

Cite as Det. No. 05-0377, 27 WTD 51 (2008)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment and Refund of)	
)	No. 05-0377
)	
...)	Registration No. . . .
)	Doc. No. . . . /Audit No. . . .
)	Docket No. . . .
)	

[1] RULE 155, RULE 245; RCW 82.04.065; ETA 544: RETAILING B&O TAX VS. SERVICE B&O TAX -- CLASSIFICATION OF INCOME – SATELLITE-BASED COMMUNICATION NETWORK -- PRIMARY NATURE – TRANSMISSION OF DATA FOR HIRE VS. USE OF COMPUTER HARDWARE OR SOFTWARE TO FURNISH INFORMATION OR DATA. In determining the proper classification of a taxpayer’s income, we will consider the “primary nature” of the taxpayer’s activities. If the primary nature of the taxpayer’s activities was the transmission for hire of data via a telephone network or similar transmission system, including a satellite transmission system, the taxpayer’s income would be subject to retailing B&O tax, and the taxpayer would be required to collect retail sales tax from its customers. In contrast, if the primary nature of the taxpayer’s activities was the use of computer hardware or software to furnish information or data, the taxpayer’s income would be subject to service B&O tax. Where the furnishing of the satellite-based communication network is the “real object” of the transaction, and positioning information is merely incidental to the communication service being rendered, the income is properly classified under the retailing classification.

[2] RULE 245; RCW 82.04.065: MEASURE OF TAX – BIFURCATION – SINGLE, INTEGRATED ACTIVITY. The measure of the retailing B&O tax must be limited to transactions billed to the taxpayer’s Washington customers. Where the taxpayer’s transactions involved the transmission of data from the customers’ trucks to a satellite, from the satellite to the taxpayer’s center, and from the center to the customers’ dispatch centers but all of these elements

comprised a single, functionally integrated, activity, or a single “call” for purposes of Rule 245, bifurcation was not allowed.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

STATEMENT OF THE CASE:

C. Pree, A.L.J -- A taxpayer engaged in the business of selling a satellite-based tracking and communications system that includes instant messaging and position reporting between vehicles in transit and their dispatch centers petitions for correction of assessment. The Audit Division determined the taxpayer’s income derived from network telephone services and assessed retail sales tax and retailing B&O tax on the taxpayer’s income. The taxpayer contends its income should be taxed under the service classification as either information or internet service. We conclude that the taxpayer’s income is properly taxed under the retailing classification as network telephone service. We further conclude that the measure includes all transactions billed to Washington customers which originate or terminate at the Washington customer’s dispatch center or trucks. Accordingly, we deny the taxpayer’s petition.¹

ISSUES:

1. Is the provision of a satellite-based tracking and communications system that includes instant messaging and position reporting between vehicles in transit and their dispatch centers properly classified as network telephone service or information or internet service?
2. What is the measure of the tax?

FINDINGS OF FACT:

The taxpayer is engaged in the business of selling [a] service (hereafter, “the service”).² Its principal place of business is [outside the State of Washington].

The service provides customers with a satellite-based tracking and communications system that includes instant messaging and position reporting between vehicles in transit and their dispatch centers. . . . The service relies upon data originating from the customers’ trucks and dispatch centers, as well as information the taxpayer provides. The service allows transportation companies to maximize the use of their vehicles and drivers to haul loads more efficiently and safely.

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

² The taxpayer also sold hardware and software relating to these services. To the extent these sales were subject to Washington taxation, the taxpayer does not dispute that these sales were properly classified under the retailing classification.

The Audit Division of the Department of Revenue reviewed the taxpayer's records for the period of January 1, 1998, through September 30, 2001, and issued an assessment comprised of retail sales tax of \$. . . , retailing B&O tax of \$. . . , and interest of \$ The taxpayer paid the assessment, which totaled \$. . . , plus additional interest and penalties, and requests a refund. Additionally, the taxpayer requests refund of additional amounts reported and paid under the retailing classification and retail sales tax on the taxpayer's excise tax returns through December 31, 2001.

In addition to providing a vehicle positioning service, the service provides two-way messaging services, via telephone service and satellite, from the customer's vehicles' dispatch centers to the vehicles. The vehicles are equipped with [a unit], which is a mobile display unit and antenna communications unit that the customers purchase from the taxpayer. The [units] have a keyboard and screen, which enable drivers to type and read messages. The [units] contain terminal applications and modem software necessary for using the service. In addition, as a prerequisite for obtaining the service, the taxpayer's customers must purchase a software license, to be used at its dispatch center, from the taxpayer.

The customer's drivers type messages to the customer's dispatch into the [unit], similar to typing an e-mail message. The message is then sent from the truck directly to a satellite. The satellite then sends the message to the [taxpayer's center]. When the message is received at the [taxpayer's center], it is temporarily stored. The data is processed at the [taxpayer's center] and additional independent information from the [taxpayer's center] is added. Such information includes the location of the vehicle and time and date stamps. The taxpayer determines the location of the vehicle based on its proprietary technology; it is not based on information contained in data messages from the vehicle. The vehicle position is determined by calculations that occur at the [taxpayer's center]. A position is sent with every electronic message. If a message is not sent within one hour, an automated position report is sent by itself. From the [taxpayer's center], the message is sent by modem or internet to the customer's dispatch center. When sent by modem, the message is sent via an 800 number or direct dial phone number into the dispatch office. If the message is sent by internet connection, a direct connection is used via the IP address.

The messages from the customer's dispatch center to a truck are relayed in the reverse order. Specifically, the customer types a message from a dispatch center personal computer. The message is sent via modem or internet connection to the [taxpayer's center]. The message is then sent on to a satellite, which then sends the message to the recipient vehicle.

At the [taxpayer's center], the data is reformatted to allow for subsequent customer access.³ Because the service uses "store and forward" protocols for data transmission, a customer need

³ Customers typically access this data by dialing the [taxpayer's center] via a third party ground telecommunications line, such as a leased line or frame relay through the Internet.

not maintain a constant link between its dispatch center and the [taxpayer's center]. For example, customers using a dial-up or internet connection can periodically access the [taxpayer's center] to retrieve stored data, without maintaining a constant connection. The messaging and position location data generated by the customer's use of the service is the property of the customer. The customer establishes the data retention requirements and is responsible for long-term data storage

....

... The service allows the taxpayer's customers to track vehicles en route to a site for pickup or delivery. It also allows the taxpayer's customers to determine the date and time when a vehicle has arrived at a site for pickup, when the vehicle is loaded, when the vehicle is leaving the pickup site, when the vehicle has arrived at a site for delivery, when the vehicle has unloaded, and when the vehicle is leaving the delivery site. The service allows the taxpayer's customers to maximize the use of tractors and trailers to prevent the hauling of empty trailers and to reroute vehicles to improve delivery times. The service further allows the taxpayer's customers to perform proactive repairs and maintenance on the vehicles and to identify unsafe driving habits by monitoring engine data, such as speed, RPMs, idle time, distance traveled, and fuel consumption.

For customers with automated dispatch systems, the service may be integrated directly into the customers' dispatch software, as well as accounting and payroll systems. In addition, customers with automated dispatch systems can use "macros," which are preformatted templates. A macro can automatically fill in and send arrival and departure information to the [taxpayer's center] by integrating the customer's automated dispatch software with the service. In addition, data generated by the truck or dispatch computer can be fed into the customer's business systems to assist the customer in the preparation of payroll, fuel tax determinations, issuance of invoices, and other services.

A communications link . . . is required for the taxpayer's customers to access the data. Customers can arrange separately for their ability to access the [taxpayer's center] through their own Internet access or local dial-up service. Alternatively, customers can arrange to use the taxpayer's 800 line for a separate charge. In addition, the taxpayer arranged for third party communication links for some of its customers and separately billed them for these charges. . . . The taxpayer's contract with its customers makes the customers responsible for the charges for the link between their dispatch centers and the [taxpayer's center]. If the customer chooses an internet link, the customer acknowledges that the taxpayer is not responsible for any break in service due to the customer's lack of internet access. If the customer chooses a dial-up or 800 service, the taxpayer [states that it has no warranty obligations with respect to the telephone ground link; however, it agreed to pass through to the customer any warranties provided by others.]

Under the taxpayer's contract with its customers, customers may choose a base plan . . . or enhanced plan The base plan charge includes no messaging, but provides one automatic position poll per hour per [unit]. The enhanced plan includes one automatic position poll per hour per [unit], plus . . . messages per month per [unit]. Under either plan, customers may purchase

additional messaging Position polls are provided with each additional message purchased. Customers may also purchase additional position polls (without messaging The taxpayer also provides [additional messaging services] for additional charges. All of these charges are at issue.

During the audit period, the taxpayer reported and paid retailing B&O and retail sales tax on the service charges billed to customers whose headquarters and trucks were in Washington, which was approximately . . . of its total billings to Washington customers. The taxpayer reasoned that it was providing a network telephone service that . . . either (i) originates from the mobile units on the trucks and terminates at the out-of-state [taxpayer's center] or (ii) originates from the out-of-state [taxpayer's center] and terminates at the mobile unit on the truck. In issuing the assessment, the Audit Division similarly concluded the taxpayer's sale of the messaging services was subject to retail sales tax as network telephone service. However, the Audit Division included 100% of taxpayer's charges to Washington headquartered customers in its retailing B&O tax and retail sales tax measure.

The taxpayer paid the assessment and petitions for refund. On appeal, the taxpayer argues that its services are properly classified as information or internet services, subject to service B&O tax. The taxpayer reasons that while its use of network telephone service is necessary to the provision of the taxpayer's service, it is not the primary nature of its activity. The Audit Division, on the other hand, reasons that while the taxpayer may separately bill for the messaging and telephone line charges, it cannot provide one service without the other, *i.e.*, both are necessary for the message to complete its journey between the vehicle and dispatch center.

ANALYSIS:

1. Is the provision of a satellite-based tracking and communications system that includes instant messaging and position reporting between vehicles in transit and their dispatch centers properly classified as network telephone service or information or internet service?

[1] In determining the proper classification of the taxpayer's income, we will consider the "primary nature" of the taxpayer's activities. *See, e.g.*, ETA 544.04.08.245 (ETA 544); Det. No. 04-0023E, 23 WTD 206 (2004). ETA 544 explains, "The Department considers the primary nature of the activity in establishing the tax classification applicable; incidental services of a possibly different classification, unless clearly identified and billed, will not affect the tax classification so established." Thus, the ETA concluded, a telephone answering service is not generally engaged in network telephone business activities, even though some of the activities it performs, when isolated from the primary or general business activity, would satisfy the retail sale definition.

Accordingly, we must determine whether the primary nature of the taxpayer's service is an information or internet service or a network telephone service.

Gross income from “computer services” is subject to tax under the service classification. WAC 458-20-155 (Rule 155); *see* RCW 82.04.290. Rule 155 defines “computer services” as “every method of providing information services through the use of computer hardware and/or software.” Rule 155, in turn, defines “information services” as follows:

every business activity, process, or function by which a person transfers, transmits, or conveys data, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium.

The term does not include transfers of tangible personal property such as computer hardware or standard prewritten software programs. Neither does the term include telephone service defined under RCW 82.04.065 and WAC 458- 20-245. . . .

Generally, persons rendering “telephone service” to consumers are taxable under the retailing classification and are required to collect retail sales tax from their customers. *See* RCW 82.04.065; WAC 458-20-245 (Rule 245). Telephone services include “network telephone service,” which is defined as follows:

“Network telephone service” means the providing by any person of access to a telephone network, . . . , or the providing of telephonic, . . . , data, or similar communication or transmission for hire, via a telephone network, toll line. . . , or similar communication or transmission system. “Network telephone service” includes the provision of transmission to and from the site of an internet provider via a telephone network, toll line . . . , or similar communication or transmission system.

RCW 82.04.065; *see also* Rule 245.

Thus, as the Audit Division contends, if the primary nature of the taxpayer’s activities was the transmission for hire of data via a telephone network or similar transmission system, including a satellite transmission system,⁴ the taxpayer’s income would be subject to retailing B&O tax, and the taxpayer would be required to collect retail sales tax from its customers. In contrast, if the primary nature of the taxpayer’s activities was the use of computer hardware or software to furnish information or data, the taxpayer’s income would be subject to service B&O tax. *See* Det. No. 90-128, 9 WTD 280-1 (1990).

The taxpayer argues its service “epitomizes the definition of ‘information services’” because it uses computer hardware and software and transfers, transmits, or conveys data facts, knowledge, procedures, and the like regarding the operational and logistical details of a trucking fleet to the [taxpayer’s center] for access by the customer’s dispatch center. While the taxpayer acknowledges

⁴ *See* Det. No. 88-193, 5 WTD 347 (1988); Det. No. 92-363, 12 WTD 519 (1992).

that the use of network telephone services is necessary to the provision of the taxpayer's services, the taxpayer argues its service is not, itself, a telecommunication service; instead it is a vehicle positioning, messaging, and information management service.

The taxpayer cites Det. No. 98-202, 19 WTD 771 (2000), in support of its argument that the fact that it uses telephone lines to transmit data does not change the "true object" of its service from information services to network telephone services. Det. No. 98-202 involved a travel agency that used a computer to make reservations. The monthly fee it paid included "communication support," which was a charge for having access to the reservation system and database. The reservation system allowed the taxpayer to receive current information on airline, hotel, and rental car availability and prices and to book the reservation with the service provider. The monthly charge for communication support included the cost of telephone lines necessary to connect the taxpayer's terminal to the reservation system. The Audit Division assessed retail sales tax on the travel agency's entire payment to the reservation service because it contended that the inclusion of the telephone line charges converted the entire charge to network telephone services. However, in Det. No. 98-202, the Department concluded that the communication support charge was properly classified under the service classification because it involved a charge for providing computer services. The Department further concluded that the telephone line charges were only incidental to the services the taxpayer received and could not be bifurcated and taxed separately from the "true object" of the transaction, which was the ability to access the information in the reservation system to make reservations.

We conclude that Det. No. 98-202 is not analogous to the facts here. Specifically, unlike the reservation system, which allowed access to a database of information from which to make reservations, the taxpayer's service provides the medium for trucks and dispatch centers to communicate and send data originating on the trucks to the dispatch center.

As we explained in Det. No. 90-128:

In carving out an exception for telephone service from the definition of information services, the Department has drawn a distinction between those persons who are engaged in the business of furnishing a particular medium over which data is transmitted and those furnishing the data or information services being transmitted. Those engaged in the business of providing the means by which data is communicated are treated as making a sale, while those furnishing the data or processing it are providing a personal service.

As in the present case, the line is not always clear as to whether a transaction is a sale or a service. The examination must focus upon the real object of the transaction sought by the taxpayer's customers and not just its component parts.

Here, we conclude that the furnishing of the satellite-based communication network is the "real object" of the transaction, and the positioning information is merely incidental to the

communication service being rendered. The taxpayer transmits data or information for hire. The Taxpayer's customers supply the data or information, and the taxpayer's satellite communication system transmits the data between the customer's truck and dispatch center. . . .

In reaching this conclusion, we find *Western Telepage, Inc. v. City of Tacoma*, 140 Wn.2d 599, 998 P.2d 884 (2000), persuasive. At issue in that case was whether the taxpayer's provision of paging services was subject to tax as network telephone services. The paging service transmitted numeric and alpha-numeric messages to customers. Generally, a numeric message was transmitted in response to a telephone call made to a customer's pager access number; a telephone company would then transmit the call to the taxpayer's paging terminal. Alpha-numeric messages were prompted by messages sent to the paging terminal via modem, dictation to a live operator, and e-mail. For either numeric or alpha-numeric messages, the taxpayer's paging terminal sent a microwave (radio) transmission to the pager device, advising the caller to return a call to the specified telephone number or transmitting the brief alpha-numeric message. The court concluded such services were properly classified as network telephone services because they transmitted data or similar communication by microwave. In other words, the taxpayer provided the medium over which the data was communicated. Similarly, the taxpayer's services here primarily provide the medium for the transmission of messages.

Finally, Det. No. 88-193, 5 WTD 347 (1988),⁵ which the Audit Division cited in support of its position, also supports the conclusion that the taxpayer's income derived from network telephone service. In that determination, the taxpayer received its income from transmitting data from an earth station to a satellite and from a satellite to a hub. Like the taxpayer in *Western Telepage*, the taxpayer in Det. No. 88-193 provided the medium for transmitting data, and we concluded the taxpayer's income was properly taxed as network telephone service. Similarly, as noted above, we conclude that the primary nature of the taxpayer's service is the provision of the medium for the transmission of messages.

. . . Based on the information before us, we conclude that the Audit Division properly classified the taxpayer's income as network telephone service.

2. What is the measure of the tax?

[2] During the period at issue, RCW 82.04.065 provided, "Network telephone service' includes interstate service, including toll service, originating from or received on telecommunications equipment or apparatus in this state if the charge for the service is billed to a person in this state." Further, Rule 245 explains:

[A] sale takes place in Washington when a call originates from or is received on any telephone or other telecommunications equipment, instrument, or apparatus in

⁵ See also Det. No. 92-363, 12 WTD 519 (1992).

Washington and the cost for the telephone service is charged to that equipment, instrument, or apparatus, regardless of where the actual billing invoice is sent.

Both the taxpayer and Audit Division agree that the measure must be limited to transactions billed to the taxpayer's Washington customers. However, they disagree as to whether each communication between a customer's vehicle and dispatch center is a single transaction, as the Audit Division contends, or whether it is two separate transactions, as the taxpayer contends. The taxpayer argues that data is transmitted between a customer's vehicle and the [taxpayer's center] via a satellite. The data is then accessed by the customer from the [taxpayer's center] via a separate land-based communication service that is not part of the service at issue. Thus, the taxpayer argues:

There are two distinct and separate communication streams: the satellite transmission and land-based transmission. These two communication streams are not included in the same charge. . . .

Since one end of any satellite transmission is always the taxpayer's out-of-state [taxpayer's center], and the other is always the customer's vehicle, a satellite transmission can only originate or terminate in Washington if the transmission originates or terminates at a customer's truck when in Washington.

The Audit Division reasoned that each communication was a single transaction because

[O]ne charge [sic] does not exist without the other. If the message is sent into the [taxpayer's center], either from the truck or from the dispatch center, it must be sent to its final destination, otherwise, the message would sit in the [taxpayer's center] and be undeliverable. . . . Although the messaging fees and the [communication link] fees are billed separately, the charges are dependent on each other and are both viewed as network telephone services.

We agree with the Audit Division. Essentially the taxpayer is engaged in a single activity—providing communication between customers' trucks and their dispatch centers—that is not subject to bifurcation. We applied this reasoning in Det. No. 00-159E, 20 WTD 372 (2001), where we concluded that where the taxpayer's network provided a computer data protocol conversion service in addition to transmitting data and information over its network to another computer, the true object of the service was the transmission of data and information. We reasoned:

[B]ifurcation is not allowed as a matter of law if the activity is essentially a single activity, even if the contract may provide a basis for determining the value of the various activities performed under the contract. If the services are functionally integrated, then the entire contract price

is subject to tax at a single rate. *See Chicago Bridge and Iron v. Department of Rev.*, 98 Wn.2d 814, 659 P.2d 463, *appeal dismissed*, 464 U.S. 1013 (1983).

In this case, Taxpayer's protocol conversion services are additional services that allow the customer's transmitted data or information to interact with the receiving computer. It is functionally integrated with the transmission activities performed by Taxpayer's shared wide-area computer network. As such, it is an integral part of the transmission activity and cannot be bifurcated from what is essentially a single activity. This is true, even though the contract may or may not provide a basis for determining the value of the protocol conversion activity alone.

Applying this analysis, we conclude that the "true object" of the taxpayer's service was the transmission of data from its customers' dispatch centers to their trucks, and vice versa. We recognize that the transactions involved the transmission of data from the customers' trucks to the satellite, from the satellite to the [taxpayer's center], and from the [taxpayer's center] to the customers' dispatch centers. However, all of these elements comprised a single, functionally integrated, activity, or a single "call" for purposes of Rule 245, and bifurcation is not allowed.

Because the Audit Division properly included all transactions billed to Washington customers, we deny the taxpayer's petition on this issue.

CONCLUSIONS OF LAW AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 30th day of December 2005.