

Excise Tax Advisory

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Taxation of Alarm Monitoring

Overview

This Excise Tax Advisory (“ETA”) addresses the taxation of a single alarm monitoring service. This ETA does not address the taxation of other security industry activities including the sale of tangible personal property, repair, maintenance, installation, private patrols, or other related products or services or combinations thereof. This ETA was developed in response to specific questions on the taxability of alarm monitoring in the context of the primarily human effort exclusion from digital automated services.

If alarm monitoring has an automated component and is transferred electronically it may be subject to retail sales tax. Otherwise alarm monitoring is generally subject to service and other activities B&O tax.

What is Alarm Monitoring?

Alarm monitoring involves people using computers, software, and telecommunications to monitor homes and businesses for break-in events, fires, etc. Alarm monitoring typically involves a combination of human effort together with automation provided through computers, software, and telecommunications.

What is a Digital Automated Service (“DAS”)?

A digital automated service (“DAS”) is defined as “...any service transferred electronically that uses one or more software applications...” RCW 82.04.192. This definition is broad but also has numerous exclusions, one of which is for services that require primarily human effort. RCW 82.04.192.

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**What is
Primarily
Human Effort?**

The exclusion from the definition of DAS for services that require primarily human effort states that the term "... digital automated service does not include ... any service that primarily involves human effort by the seller and the human effort originated after the customer requested the service ..." RCW 82.04.192.

Thus, if a service that otherwise fits the definition of DAS is performed using primarily human effort, then it is not subject to sales tax because it is excluded from the definition of DAS. Determining whether a service is performed using primarily human effort requires an evaluation of the relative human effort *cost* to provide the service and the relative human effort *time* spent performing the service. WAC 458-20-15503. An average of the time factor and cost factor is used to determine whether the service is conducted using primarily human effort. If the average exceeds 50% human effort, then the service is conducted using primarily human effort. WAC 458-20-15503.

**How Does it Fit
Together?**

If an alarm monitoring service is transferred electronically and uses one or more software applications it is subject to retail sales tax as a DAS unless the exclusion for primarily human effort applies. In this case an analysis must be conducted as described in Examples 1 and Example 2 below. If the service is not transferred electronically, as described in Example 3, the service is not a DAS and the human effort analysis is not needed.

Examples included in this ETA identify a number of facts and then state a general conclusion; they should be used only as a general guide. The tax consequences of all situations must be determined after a review of all the facts and circumstances.

**Alternative
Methods**

If the time and cost factors as discussed in this ETA do not fairly represent the extent of human effort required to perform the service, the taxpayer may request in writing, or the Department may require, the use of another reasonable method to equitably determine whether the service is performed using primarily human effort. Rule 15503(303).

**Example 1:
Always
Connected**

ABC provides alarm monitoring services. ABC uses software and hardware to remotely monitor customer locations for break-in events. ABC is connected to its customers via telecommunications on a 24/7 basis, which allows it to use its software and equipment to monitor its customers' homes and businesses.

General Information

ABC has 50 total employees, 25 of which actually monitor alarms for customers in ABC's alarm monitoring center. During their monitoring shift employees conduct multiple activities that include calling first responders. The 25 employees each work 40-hour shifts each week to serve ABC's 6,000 customers. The total human effort hours per month is determined as follows:

25 employees x 40 hours per week x 4.3 weeks per month = 4,300 hours.

Time Factor

The automated portion of the service is provided to each customer on a 24/7 basis. The total number of hours per month that a subscriber may receive the automated component of the service is 24 hours x 7 days per week x 4.3 weeks per month = 722.4 hours.

The human effort component of the service provided to each customer, on average, is calculated by taking the total human effort hours worked to provide the service (4,300) and dividing it by the number of customers (6,000). As such, each customer receives, on average, 0.72 hours of human effort per month. In comparison, the automated system works for each customer 24/7 as described above. The total service time is 722.4 hours plus 0.72 hours, or 723.12 hours. The human effort time percentage is $0.72/723.12$ or 0.10%.

Cost Factor

ABC spends \$750,000 on salary, benefits and other direct human effort costs for its 25 monitoring employees. ABC also incurs \$250,000 on its direct automated costs, including software, computers, and telecommunications. ABC's human effort cost percentage is $\$750,000/\$1,000,000$ or 75%.

Conclusion (Average of Time and Cost Factors)

The average of ABC's time and cost factor is $(75\% + 0.10\%)/2$ or 37.5%. Because the average of the human effort time and cost factor does not exceed 50%, the service is not conducted using primarily human effort. The monitoring service is a DAS subject to retail sales tax and retailing B&O tax.

**Example 2:
Persistently
Connected**

PKO provides alarm monitoring services. PKO uses software and hardware to remotely monitor customer locations for break-in events. PKO is connected to its customers via telecommunications on a persistent but not continuous basis. PKO uses software and hardware to check-in on its customer locations (e.g., test batteries and smoke alarms, etc.) on average for 5 minutes every hour. In this respect ABC is persistently connected to the customer location and uses its hardware and software to monitor the customer location.

General Information

PKO has the same general information as ABC above, 4,300 human effort hours and 6,000 customers.

Time Factor

The automated portion of the service is provided to each customer for 5 minutes every hour. There are 24 hours in the day, and approximately 30 days in a month, therefore the total time per month that a subscriber may receive the automated component of the service is $(24 \text{ hours} \times 5 \text{ minutes}) \times 30 \text{ days}$ or 3,600 minutes or 60 hours.

The human effort component of the service provided to each customer, on average is

calculated by taking the total human effort hours worked to provide the service (4,300) and dividing it by the number of customers (6,000). As such, each customer receives, on average, 0.72 hours of human effort per month (i.e., 4,300 human effort hours worked divided by 6,000 subscribers). The total service time is 60 hours plus 0.72 hours, or 60.72 hours. The human effort time percentage is $0.72/60.72$ or 1.2%.

Cost Factor

ABC spends \$750,000 on salary, benefits and other direct human effort costs for its 25 monitoring employees. ABC also incurs \$250,000 on its direct automated costs, including software, computers, and telecommunications. ABC's human effort cost percentage is $\$750,000/\$1,000,000$ or 75%.

Conclusion(Average of Time and Cost Factors)

The average of ABC's time and cost factor is $(75\% + 1.2\%)/2$ or 38.1%. Because the average of the human effort time and cost factor does not exceed 50%, the service is not primarily human effort. The monitoring service is a digital automated service subject to retail sales tax and retailing B&O tax.

**Example 3:
Not
Transferred
Electronically**

The alarm monitoring service will generally *not* be subject to retail sales tax as a DAS when the alarm monitoring service is only briefly connected via telecommunications to the customer when a specific event occurs. In that case, the service provider is not providing a service transferred electronically because it is not using its computers and software to electronically monitor the customer location.

XYZ provides alarm monitoring services. XYZ does *not* use software and hardware to remotely monitor customer locations for break-in events, etc. In this respect, XYZ is *not* always or persistently connected to the customer location via telecommunications and is *not* using hardware and software to monitor the customer location. Instead the house or business monitors itself and when an event occurs the alarm panel located on the customer premises will originate a call to XYZ. XYZ's employees will then make calls to first responders, etc. The service provided by XYZ is not "transferred electronically" to the customer and, therefore, the monitoring service is not a DAS.

Conclusion

The monitoring service is not subject to retail sales tax or retailing B&O tax, but instead, service and other activities B&O tax.

**Cost
Depreciation**

Costs used in the cost factor should be depreciated using a "straight line method" so that the value of an asset at the time of purchase is divided by its useful life. The asset will then have a set value for the purposes of the cost factor calculation regardless of whether or not the asset is fully depreciated. For example, an asset purchased in year one has a value of \$10,000.00. The useful life of the asset is four years. Therefore, the asset value for the purposes of the cost calculation is \$2,500.00 ($\$10,000/4$) so long as the asset is used, even after it is fully depreciated (e.g. year five). However, to the extent that this method does not fairly represent the costs,

another method may be used consistent with the “Alternative Methods” discussion above in this ETA.

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