as email. If taxes on Internet access are barred in some states, then likewise taxes on VoIP may be prohibited in those states.

Congress sought to further its hands-off approach to Internet access services and electronic commerce when it passed the ITFA, which imposes a three-year moratorium for state taxes on Internet access or multiple or discriminatory taxes on electronic commerce.¹²¹ The moratorium, however, does not apply to Internet access taxes that were imposed and enforced prior to October 1, 1998 and does not apply if either (1) a provider of Internet access services had a reasonable opportunity to know that such a tax was applied to Internet access services, or (2) the state or local government generally collected a tax on Internet access.¹²² The ITFA defines Internet access as “services that enable users to *access* content, information, electronic mail, or other services offered over the Internet and may also include . . . other services as part of a package of services offered to consumers.”¹²³

While VoIP services may enable consumers to store, retrieve, and manipulate information such as electronic mail or voicemail, some VoIP services may not qualify under the ITFA’s definition of Internet Access. For example, some providers, such as Pulver.com, only provide the computer *applications* that enable consumers to use such services, not the *means to access* the Internet; consumers must access pulver.com through their own ISP.¹²⁴

On the other hand, some VoIP services may qualify as “other services as part of a package of services offered to consumers.”¹²⁵ The bar on Internet taxation includes services, such as email, that an access provider reasonably bundles to consumers.¹²⁶ VoIP services resemble bundled services such as instant messaging and email, as VoIP is similarly another communication tool operating over broadband that enables consumers to manipulate and control communicated information.¹²⁷ The Government

121. 112 Stat. at 2681-719.

122. H.R. Rpt. 107-240 at § 2 (concerning the Internet Tax Nondiscrimination Act). Connecticut, Montana, New Mexico, Ohio, South Carolina, North Dakota, Tennessee, Texas, Washington, and Wisconsin presently have authority under the ITFA to tax Internet access. *Id.*

123. 112 Stat. at 2681-719.

124. *In re Pulver.com*, 19 F.C.C.R. at 3309.

125. 112 Stat. at 2681-719.

126. *Id.*

127. Indeed, VoIP has been offered as a bundled Internet access service. For instance, Comcast’s Digital Voice VoIP service is offered at a discount price as part of a package including high-speed Internet access and cable. Comcast Corporation, *Preferred Savings*, http://www.comcast.com/Benefits/Voice_CMPage.ashx?CTMID=2204&SlotNumber=3 (accessed May 22, 2006).

Accountability Office, however, argues that tax-exempt bundles do not include video, traditional telephone services, or VoIP.¹²⁸

Bundled services must be distinguished from acquired services, or services used to deliver Internet access, as such services are in fact taxable.¹²⁹ VoIP services are unlike taxable acquired services though, as Internet access must already be in place in order to use VoIP. The ITFA is helpful in analyzing whether states should be authorized to tax VoIP, however, as it also serves as an example of the hands-off regulatory approach that Congress has adopted in relation to the Internet and related services.

E. *The Internet Tax Nondiscrimination Act*

Upon the sunset of the ITFA moratorium, Congress retroactively extended the tax suspension to November 1, 2007 in the Internet Tax Nondiscrimination Act.¹³⁰ One of the prime reasons for the extension was to allow electronic commerce to grow, as the Department of Commerce reported that in the year 2000, "IT industries accounted for 35 percent of real US economic growth."¹³¹ Interstate online merchants could potentially be subject to multiple state and local taxes that are imposed on traditional brick and mortar enterprises, including income, franchise, licensing, business activity, and other direct taxes.¹³² The moratorium for state taxes on electronic commerce thus enables the online merchant to conduct business across state lines without being penalized for utilizing a borderless means of communications to initiate business transactions.

Because VoIP services are likewise borderless in nature, and form a growing communications industry, they should not be subject to multiple state and local taxes. While a VoIP consumer may have a number with an area code in a certain state, they may use the VoIP service to initiate a call originating in any state or country in which they may have Internet access. Furthermore, some VoIP services, such as Pulver.com's Free World Dialup, have no way of tracking where the call originated and where the receiver is located.¹³³ Without the ability to determine where a call originates and terminates, different states may have different definitions as to what qualifies as an interstate communication and an intrastate communication and thus, to what extent a communication may be taxed. As a re-

128. GAO Report, *supra* n. 8, at 8.

129. *Id.* at 3.

130. 115 Stat. 703.

131. H.R. Rpt. 107-240 at § 2.

132. *Id.* at 3.

133. *In re Pulver.com*, 19 F.C.C.R. at 3310.

sult, this lack of uniformity may open VoIP services up to multiple and discriminatory state taxation.

The ITNA was amended in 2004 to clarify certain problematic provisions.¹³⁴ The grandfather clause that applies to pre-October 1998 taxes was amended to terminate on November 1, 2007.¹³⁵ The amendments included a second grandfather term that applies to taxes on Internet access enforced as of November 1, 2003, and terminated as of November 1, 2005.¹³⁶ The definition of 'tax on Internet access' was amended to apply to a tax imposed on both providers and consumers of Internet access.¹³⁷ Furthermore, the amendments added language that exempted telecommunications services from the tax moratorium.¹³⁸

Most importantly, the amendments included an exception for voice services over the Internet, clarifying that the ITNA shall not be "construed to affect the imposition of tax on a charge for voice or similar services utilizing Internet Protocol."¹³⁹ This amendment indicates that VoIP should not be included under the Internet tax moratorium, even as a bundled service, as it specifically states that the exception for VoIP shall not apply to "any services that are incidental to Internet access, such as voice-capable email or instant messaging."¹⁴⁰ This amendment may lead states to treat VoIP not as an Internet access service for taxation purposes, but rather as a telecommunications service, which is generally taxable.¹⁴¹

State taxation of VoIP is riddled with problems that extend above and beyond the possibility of imposing multiple state taxes on VoIP services. For instance, what should determine which state can tax this borderless service: (1) the state in which the consumer resides when he purchases the service; (2) the state in which the consumer resides according to his mailing address on his billing statement; or (3) the state of the consumer's area code? The answers to these questions would have to be applied by all states in a uniform fashion in order to avoid multiple state taxations.¹⁴² In

134. GAO Report, *supra* n. 8, at 1.

135. *Id.* at 6.

136. *Id.* at 7.

137. Pub. L. No. 108-435, § 1108, 118 Stat. 2615, 2618 (2004).

138. GAO Report, *supra* n. 8, at 7.

139. 118 Stat. at 2618.

140. *Id.*

141. However, VoIP services that may be declared telecommunications services may still be included under the tax moratorium, as the 2004 amendments altered the definition of Internet access, which originally specifically excluded telecommunications services. The new definition provides that there is an exception for telecommunications services that "are purchased, used, or sold by a provider of Internet access to provide Internet access." *Id.* at 2616.

142. New Hampshire's CST includes a provision for determining the origination and destination of interstate communications services, though its application to VoIP may be uncertain. *See infra* pt. IV(B). Perhaps as VoIP technology evolves, tracking mechanisms such as those used in cell phones may be implemented to provide VoIP providers with exact origination and destination locations.

order to receive fair, nationwide treatment, taxation and regulation of VoIP service should be handled at the federal level, rather than the state level.

F. *The Proposed VoIP Regulatory Freedom Act*

In 2004, Congress sought to specifically address regulation and taxation of VoIP with the introduction of the VoIP Regulatory Freedom Act ("VRFA").¹⁴³ In fact, New Hampshire Senator John Sununu was the main proponent of the bill.¹⁴⁴ The VRFA aims to "prevent the imposition of harmful obligations or a patchwork of multiple and discriminatory regulations on the providers of applications that utilize the Internet protocol [VoIP] or any successor protocol to offer 2-way or multidirectional voice communications."¹⁴⁵ In effect, the proposed legislation would prevent states from enacting laws or regulations that "[regulate], or [have] the effect of regulating" VoIP,¹⁴⁶ strictly limiting regulatory power over VoIP to the federal government and giving the FCC broad authority to regulate.¹⁴⁷

The definition of regulate as set forth in the act "includes taking any governmental action that restricts, limits, or burdens, or imposes any . . . duty, or interferes with, an application."¹⁴⁸ By preventing the states from regulating VoIP, which includes imposing a duty, or tax, on VoIP, the VRFA is in effect preventing the states from taxing VoIP. Furthermore, the bill directly prevents states from "impos[ing] any tax, fee, surcharge, or other charge for the purpose of generating revenues for governmental purposes on the offering or provision of a VoIP application."¹⁴⁹ This additional provision further reinforces the purpose of the bill: to prevent states from burdening VoIP providers with a myriad of differing regulations and taxes and stifling innovation in this growing industry.

The bill goes even further to distinguish VoIP from PSTN and other telecommunications services, exempting VoIP applications from access or successor charges for interstate or foreign access services provided by tele-

143. H.R. 4129, 108th Cong. (as introduced); Sen. 2281, 108th Cong. (as introduced).

144. Sen. 2281, 108th Cong. In his letter to Michael Powell, Chairman of the FCC, regarding the VRFA, Senator Sununu highlighted his concerns about state regulation and taxation of VoIP, stating "if states approach VoIP in the same manner they regulate the current local phone systems, the external benefits of the technology, including increased levels of connectivity and significant network efficiencies, could be lost, which would hurt individual companies and more importantly consumers." Ltr. from John E. Sununu, Sen., N.H. to Michael K. Powell, Chairman, F.C.C., *supra* n. 13. Senator Sununu was further concerned that state regulation and taxation "might undermine the ability of [VoIP] to develop and succeed." *Id.*

145. Sen. 2281, 108th Cong.

146. *Id.*

147. Nemeth & Janiczek, *supra* n. 42.

148. Sen. 2281, 108th Cong. (emphasis added).

149. *Id.*

phone companies.¹⁵⁰ This provision makes sense, as most VoIP calls travel over broadband and do not continually utilize the local exchange facilities needed to complete a long distance call; it is the continuous use of these exchange facilities over the course of a call that triggers access charges for most telecommunications services.

The VRFA does attempt to level the playing field, however, by providing that VoIP services shall “contribute, directly or indirectly, to the preservation and advancement of Federal universal service programs based on a flat fee.”¹⁵¹ Although it has a continually evolving definition, the aim of universal service is to make reasonably comparable information and telecommunication services accessible to consumers in all regions of the nation, at reasonably comparable rates.¹⁵² Universal service contributions are generally provided to schools, libraries, health care providers, and the Lifeline Assistance Program, providing emergency 911 services.¹⁵³

Under the Telecommunications Act of 1996, every carrier that provides interstate telecommunications services, not information services, must “contribute, on an equitable and nondiscriminatory basis,” to the universal service fund.¹⁵⁴ Furthermore, states may adopt regulations that require telecommunications carriers to contribute to the universal service fund, as long as those regulations are consistent with the FCC’s rules.¹⁵⁵ The VRFA, therefore, goes one step further than the Telecommunications Act of 1996, requiring VoIP providers to contribute to schools, libraries, and emergency calling services.¹⁵⁶

If VoIP customers utilize the emergency 911 services and services for the hearing and sight impaired funded through universal service, VoIP providers should also have to contribute to universal service. VoIP providers and consumers should not receive a benefit just because their 911 calls travel along broadband lines as opposed to over the PSTN; the services they gain at the end of the call require the same resources as those 911 services provided to telecommunications providers and consumers.

Additionally, VoIP providers must offer services commensurate with existing 911 emergency calling services under the VRFA.¹⁵⁷ If the pro-

150. *Id.* Access charges occur when the telephone company uses local exchange facilities in interstate or foreign service in order to relay and complete a long distance call. 47 C.F.R. § 69(2)(a) (2005).

151. Sen. 2281, 108th Cong.

152. 47 U.S.C. § 254(d).

153. *Id.*

154. *Id.* Although the definition of universal service is explicitly limited to telecommunications services, the FCC has found the Telecom Act to provide authority to support a broad class of services, including Internet access, which is an information service, for libraries and schools. *In re IP-Enabled Services*, 19 F.C.C.R. at 4906-07.

155. 47 U.S.C. § 254(d).

156. Sen. 2281, 108th Cong.

157. *Id.*

vider is unable to offer such services, it must provide its customers with a clear and conspicuous notice of its failure to do so.¹⁵⁸ As an extra measure of consumer protection, providers must offer technical support in the event that the provider is not able to complete a 911 call.¹⁵⁹ If VoIP providers must create new 911 calling services such that VoIP customers are utilizing different resources than telecommunications customers when making 911 calls, perhaps the flat universal services that VoIP providers are obligated to pay should be marginally reduced.

The VRFA is the most recent congressional effort to explicitly exempt VoIP services from regulations governing telecommunications services. Unfortunately, neither version of the bill has been passed to date,¹⁶⁰ and thus the future relationship between VoIP and state and local governments remains undecided.

G. Constitutional Limitations

While statutory limitations on state taxation authority of Internet services, which may arguably include VoIP services, will be the most relevant sources dictating whether and how VoIP should be taxed, the Dormant Commerce Clause of the United States Constitution occasionally appears in analyses of VoIP taxation.¹⁶¹ The Dormant Commerce Clause stands for the “principle that state and local laws are unconstitutional if they place an undue burden on interstate commerce,”¹⁶² creating a negative limitation on state power to regulate in those areas that may adversely impact interstate commerce.¹⁶³ In the ITNA House Report, Congress suggested that Internet merchants “may lack a substantial nexus to justify the imposition of state and local taxes under the Commerce Clause.”¹⁶⁴

Similarly, there may not be a significant connection between the taxing state and VoIP providers, and thus, some may argue that it is unfair and unconstitutional for the state to impose a tax on VoIP. As with online

158. *Id.*

159. *Id.*

160. *Id.* The VFRA was referred to the House Committees on Energy and Commerce and on the Judiciary on April 20, 2004, and to the Senate Committee on Commerce, Science, and Transportation on December 7, 2004. H.R. 4129, 108th Cong.; Sen. 2281, 108th Cong.

161. H.R. Rpt. 107-240 at § 2.

162. Erwin Chemerinsky, *Constitutional Law: Policies and Principles*, 401 (2d ed., Aspen Law & Business 2002).

163. H.R. Rpt. 107-240 at § 2.

164. *Id.* at § 4. Congress bases this suggestion on the holding in *Quill Corp. v. North Dakota*, where North Dakota attempted to collect use taxes from a mail-order catalog house, the United States Supreme Court held that “a vendor whose only connection with customers in a taxing state is by common carrier or the United States mail is free from state-imposed duties to collect sales and use taxes, because such a vendor lacks the substantial nexus with the taxing state required by the commerce clause.” 504 U.S. 298 (1992); H.R. Rpt. 107-240 at § 4.

merchants, who inhabit digital real estate in cyberspace, on servers, and on routers, VoIP services do not physically exist within the borders of any particular state, but rather permeate the Internet and travel through broadband.¹⁶⁵ Furthermore, a state could burden interstate commerce by heavily taxing VoIP providers.

Unlike telephone companies, who could refrain from putting up telephone lines and offering service to consumers in a certain state to avoid a high tax rate, VoIP providers can either offer their services universally, if they can afford to pay the tax, or go out of business; there is no way to prevent residents of that state from purchasing VoIP services when they are made available on and through the Internet. While all of these concerns are legitimate, Congress has implicitly authorized state taxation of Internet access through the grandfather provision in the ITNA, which allows states to impose a tax on Internet access if they had been doing so, and have given the public notice that they are doing so, before October 21, 1998.¹⁶⁶

IV. TAXATION OF VOIP IN NEW HAMPSHIRE

New Hampshire is not currently taxing VoIP, and the State has yet to reach a conclusion as to whether it will enact such a tax in the future.¹⁶⁷ In order to avoid multiple or discriminatory state taxes on VoIP services, which could burden interstate commerce and stifle a new communications technology that empowers consumers with choice and versatility in their daily transactions, New Hampshire should be wary of taxing or regulating VoIP in the near future. Deregulation of VoIP would likely decrease the cost of communication, spur innovation and individualization in communications, increase efficiency through a highly customized, low cost suite of communication tools, bolster network resiliency, and increase economic productivity and growth.¹⁶⁸ Because “regulatory certainty is crucial to attracting capital to deploy infrastructure and new services that will benefit consumers,”¹⁶⁹ New Hampshire must act quickly and provide clear regulations for VoIP providers. Until New Hampshire and other states can obtain regulatory certainty, a federal flat tax should be imposed on all VoIP ser-

165. In the FCC order “In the Matter of IP-Enabled Services,” the FCC noted that the nature of VoIP raises large jurisdictional problems, as “packets routed across a global network with multiple access points defy jurisdictional boundaries.” *In re IP-Enabled Services*, 19 F.C.C.R. at 4867.

166. 112 Stat. at 2681-719.

167. Interview with G. Phillip Blastos, *supra* n. 12.

168. *In re IP-Enabled Services*, 19 F.C.C.R. at 4867.

169. Ltr. from John Ensign, Sen., Nev., to Michael K. Powell, Chairman, F.C.C., *Forum to Discuss Voice over Internet Protocol 1*, <http://www.fcc.gov/voip/comments/JohnEnsign.pdf> (Dec. 1, 2003).

vices to cover universal services, such as emergency 911 calling, that are provided to VoIP customers but currently only funded by the telecommunications industry.

A. *The Granite State VoIP Debate*

The New Hampshire Senate has recently attempted to establish a commission to “study and determine the effect of ceasing the collection of Internet-related communications services tax.”¹⁷⁰ This commission will ultimately have to craft a way to achieve equal taxation treatment of communications services in New Hampshire, while ensuring that such taxation does not stifle economic growth: two goals that appear to be mutually exclusive of each other.¹⁷¹

“The power to tax is also the power to destroy. And we don’t want to destroy anything,” State Senator Lou D’Allesandro said of the ITNA.¹⁷² Enacting a tax on VoIP would be detrimental to local small IP businesses that may provide VoIP service, as they do not have the resources to assume responsibility for the tax accounting and to create a system to collect and pay taxes, which could be required by possible new VoIP taxation legislation. This tax would put smaller VoIP providers at a disadvantage, as larger telecommunications and Internet access providers who may choose to offer VoIP services would already have the systems in place to handle the accounting and collection requirements that accompany taxation.

Furthermore, taxation of VoIP will trigger an increase in cost, which may cause many consumers to start looking for alternative means of communication, such as wireless providers. This may not have a significant impact on larger telecommunications companies such as AT&T, who offer both VoIP and wireless services,¹⁷³ but smaller local IP and VoIP providers who cannot offer such alternatives will not likely be able to compete with the more established telecommunications service providers. Most importantly, taxation of VoIP would inevitably draw resources away from important technological innovations, such as perfecting emergency 911 services to ensure constant, accurate transmission of emergency calls, stifling the progress of VoIP. As Jonathan Zuck, president of the Association for Competitive Technology, once remarked, “[i]deally, we’d like to see things

170. N.H. Sen. 363, 2005-2006 Biennial Sess. (Dec. 23, 2005).

171. “Taxes on consumption, like those on capital or income, to be just, must be uniform.” Ltr. from Thomas Jefferson to Samuel Smith (1823) (copy on file with the *Pierce Law Review*).

172. Jeanne Morris, *Telecommunications taxes; State could lose millions*, Union Leader A1 (Dec. 14, 2003).

173. AT&T provides both business and personal VoIP service. AT & T, *Voice over Internet Protocol (VoIP)*, <http://www.att.com/voip> (accessed May 22, 2006).

like hybrid VoIP be less regulated or taxed in its infancy so that it has the opportunity to really mature and grow;¹⁷⁴ taxation may not kill VoIP, but may severely limit its technological capabilities and the additional efficient services it may bring to consumers.

On the other hand, New Hampshire Department of Revenue Administration commissioner G. Phillip Blatsos estimates that the State would lose up to \$18.5 million per year if it is unable to tax VoIP.¹⁷⁵ If traditional calls over the PSTN continue to be taxed and VoIP remains free from State taxation, it seems natural that most providers will eventually migrate to the cheaper, non-tax technology and the State tax revenue will be significantly impacted. Most proponents for VoIP taxation argue that the service, not the technology behind the service, should distinguish whether one pays taxes or not. Moreover, VoIP services utilize consumer services, such as emergency 911 calling, that telecommunications finance via the universal service fund; if VoIP is not being taxed and does not have to contribute to the universal service fund, VoIP providers are essentially receiving a free ride from telecommunications services.

To tax or not to tax: either way, New Hampshire's decision will undoubtedly have significant impacts on the communications market. To achieve a balance between State officials' and large telecommunications companies' concerns over loss of revenue and equal taxation on one hand, and consumers' and small IP companies' concerns over stifling innovation in VoIP services and increasing barriers to enter the communications market on the other hand, a federal flat tax on VoIP, not a state tax, should be enacted. The federal flat tax will allow states such as New Hampshire time to define various VoIP services within the scope of communications services. A federal flat tax will avoid the multiple discriminatory taxes that will likely result when states adopt different ways of differentiating between and taxing VoIP services, but will also oblige VoIP providers to contribute to the universal service fund as well as state and local revenue streams.

B. *New Hampshire Regulations Impacting VoIP*

As a two-way communications service, VoIP will most likely be dealt with under New Hampshire's communications services tax, which imposes a seven percent tax on those who use two-way communications services.¹⁷⁶ Communications services are broadly defined as "services for transmitting,

174. Paiste, *supra* n. 40.

175. Morris, *supra* n. 172.

176. N.H. Rev. Stat. Ann. § 82-A.

emitting, or receiving signs, signals, writing, images, sounds or intelligence of any nature by any electromagnetic system capable of two-way communication;”¹⁷⁷ such services include computer exchange services.¹⁷⁸ Communications services expressly exclude, however, “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.*”¹⁷⁹ The CST specifically mentions two-way communications services and does not attempt to differentiate between information and telecommunications services; this type of distinction occurs purely at the federal level.¹⁸⁰ Under the Telecom Act, New Hampshire may only tax telecommunication services, and thus the CST largely applies to telecommunication, not information, services.

VoIP qualifies as an interstate communications service under the CST and likely does not fall under the value added service exception, as it serves the purpose of *transmitting* and receiving digital voice signals via broadband.¹⁸¹ In order for VoIP to qualify as an interstate communications service furnished to someone with a place of primary use in New Hampshire under the CST, one must determine where the signal originated and terminated.¹⁸² The CST provides for two means by which one can determine the origination point of the communications signal: (1) the seller’s telecommunications system, or (2) “information received by the seller from its service provider, where the system used to transport such signals is not that of the seller.”¹⁸³ These two means of identifying the origination point may not yet be applicable to VoIP, especially computer to computer VoIP, because a VoIP user may place a call anywhere she may find a broadband connection, and the signal travels over broadband. Unlike PSTN or wireless consumers, VoIP consumers are not constrained by geographic area codes; at first, more effort will be required in order to trace the origination and destination of VoIP calls.

The CST also provides for protection from multistate taxation of communications services that are subject to taxation under the CST.¹⁸⁴ This provision enables a taxpayer to present proof that he has paid a tax in another state on the same communications services in order to receive a

177. *Id.* at § 82-A:2.

178. *Id.*

179. *Id.* (emphasis added).

180. *See* 47 U.S.C. § 151.

181. Interstate communications services include “all communications services that either originate or terminate outside” New Hampshire. N.H. Rev. Stat. Ann. § 82-A:2.

182. *Id.* at § 82-A:4.

183. *Id.*

184. *Id.*

credit against interstate services taxes “to the extent of the amount of such tax properly due and paid in such other state.”¹⁸⁵

While seemingly consumer-friendly, this provision merely moves the burden to the taxpayer to keep track of charges and itemize receipts in order to ensure they are not being doubly taxed. The average consumer likely does not take into account every charge on her bills and does not inquire as to the originating state of that charge. Currently the best protection from multiple state taxation could be found in a federal flat tax applied equally to all states until the collective states can establish and classify a uniform system to classify and tax various VoIP services. A flat tax would ensure that each customer is taxed equally, and tax revenues could be contributed to the universal service fund.

Most importantly, under the CST, if certain communications services are not subject to taxation by the State under the United States Constitution and statutes, New Hampshire will not impose a tax on such services.¹⁸⁶ If VoIP is considered to be part of a bundled Internet access service, or an added Internet access service, it may be exempt from State taxation under this provision in light of the ITNA.¹⁸⁷ Under the grandfather clause in the ITNA,¹⁸⁸ if a state law pertaining to Internet access taxation was in effect by October 21, 1998 or November 1, 2003, the state may continue to tax Internet access and the tax is exempt under the moratorium until November 1, 2007 or November 1, 2005.¹⁸⁹ Under the second prong of the exemption under the moratorium, the aforementioned enforced tax must either be generally collected by the state or local government or Internet access service providers must have a reasonable opportunity to know that the state has enforced a tax on Internet access.¹⁹⁰

Federal, State, and local officials have held different opinions about whether certain taxes were grandfathered under the ITNA and about whether the moratorium applied in various circumstances.¹⁹¹ Under the moratorium, New Hampshire is currently taxing Internet access.¹⁹² The point of taxation does not occur between the ISP selling the bundled Internet access service to the consumer; rather, the sale of acquired services to

185. *Id.*

186. *Id.*

187. 115 Stat. 703.

188. “Nothing in this title shall be construed to modify, impair, supersede, or authorize the modification, impairment, or superseding of any state or local law pertaining to taxation that is otherwise permissible by or under the Constitution or other federal law an in effect on the date of enactment of this act.” 112 Stat. at 2681-719. The date of enactment of the ITFA (later the ITNA) is October 21, 1998. *Id.*

189. *Id.*

190. 118 Stat. at 2618.

191. *GAO Report, supra* n. 8, at 20.

192. Interview with G. Phillip Blastos, *supra* n. 12.

an ISP, the wire, cable, server capacity, and hardware, is subject to taxation.¹⁹³ Under the amended definition of ‘a tax on Internet access’ under the ITNA, which applies to both providers as well as consumers, New Hampshire’s tax that occurs on the provider front-end of the transaction qualifies as a tax on Internet access.

However, confusion exists as to whether or not New Hampshire is in fact grandfathered under the ITNA, or if the State is illegally taxing Internet access and thus, is in violation of federal law.¹⁹⁴ While the House Report on the ITNA does not include New Hampshire among the ten states specifically mentioned as grandfathered under the ITNA,¹⁹⁵ the Congressional Budget Office Cost Estimate on the ITNA as well as a CRS Report regarding the ITNA both list New Hampshire amongst states that may legally tax Internet access services under the ITNA.¹⁹⁶

Given the confusion amongst State and local officials, New Hampshire does not likely meet the second prong of the exemption to be qualified as grandfathered under the ITNA.¹⁹⁷ First, New Hampshire must have enacted and enforced a tax on Internet access prior to either October 1, 1998 or November 1, 2003.¹⁹⁸ Unfortunately, Internet access is not explicitly mentioned in the CST or any other State statute regarding taxation; instead, it appears that Internet access was included under the umbrella of two-way communications via broadband in the CST.¹⁹⁹ The tax on Internet access thus most likely fails the first prong of the ITNA grandfathering provision.

A tax on Internet access must also be made known to the general public or be generally collected in order to fall under the grandfathering provision of the ITNA.²⁰⁰ When federal, local, and State officials are not even sure whether New Hampshire is grandfathered under the ITNA, local ISPs cannot be deemed to have had a “reasonable opportunity to know [about such a tax on Internet access] by virtue of a public rule or other public proclamation.”²⁰¹ If New Hampshire ISPs can be found not to possess knowledge of a tax on Internet access, the second prong of the grandfathering provision of the ITNA will not likely be met, and New Hampshire will be found to be illegally taxing Internet access.

If New Hampshire is found to be in violation of the ITNA and may no longer tax Internet access, VoIP may remain free from State taxation if it

193. *GAO Report*, *supra* n. 8, at 11.

194. *Id.* at 20.

195. H.R. Rpt. 107-240 at § 2.

196. Cong. Research Serv., *supra* n. 17; *CBO Cost Estimate*, *supra* n. 11.

197. 118 Stat. at 2618.

198. *Id.*

199. N.H. Rev. Stat. Ann. § 82-A:2.

200. *Id.*

201. *Id.*

qualifies as a bundled or added Internet access service. Ultimately, this confusion as to whether or not New Hampshire may legally tax Internet access should be resolved before the State can consider how to approach taxation of VoIP.

V. CONCLUSION

New Hampshire's struggles to classify VoIP and Internet access for taxation purposes suggest that the best way to deal with VoIP taxation is at the federal level. The majority of VoIP services, with the exception of phone-to-phone IP telephony, should be classified as information services under the Telecommunications Act of 1996 because, unlike telecommunications services such as the PSTN, VoIP services enable consumers to manage and manipulate the communications they send and receive over broadband and make calls from their number anywhere in the world where they can connect to the Internet. Therefore, the FCC, not individual states, should have the authority to regulate and tax VoIP.

In order to avoid the free-rider problem, VoIP providers should be required to contribute to the universal service fund and should be responsible for some of the obligations of telecommunications services, such as providing service on just, nondiscriminatory terms and meeting certification requirements. In an effort to allow VoIP providers space to grow to a capacity where they are able to compete in the communications market without harm to established telecommunications providers, the federal government should collect a low, flat tax on VoIP to be directed to states and localities.²⁰² The flat tax would thus be distributed to states and localities to alleviate any fears of losing millions in tax revenue. Furthermore, the tax should be just high enough to dissuade consumers from completely switching over from PSTN services and wireless services to VoIP. Moreover, such a tax at the federal level would prevent multiple and discriminatory taxation by the states on VoIP transactions and would remove the burden from consumers to continually monitor their bills and determine when they have been taxed twice in different states for the same service.

Convergent technologies such as VoIP will likely be springing up in the future at a more frequent rate, continually challenging and redefining our preexisting notions of the various technologies that we have assimilated and adapted to in both the workplace and the home. In an effort to regulate these new technologies, governments will typically attempt to

202. Paula Brown, *Cities and states overtax communication services*, Union Leader A17 (Apr. 21, 2005).

classify them as preexisting technologies and alter definitions to include new developments. As the confusion surrounding the ITNA's designation of what constitutes Internet access has demonstrated, oftentimes altering definitions to be more inclusive results in allowing unexpected developments through the door, sparking great controversy. Instead of simply altering definitions in preexisting legislation, governments should take time to investigate the matter and understand the technology and the effects that different forms of taxation will have on the market as well as on innovation. New Hampshire's attempt to establish a committee to investigate Internet access and VoIP issues in Senate Bill 363²⁰³ is certainly a step in the right direction.

203. See *supra* nn. 170-71 and accompanying text (discussing committee).