TO: Virginia Department of Taxation

FROM: AT&T, Comcast, Sprint, and Verizon

RE: Comments on Market Sourcing for Virginia Study Working Group

DATE: July 7, 2015

Thank you for the opportunity to provide comments on the issue of "market-based sourcing" for income tax purposes. The Virginia Department of Taxation did an excellent job of identifying the key issues in its June 4th presentation.

The communications services providers listed above do not support a proposal that repeals the current method for apportioning service revenues, which is based on a "cost of performance" standard, and replaces it with a market-based approach. While market sourcing may benefit some taxpayers headquartered in Virginia, it will increase the tax burden on communications service providers that are currently making substantial investments in both employment and infrastructure in Virginia, and impose additional administrative costs on both communications providers and the Department.

Some proponents of market-based sourcing argue that it would lower the tax burdens of companies that invest significant resources in Virginia and sell services outside of the state. However, if the goal of switching to market-based sourcing is to create incentives for business investment in Virginia, increasing tax burdens on the communications sector would have the opposite impact by increasing tax burdens and thereby lowering funds available for investment. In theory, market based sourcing is intended to increase the tax paid by companies with little presence in the state but that earn substantial revenue by selling goods to in state residents. This theory does not hold up when applied to communications companies that are making major capital investments in the state and providing important and valuable services to state residents.

To make matters worse for communications companies, in 2006, the General Assembly eliminated the sales and use tax exemption for machinery and equipment used in communications networks. As a result, communications companies investing in Virginia networks already pay sales and use taxes on their business inputs while manufacturers do not. The adoption of market sourcing in Virginia and its application to communications companies would be a move toward a tax policy that further discourages investment by communications carriers and may not be the best course for the Virginia economy.

Market sourcing may seem practical in theory because the intent is to apportion revenue on the basis of the customer markets. However, for the communications industry, market sourcing would create uncertainty and administrative challenges. With the explosion of electronic commerce, it is difficult to determine where a service is received by a customer or where the benefit of a service is realized by the customer. Unlike the cost of performance method, which uses data regarding the taxpayer's own activities, a market-based sourcing rule sources receipts based upon the "market." Where the "market" is located is often difficult to determine, particularly if the customer is a multistate company or if the benefits from the services provided transcend the boundaries of a single state.

Identification of a 'service' or 'benefit' location is a complex concept, particularly in the context of mobile communication services that are provided on national networks with no fixed service location. Consider the difficulty of trying to ascertain where the benefit is received for a mobile service that allows a wireless caller to maintain the same call while driving through several states. Audit controversies and confusion would likely result due to the practical limitations of gathering and reporting the necessary information.

In summary, we therefore believe that it is counter-productive for the same companies that are the engine of economic growth in Virginia to be burdened by increased corporate income taxes and new administrative burdens.

Thank you for your consideration.