

SC REVENUE RULING #03-1

SUBJECT: Universal Service Fund Surcharge
(Sales and Use Tax)

EFFECTIVE DATE: November 1, 2003

SUPERSEDES: All previous advisory opinions and any oral directives in conflict herewith.

REFERENCES: S. C. Code Ann. Section 12-36-910(B)(3) (Supp. 2001)
S. C. Code Ann. Section 12-36-1310(B)(3) (Supp. 2001)
S. C. Code Ann. Section 12-36-60 (2000)
S. C. Code Ann. Section 12-36-90 (2000 and Supp. 2001)
S. C. Code Ann. Section 58-9-280 (Supp. 2001)
S. C. Code Ann. Section 12-36-2120 (2000 and Supp 2001)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (Supp. 2001)
SC Revenue Procedural Bulletin #02-3

SCOPE: The purpose of a Revenue Advisory Bulletin is to provide guidance to the public and to Department personnel. It is a written statement issued to apply principles of tax law to a specific set of facts or a general category of taxpayers. A Revenue Advisory Bulletin does not have the force or effect of law, and is not binding on the public. It is, however, the Department's position and is binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

Question:

Are Universal Service Fund surcharges billed by telephone companies to their customers subject to the sales and use tax?

Conclusion:

Universal Service Fund surcharges billed by telephone companies to their customers are part of the "gross proceeds accruing or proceeding from the charges for the ways or means for the transmission of the voice or of messages" and therefore subject to the sales and use tax.

However, any portion of the Universal Service Fund surcharge based on charges for telecommunication services that are exempt from the sales and use tax under Code Section 12-36-2120 (e.g., sales to the federal government, long distance charges, or certain access charges) or are otherwise nontaxable, are a part of the gross proceeds accruing or proceeding from the charges for an exempt service or a nontaxable charge and therefore not subject to the sales and use tax.

Facts:

Beginning October 1, 2001, telephone companies in South Carolina began adding to their customers' bills a Universal Service Fund ("USF") surcharge of 2.13% of their charges for telecommunication services. The surcharge reimburses the companies for the contributions they must make to the USF maintained and administered by the South Carolina Public Service Commission ("PSC").

The purpose of the USF is to promote universal service by ensuring the continued availability of basic local exchange service at affordable rates. The PSC distributes money from the USF to companies whose cost of providing local exchange service exceeds the rates that those companies are allowed to charge for that service.

The issue at hand is whether this surcharge is a part of the gross proceeds of the charges for communication services and subject to the tax.

Discussion:

Code Sections 12-36-910(B)(3)(a) and 12-36-1310(B)(3) impose the sales and use tax upon:

the gross proceeds accruing or proceeding from the charges for the ways or means for the transmission of the voice or of messages, including the charges for use of equipment furnished by the seller or supplier of the ways or means for the transmission of the voice or of messages ...

In addition, Code Section 12-36-910(B)(3)(b), which concerns "bundled transactions" under the sales tax law, states:

- (i) for purposes of this item, a 'bundled transaction' means a transaction consisting of distinct and identifiable properties or services, which are sold for one nonitemized price but which are treated differently for tax purposes;
- (ii) for bills rendered on or after January 1, 2004, that include telecommunications services in a bundled transaction, if the nonitemized price is attributable to properties or services that are taxable and nontaxable, the portion of the price attributable to any nontaxable property or service is subject to tax unless the provider can reasonably identify that portion from its books and records kept in the regular course of business for purposes other than sales taxes.

The term "tangible personal property," as used in Chapter 36, is defined at Code Section 12-36-60, in part, as "personal property which may be seen, weighed, measured, felt, touched or which is in any other manner perceptible to the senses." The next sentence of that section reads in part:

It also includes services and intangibles, including communications, laundry and related services, furnishing of accommodations and sales of electricity, the sale or use of which is subject to tax under this chapter ... (Emphasis added)

The Code does not provide definitions for various terms or phrases found in Code Sections 12-36-910(B)(3)(a) and 12-36-1310(B)(3); therefore, it is necessary to determine their "ordinary and popular meaning." The Department, in interpreting Code Sections 12-36-910(B)(3)(a) and 12-36-1310(B)(3) (and their predecessors), has long used the definitions found in the Second College Edition of the American Heritage Dictionary for defining these terms and phrases. Substituting the definitions in the Second College Edition of the American Heritage Dictionary for terms found in Sections 12-36-910(B)(3)(a) and 12-36-1310(B)(3), the literal meaning becomes - the total amount of money derived, exclusive of deductions, from a commercial venture and accruing or proceeding from charges for the manner, method or instruments for sending a signal of the voice or of messages is subject to the sales and use tax. See SC Revenue Ruling #89-14.

Furthermore, the definition of tangible personal property, as defined in Code Section 12-36-60, includes services and intangibles "the sale or use of which is subject to tax under [Chapter 36]." A service or intangible "the sale or use of which is subject to tax under [Chapter 36]" is "communications." The Second College Edition of the American Heritage Dictionary defines "communication," in part, as "[t]he exchange of thoughts, messages or information, as by speech, signals or writing." "Communications" is defined, in part, as, "a means of communicating esp.: a system of sending and receiving messages, such as mail, telephone and television." As with the above definitions, the Department has long used the definition found in the Second College Edition of the American Heritage Dictionary for the term "communications."

Based on the above discussion, it is the Department's position that charges for the ways or means of communication include charges for access to, or use of, a communication system (the manner, method or instruments for sending or receiving a signal of the voice or of messages), whether this charge is based on a fee per a specific time period or per transmission. This is further supported by the definition of the terms "sale" and "purchase," which are defined in Code Section 12-36-100 to include "a license to use or consume." Therefore, the gross proceeds accruing or proceeding from the charges for access to, or use of, a telephone system is subject to the tax.

To specifically address the application of the tax to the USF surcharge, we must look more closely as to what is includable in "gross proceeds."

Code Section 12-36-90 defines "gross proceeds" and reads, in part:

Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property.

(1) The term includes:

* * * *

(b) the proceeds from the sale of tangible personal property without any deduction for:

(i) the cost of goods sold;

(ii) the cost of materials, labor, or service;

(iii) interest paid;

(iv) losses;

(v) transportation costs;

(vi) manufacturers or importers excise taxes imposed by the United States; or

(vii) any other expenses.

In Meyers Arnold v. South Carolina Tax Commission, 285 S.C. 303, 328 S.E. 2d. 920 (1985), the Court of Appeals, in interpreting the definition of "gross proceeds of sales" with respect to lay away fees paid in conjunction with lay away sales, held:

Section 12-35-30 [now Section 12-36-90] defines gross proceeds of sales as "the value proceeding or accruing from the sale of tangible personal property ... without any deduction for service costs." But for the lay away sales, Meyers Arnold would not receive the lay away fees. The fees are obviously rendered in making lay away sales. For these reasons, this court holds the lay away fees are part of the gross proceeds of sales and subject to the sales tax.

The Commissioners, in Decision S-D-174, held a property damage waiver fee charged by a person engaged in the business of renting tangible personal property was subject to the sales tax. The Commission, in citing Meyers Arnold v. South Carolina Tax Commission, supra, stated:

Just as in Meyers Arnold, supra, the service fee here is taxable. But for the lease of tangible personal property, the taxpayer would not have received the fee. The fee is obviously charged for the additional service of providing a lease of property free from liability for damage. In the absence of such service, the lessee, under the taxpayer's lease agreements, would be "liable for any loss, theft, damage or destruction of leased

property." We find and conclude the fee for the property damage waiver is part of gross proceeds of sale subject to tax.

In Decision S-D-127, the Commissioners held that "the amount in a lease contract equal to ad valorem taxes which is paid annually by the lessee to the lessor is includable in gross proceeds of sales."

The Department addressed a similar issue in SC Revenue Ruling #97-20 when determining if certain local fee and taxes were includable in "gross proceeds" and subject to the sales tax. In that advisory opinion the Department held:

Finally, the following additional issues must be considered when determining if local fees and taxes are includable in "gross proceeds of sales" for purposes of the state sales tax:

- (1) Is the local government fee or tax imposed on the retailer or the consumer?
- (2) Is the fee or tax, by state law, administered in the same manner as the state sales and use tax?

With respect to the first issue, a distinction must be made between local fees or taxes that are imposed upon the retailer and local fees or taxes that are imposed upon the customer. With respect to fees and taxes imposed upon the customer, the retailer is merely a collection agent for the local government that has enacted the fee or tax by ordinance. As such, the fee or tax the retailer is required to collect and hold in trust for the local government is not a receipt of the retailer. It is a receipt of the local government for whom the retailer is the collection agent. Therefore, local fees and taxes imposed upon the retailer's customers are not includable in "gross proceeds of sales."

A fee or tax imposed upon the retailer is a receipt of the retailer. The retailer has the discretion to collect the fee or tax from his customer, but he is not required to do so. As such, the fee or tax when collected is a receipt of the retailer. When paid to the local government, the fee or tax is an expense of the retailer. Therefore, local fees and taxes imposed upon the retailer are includable in "gross proceeds of sales."

Therefore, city and county fees and taxes, when imposed on the retailer, are part of gross proceeds of sales and therefore subject to the sales tax. City and county fees and taxes, when imposed on the consumer, are not a part of gross proceeds of sales and therefore not subject to the sales tax.

With respect to the USF, Code Section 58-9-280 reads in part:

(E) In continuing South Carolina's commitment to universally available basic local exchange telephone service at affordable rates and to assist with the alignment of prices and/or cost recovery with costs, and consistent with applicable federal policies, the commission [PSC] shall establish a universal service fund (USF) for distribution to a

carrier(s) of last resort. The commission shall issue its final order adopting such guidelines as may be necessary for the funding and management of the USF within twelve months of the effective date of this section except that the commission, upon notice, may extend that period up to an additional ninety days. These guidelines must not be inconsistent with applicable federal law and shall address, without limitation, the following:

(1) The USF shall be administered by the commission or a third party designated by the commission under guidelines to be adopted by the commission.

(2) The commission shall require all telecommunications companies providing telecommunications services within South Carolina to contribute to the USF as determined by the commission.

(3) The commission also shall require any company providing telecommunications service to contribute to the USF if, after notice and opportunity for hearing, the commission determines that the company is providing private local exchange services or radio-based local exchange services in this State that compete with a local telecommunications service provided in this State.

(4) The size of the USF shall be determined by the commission and shall be the sum of the difference, for each carrier of last resort, between its costs of providing basic local exchange services and the maximum amount it may charge for the services. The commission may use estimates to establish the size of the USF on an annual basis, provided it establishes a mechanism for adjusting any inaccuracies in the estimates.

(5) Monies in the USF shall be distributed to a carrier of last resort upon application and demonstration of the amount of the difference between its cost of providing basic local exchange services and the maximum amount it may charge for such services.

(6) The commission shall require any carrier of last resort seeking reimbursement from the fund to file the information necessary to determine the costs of providing basic local exchange telephone services. In the event that a carrier of last resort does not currently conduct detailed cost studies relating to such services, the commission shall allow for an appropriate surrogate for such study.

(7) The commission shall have the authority to make adjustments to the contribution or distribution levels based on yearly reconciliations and to order further contributions or distributions as needed.

(8) After notice and an opportunity for hearing to all affected carriers, the commission by rule may expand the set of services within the definition of universal service based on a finding that the uniform statewide demand for such additional service is such that including the service within the definition of universal service will further the public interest; provided, however, that before implementing any such finding, the commission shall provide for recovery of unrecovered costs through the USF of such additional service by the affected carrier of last resort.

In Order No. 2001-1088 of the SC Public Service Commission, the administrator of the USF, the Commission held the following in its “Guidelines for South Carolina Universal Service Fund (USF)” (See Exhibit A of the order):

8. Recovery of USF Contributions

- Contributions to the USF may be recovered through an explicit surcharge on retail customers’ bills. A carrier may choose not to recover its contribution. However, any carrier attempting to recover contributions to the State USF shall do so through the use of a uniform surcharge on end-user retail revenues. Any surcharge applied to end user retail revenues by the carrier shall not exceed the percentage assessed to the carrier, as determined by the Commission Staff.
- The USF Administrator shall develop an explicit uniform retail surcharge percentage to be used as a USF contribution recovery mechanism. The USF surcharge may be applied to the retail revenue billed to all end users of telecommunications. The surcharge shall be updated at least annually and shall be applied in a manner consistent with the contributions collected by the Administrator, including periodic updates.

Based on the above, the USF surcharge is a receipt of the retailer (telecommunications company). The retailer has the discretion to collect the USF surcharge from its customer, but the retailer is not required to do so. As such, the USF surcharge when collected is a receipt of the retailer. When paid to the PSC, the USF surcharge is an expense of the retailer. Therefore, the USF surcharge is includable in “gross proceeds of sales.”

In addition, the USF surcharge is not an access charge. As stated in Code Section 58-9-280(E) the USF was established as part of “South Carolina’s commitment to universally available basic local exchange telephone service at affordable rates and to assist with the alignment of prices and/or cost recovery with costs.” The American National Standard for Telecommunications – Telecom Glossary 2000 (<http://www.atis.org/tg2k/>) defines the term “access charge” as:

1. A fee charged by a local exchange carrier for use of its local networks. [FCC] 2. A charge made by a local exchange carrier for use of its local exchange facilities for a purpose such as the origination or termination of traffic that is carried to or from a distant exchange by an interexchange carrier.

Based on this definition, a “customer access line charge” exempt under Code Section 12-36-2120(11)(c) is generally defined as a line fee charged a customer by a local exchange carrier for use of its local networks. A “carrier access charge” exempt under Code Section 12-36-2120(11)(c) is generally defined as a charge made by a local exchange carrier to an interexchange carrier for use of its local exchange facilities for the origination or termination of traffic that is carried to or from a distant exchange by an interexchange carrier.

The USF surcharge is not a charge by a local exchange carrier for use of its network or facilities. As stated above, the purpose of the USF is to ensure “universally available basic local exchange

telephone service at affordable rates and to assist with the alignment of prices and/or cost recovery with costs.” Also, unlike an access charge, the carrier does not retain the USF surcharge. It is remitted to the PSC.

Therefore, the USF surcharge is not a customer access line charge or a carrier access charge and is not exempt under the provisions of Code Section 12-36-2120(11)(c).

Furthermore, based on the provisions of Code Section 58-9-280 and Order No. 2001-1088 of the SC Public Service Commission, the USF surcharge, by itself, is not a charge set by statute for a governmental license or permit. Again, the purpose of the USF is to ensure “universally available basic local exchange telephone service at affordable rates and to assist with the alignment of prices and/or cost recovery with costs.”

In addition, neither the South Carolina Sales and Use Tax Code (Title 12, chapter 36) nor the provisions of Code Section 58-9-280 provide a specific exemption from the sales and use tax for the USF surcharge.

Finally, Code Section 12-36-2120 exempts from the sales and use tax certain sales that may apply to charges by a telephone company to a customer. For example, Code Section 12-36-2120(2) exempts sales to the federal government and Code Section 12-36-2120(11) exempts toll charges for the transmission of voice or messages between telephone exchanges (long distance) and carrier access charges and customer access line charges established by the Federal Communications Commission or the South Carolina Public Service Commission.

Therefore, Universal Service Fund surcharges billed by telephone companies to their customers are part of the “gross proceeds accruing or proceeding from the charges for the ways or means for the transmission of the voice or of messages” and therefore subject to the sales and use tax.

However, any portion of the Universal Service Fund surcharge based on charges for telecommunication services that are exempt from the sales and use tax under Code Section 12-36-2120 (e.g., sales to the federal government, long distance charges, or certain access charges) or are otherwise nontaxable, are a part of the gross proceeds accruing or proceeding from the charges for an exempt service or a nontaxable charge and therefore not subject to the sales and use tax.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Burnet R. Maybank

Burnet R. Maybank, Director

July 2, 2003
Columbia, South Carolina