

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	WC Docket Nos. 05-337, 06-122
Request for Universal Service Fund Policy)	CC Docket No. 96-45
Guidance by the Universal Service)	DA 09-2117
Administrative Company)	



INITIAL COMMENTS

The National Telecommunications Cooperative Association (NTCA)¹ responds to the September 28, 2009 Public Notice (Public Notice) by the Federal Communications Commission (Commission or FCC) seeking comment on two requests for guidance issued by the Universal Service Administrative Company (USAC) on August 19 and August 21, 2009.² Three USAC requests are of particular concern to small rural telcos due to the ramifications of changing the industry's historical approach on audits. The Commission, in responding to the USAC guidance requests, should direct USAC to instruct its auditors that, for purposes of universal service support, income taxes attributable to Subchapter S corporation activities are includable in the carrier's revenue requirement and are therefore recoverable through universal service support.

Also, the Commission should not punish retroactively those eligible telecommunications carriers

¹ NTCA is a premier industry association representing rural telecommunications providers. Established in 1954 by eight rural telephone companies, today NTCA represents 585 rural rate-of-return regulated telecommunications providers. All of NTCA's members are full service rural local exchange carriers (LECs) and many of its members provide wireless, cable, Internet, satellite and long distance services to their communities. Each member is a "rural telephone company" as defined in the Communications Act of 1934, as amended (Act). NTCA's members are dedicated to providing competitive modern telecommunications services and ensuring the economic future of their rural communities.

² *In the Matter of Request for Universal Service Fund Policy Guidance Requested by the Universal Service Administrative Company*, WC Docket No. 05-337, 06-122, CC Docket No. 96-45, DA 09-2117, Public Notice setting comment cycle (rel. Sep. 28, 2009) (Public Notice).

(ETCs) who may lump services together as “local telephone service” or who have neglected to list or advertise separately every segment of their supported service offerings. Finally, the Commission should not penalize high-cost program auditees for not complying with a five-year document retention rule that did not exist at the time the documents were created.

I. SUBCHAPTER S INCOME TAXES SHOULD CONTINUE TO PASS THROUGH TO CARRIER CORPORATE SHAREHOLDERS, AS THEY HAVE FOR AT LEAST A DECADE.

USAC seeks guidance regarding the appropriate tax treatment of IRS Subchapter S corporate income taxes.³ According to USAC, auditors on over 20 high-cost program beneficiary audits do not agree with the historical industry practice that permits pass-through of Subchapter S income taxes to shareholders.⁴ Specifically, USAC asks for “clarification on whether income taxes attributable to S-corporation shareholders as a result of their ownership of the corporation’s equity are includable in the carrier’s revenue requirement and, therefore, recoverable through the Universal Service Fund (USF).”⁵ The answer to this inquiry should be a solid “Yes,” and the Commission should direct USAC to instruct its auditors to permit the historical industry practice. Subchapter S income taxes on regulated carriers’ telecommunications income should continue, as they have for more than a decade, to pass through to the carriers’ shareholders, be included in the carriers’ revenue requirement and be subject to USF recovery.

Rural telecommunications companies who have chosen Subchapter S tax status, instead of Chapter C (traditional corporation) tax status, have historically been able to pass through their business income and income taxes to their shareholders, with the shareholders paying the income

³ Subchapter S provisions are part of the Internal Revenue Code §§ 1361 – 1379.

⁴ Letter to Julie Veach, Acting Chief, Wireline Competition Bureau, from USAC (dated Aug. 19, 2009) (USAC Aug. 19 2009 Guidance Letter), p. 4; Public Notice, fn. 1.

⁵ *Ibid.*

taxes. An NTCA member who elects Subchapter S status will, under the auspices of the Internal Revenue Code, allocate a pro-rata share of the S corporation's income, deductions, charitable contributions and credits to pass through to their shareholders, who then pay taxes on a pro-rata basis at shareholder rates depending on their share of the Subchapter S company net taxable income. These income taxes, in turn, are recovered under Subchapter S through the NECA pools and universal service fund as part of the company's revenue requirement.⁶

For example, one NTCA member that converted to Subchapter S status in 2000 passed through about \$900,000 of regulated income taxes to its shareholders. In fairness to the rural shareholders, the company makes distributions to the shareholders sufficient enough to pay the taxes. This company has been paying distributions and dividends to its shareholders, supporting the rural community for years, and bases its capital expenditure budget on the amount of available cash. USAC states that some USF auditors suggest that the Commission should reverse the historical treatment of Subchapter S income taxes.⁷ If the Commission unwisely adopts this approach, this NTCA member company will have to reconsider its tax status, revise its distribution and dividends programs, and inform and educate its shareholders about the new tax treatment rules. Aside from corporate structure reorganization, a rule change simply means substantially less cash for capital expenditures, including broadband-capable plant, because the cash is being used to pay income taxes at the corporate level, rather than at the shareholder level.

NECA has noted that member companies, including NTCA's members, who chose Subchapter S formation, are allowed to recover the interstate portion of the federal income taxes on operating income.⁸ This standard industry practice derives the income tax portion of a revenue requirement based on the taxable income association with regulated telephone

⁶ *Ibid.*

⁷ USAC Aug. 19 Guidance Letter, p. 4.

⁸ See NECA Cost Issues Manual, Section 3.1, *cited in* USAC Aug. 19, 2009 Guidance Letter, p. 4.

company's operations. These taxes are then recoverable, based on NECA formulas, as reimbursement from the NECA pools. NECA has advised its members that, absent a definitive ruling to the contrary, NECA intends to continue the standard industry practice and allow recovery for pass-through Subchapter S income taxes.⁹

Consequently, the Commission should maintain the status quo to minimize disruption of the Subchapter S corporate and shareholder expectations and to maximize the amount of carrier cash available for capital expenditures, such as broadband infrastructure projects. A ruling that changes the status quo will directly and adversely affect every NTCA company member who elected Subchapter S tax status years ago because of their interpretations, and interpretations by NECA, of the pass-through provisions of Subchapter S.

II. ETCS SHOULD NOT BE REQUIRED TO LIST AND ADVERTISE SEPARATELY EVERY SUPPORTED SERVICE FOR LOCAL TELEPHONE SERVICE.

USAC also seeks guidance on how eligible telecommunications carriers (ETCs) should advertise their services. Specifically, USAC asks for “clarification from the Commission as to whether an ETC that fails to list and advertise each separate supported service enumerated in 47 C.F.R. § 54.101 as part of the “local telephone service” is in violation of 47 C.F.R. §54.201(d)(2).”¹⁰ USAC also seeks guidance on “what recovery action, if any, USAC should take.”

Section 47 C.F.R. § 54.101 requires ETCs to list and advertise separately the following services: 1) voice grade access to the public switched network; 2) local usage; 3) dual-tone multi-frequency signaling or its functional equivalent’ 4) single-party service or its functional

⁹ *Ibid.* NECA also notes in its Cost Issues Manual that limited liability companies (LLCs) and partnerships are also allowed to receive reimbursement for interstate portion of income taxes because, like Subchapter S corporations, the LLCs and partnerships pass their income and expenses through to the individual shareholder/partner.

¹⁰ USAC Aug. 21 Guidance Letter, p. 2.

equivalent; 5) access to emergency services; 6) access to operator services; 7) access to interexchange services; 8) access to directory assistance; and 9) toll limitation for qualifying low-income consumers.¹¹ Section 47 C.F.R. § 54.201(d)(2) requires: “(d) A common carrier designated as an eligible telecommunications carrier under this section shall be eligible to receive universal service support in accordance with section 254 of the Act and shall, throughout the service area for which the designation is received: (2) Advertise the availability of such services and the charges therefore using media of general distribution.”¹² USAC states in its August 21 Guidance Letter that USAC is not currently acting against ETCs who have failed to advertise each supported service.¹³

The Commission should not punish retroactively those ETCs who may lump services together as “local telephone service” or who have neglected to list or advertise separately every segment of their supported service offerings. Some ETCs appear to have concluded that separate listing and advertising of certain segments is not reasonable or may confuse the consumer with too much detail. Combining several services under the label “local telephone service” or an equivalent may convey the information needed by the consumer far more effectively than by listing component parts. This is somewhat kin to requiring automobile dealers to list the price of the tires, steering wheel, antenna and seats when advertising the price of the car – the consumer cares about the total price, not each part’s price. Some of the segments of local telephone service, also, may not have been advertised separately because the segments may involve functions in common with other services.

The Commission, consequently, should not take any adverse action against ETCs who did not separately list or advertise every one of their supported services. Any actions to enforce

¹¹ 47 C.F.R. § 54.101; USAC Aug. 21, 2009 Guidance Letter, p. 1.

¹² 47 C.F.R. § 54.201(d) (2).

¹³ USAC Aug. 21 Guidance Letter, p. 2.

an itemized component listing of “local telephone service” per 47 C.F.R. § 54.101 and §54.201(d) (2) should be done prospectively, with clear advance notice to ETCs.

III. RETROACTIVE DOCUMENTATION RETENTION RULES SHOULD NOT APPLY TO HIGH COST PROGRAM AUDITS.

USAC also seeks guidance regarding high cost program document retention rules.

USAC notes that the Commission, in 2008, set five-year documentation retention rules for audits of the high-cost USF program, but did not state whether that five-year period started before or after 2008, the date rural telcos and other high-cost recipients became aware of the retention obligation.¹⁴ Specifically, USAC states it “is not able to take action on these findings until the Commission provides policy guidance.”¹⁵

It is unreasonable to expect high-cost program recipients to comply with document retention rules that did not exist at the time the documents were created. Evidence exists in USAC’s guidance request to support this view – about 100 high-cost audits have resulted in a finding that the auditees did not retain the specific five-years of documents sought by the auditors predating 2008, the rule’s effective date. Any application of the five-year documentation rule must, in all fairness to the program participants, be applied prospectively only – that is, for years starting 2008 forward. The Commission should not penalize high-cost program auditees for not complying with a documentation rule that did not exist at the time the documents were created.

IV. CONCLUSION.

For these reasons, the Commission should instruct its auditors that, for purposes of universal service support, income taxes attributable to Subchapter S corporation activities are includable in the carrier’s revenue requirement and are therefore recoverable through universal

¹⁴ *Ibid.*

¹⁵ USAC Aug. 19, 2009 Guidance Letter, p. 3.

service support. Also, the Commission should not punish retroactively those ETCs who may lump services together as “local telephone service” or who have neglected to list or advertise separately every segment of their supported service offerings. Finally, the Commission should not penalize high-cost program auditees for not complying with a five-year document retention rule that did not exist at the time the documents were created.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Adrienne L. Rolls, certify that a copy of the foregoing Initial Comments of the National Telecommunications Cooperative Association in WC Docket No. 05-337 & 06-122 and CC 96-45, DA 09-2117, was served on this 27th day of October 2009 by first-class, United States mail, postage prepaid, or via electronic mail to the following persons:

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