Cite as Det. No. 94-071, 14 WTD 232 (1995).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 94-071
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 245; RCW 82.04.050(5), 82.04.065, AND 82. 08.0289: RETAIL SALES TAX -- NETWORK TELEPHONE SERVICES -- LOCAL SERVICE -- INTRASTATE SERVICE. Except for local telephone service charged to a residential account, all charges by an operator service for access to a local telephone network are subject to retail sales tax. All calls charged through an operator service for access to an intrastate toll service are subject to retail sales tax, even if charged to an out-of-state residential or commercial account.

[2] RULE 245; RCW 82.04.065: RETAIL SALES TAX -- NETWORK TELEPHONE SERVICE -- INTERSTATE SERVICE. In accordance with the Commerce Clause, it was the intent of the legislature that only those interstate calls which originate or terminate in Washington and are charged in Washington are subject to retail sales tax.

[3] RULE 245; RCW 82.04.065: RETAIL SALES TAX -- NETWORK TELEPHONE SERVICE -- RULE CONSTRUCTION. The language in Rule 245 concerning calls charged to an apparatus in Washington applies only to interstate calls.

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.

NATURE OF ACTION:

A company which handles local and long distance telephone traffic and billing for hotels, motels, and hospitals protests assessment

of retail sales tax on its services and the disallowance of deductions for commissions paid to its clients.[1]

FACTS:

Mahan, A.L.J. -- The taxpayer describes itself as an "operator service provider" or "OSP" which provides operator services for hotels and for owners of pay phones where the customer is not able to provide its own services. Typically, a guest makes a call and the taxpayer acts as the operator on the call. It does not own the transmission lines or any part of the telephone network. The taxpayer sends all data regarding the call -- that is, where the call came from, where the call was received, where to bill, whether the call was collect or by credit card, and the time involved -- to a billing aggregator. The billing aggregator sends the information to the billing party's phone company, which bills for the call. The funds collected by the phone company are sent to the billing aggregator, who then provides the funds to the taxpayer. A certain portion of the gross receipts are paid to the taxpayer's customers, limited only by any applicable state or federal tariff. The taxpayer pays all expenses related to the call, including any payment to long distance network providers.

The taxpayer was audited for the February 1, 1987 through September 30, 1991 period. The Department assessed additional taxes and interest. The taxpayer protests Schedule II, concerning future instructions on what calls are subject to retail sales tax, and Schedule III, concerning disallowed deductions of commissions paid to the taxpayer's customers.

With respect to Schedule II, in 1988, the taxpayer received a letter from the Taxpayer Information and Education Division regarding which calls were subject to retailing or wholesaling B&O tax in accordance with WAC 458-20-245 (Rule 245). The auditor disagreed with that letter and, for future reporting purposes, instructed the taxpayer that additional calls were subject to tax. The following matrix indicates which calls the auditor instructed the taxpayer were subject to retailing or wholesaling B&O tax:

CALL ORIGINATES	CALL TERMINATES	CALL CHARGED	SALES TAX
1. Wa	Wa	Wa	Yes
2. Wa	Other	Wa	Yes
3. Wa	Wa	Other	Yes
4. Wa	Other	Other	No

[1]Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

5. Other	Other	Wa	No
6. Other	Wa	Wa	Yes
7. Other	Wa	Other	No

The taxpayer does not dispute the fact that it is providing a telephone service. Rather, it first argues that none of its income is subject to tax because no sale took place in Washington as defined under Rule 245. It further argues that under Rule 245 scenario no. 3 above is not taxable because there was no charge to a person in this state.

The taxpayer further argues that the commissions that it pays to its customers should be deducted either as being similar to the sharing of income in an interstate revenue pool as defined under Rule 245 or as an advance or reimbursement under WAC 458-20-111 (Rule 111).

ISSUES:

1. Whether the taxpayer's activities are subject to tax under Rule 245 as a telephone service where there is no charge to the equipment, instrument, or apparatus from which the call originated.

2. Whether the above matrix accurately represents the calls which are taxable under Rule 245.

3. Whether the taxpayer can deduct payments to its customers of their share of the gross income received from the payment of telephone charges.

DISCUSSION:

1. Telephone Services.

[1] RCW 82.04.050(5) provides that the term retail sale includes the "providing of telephone service". Telephone service is defined at RCW 82.04.065(3) to include "competitive telephone service" and "network telephone service". Those terms are further defined as follows:

> (1) "Competitive telephone service" means the providing by any person of telecommunications equipment or apparatus, or service related to that equipment or apparatus such as repair or maintenance service, if the equipment or apparatus is of a type which can be provided by persons that are not subject to regulation as telephone companies under Title 80 RCW and for which a separate charge is made.

> (2) "Network telephone service" means the providing by any person of access to a local telephone network, local telephone network switching service, toll service, or coin telephone services, or the providing of telephonic, video, data, or similar communication or transmission for hire, via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. "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. "Network telephone service" does not include the providing of competitive telephone service, the providing of cable television service, nor the providing of broadcast services by radio or television stations. (Emphasis added.)

RCW 82.04.065.

Rule 245 repeats these definitions and discusses the B&O tax and retail sales tax liability of companies which provide telephone services.

As defined, the telephone services subject to the retail sales tax are not limited to services provided by telephone companies. By its terms the law applies to "any person".

In Det. No. 88-378A, 8 WTD 427 (1989), a hotel provided telephones, telephone equipment, and access to local and long distance phone networks to guests at cost-plus rates. We held:

> After reviewing the facts in this case, and the June 26, 1989 letter of the taxpayer's accountant, we find that the taxpayer's telephone activities vis-a-vis its guests constitute that of a retail "telephone business." The taxpayer provides a "network telephone service" by accessing for its guests "local telephone network(s)," "local telephone network switching service(s)," and "toll service(s)" including interstate communications billed locally.

Accordingly, the providing of "access" or "transmission for hire" through a telephone network by "any person" gives rise to a retail sale.

[2] Under both the statute and the definitions in the rule a distinction is made between local or intrastate transmissions and interstate transmissions. Within the context of interstate sales, such sales cannot violate the Commerce Clause of the United States Constitution, Art. I, § 8, Cl. 3. In order not to unduly burden interstate commerce, only those interstate transmissions which originate or are received in Washington and

are charged in Washington are subject to tax. See Goldberg v. Sweet, 488 U.S. 252 (1989) (Washington is "a state which taxes the origination or termination of an interstate telephone call billed or paid within that State."). The same concerns do not exist for transmissions which are purely local or intrastate in nature. Accordingly, under the statutory framework, almost all intrastate and local network access charges are subject to retail sales tax.[2] In contrast, not all interstate toll and network access charges are subject to tax.

Applying the statute and definitions set forth in the rule, calls under scenario no. 1 in the above matrix are generally subject to retail sales tax. However, charges for local (non-toll) calls when charged to a residential number, as opposed to a commercial account, are not subject to tax. See fn. 1, supra. Under scenario no. 3, with the exception of charges for local calls charged to a residential number, retail sales tax should be collected and remitted. Such calls involve purely intrastate calls and do not raise any Commerce Clause concerns. This is true even if the calls are billed to an out-of-state telephone apparatus or person. Det. No. 92-015, 12 WTD 057 (1992). Nos. 2 and 6 on the matrix involve calls which either originate or terminate in Washington and are charged in Washington. As such, those calls are subject to retail sales tax. Nos. 4, 5, and 7 on the other hand do not meet the criteria for the imposition of tax on interstate calls.

[3] The taxpayer relies on a portion of Rule 245 in arguing that there was no sale of telephone services because its customers had no specific charge made to telecommunications equipment in this state. In this regard, Rule 245 in part provides that "a sale [for B&O tax purposes] takes place in Washington when a call originates from or is received on any telephone or other telecommunications equipment, instrument, or apparatus in 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."
We cannot construe the sentence relied on by the taxpayer in isolation and must look at the rule in its entirety. We construe rules in the same manner as statutes. The language of a statute must be read in context with the entire statute and construed in a manner consistent with the general purpose of the statute. Graham v. State Bar Ass'n, 86 Wn.2d 624, 627, 548 P.2d 310

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[2]RCW 82.08.0289 provides that retail sales tax does not apply to "Network telephone service, other than toll service, to residential customers." This language has been construed as exempting local calls from coin operated telephones which are billed to residential credit cards. Det. No. 92-015, 12 WTD 057 (1992).

(1976). Under certain circumstances, the "spirit or intention" must prevail over the letter of the law. State v. Brasel, 28 Wn. App. 303, 309, 623 P.2d 696 (1981).
Read in context it is clear that the language relied on by the taxpayer concerns only interstate transmissions and not all telephone services. To construe the sentence as applying across the board would result in much of the definition section as being superfluous and meaningless and would violate the spirit and intention of the statute. If we accepted the taxpayer's construction, no local call service would ever be subject to tax because such calls do not generally result in a charge to a specific apparatus. Yet the statute and rule address "access to a local telephone network, local telephone network switching service . . . ." Obviously the reach of the statute and the rule is much broader than specific toll charges to apparatus in Washington.

Rule 245 goes on to provide that the "tax shall also apply to the gross proceeds of sales of network telephone service, other than interstate and intrastate toll service, measured by total gross billings to customers." This language also would have been unnecessary if the sentence relied on by the taxpayer controlled all transmission, both local and interstate. Thus, we construe the language relied on by the taxpayer as applying only to interstate calls and not to local and intrastate calls.[3]

2. Deduction of Fees and Commissions.

With respect to the deduction of payment of fees or commissions to its customers, we cannot find in favor of the taxpayer. RCW 82.04.220 imposes the B&O tax "for the act or privilege of engaging in business activities" in Washington. "Business . . . is a broad and virtually all-encompassing commercial activity." Budget Rent-A-Car, Inc. v. Department of Rev., 81 Wn.2d 171, 173, 500 P.2d 764 (1972). It "includes all activities engaged in with the object of gain, benefit, or advantage." RCW 82.04.140.

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[3]Within the rule there is a variation in language regarding charges in Washington. Whereas the definition section of the rule (and the statute) refer to a call "billed to a person in this state", the rule also refers to a call "charged to that equipment, instrument, or apparatus, regardless of where the actual billing invoice is sent." No issue has been raised on this variation and we do not otherwise address it here. For practical purposes for this taxpayer there is no distinction on credit card charges on interstate calls which originate or terminate in Washington.

The B&O tax is based on "gross income of the business" without any deduction for "fees," "commissions," or other expenses. RCW 82.04.080. Thus, the taxpayer cannot deduct the fees or commissions paid to its customers in determining the measure of its tax.

3. Revenue Pool/Advances and Reimbursements.

With respect to the sharing of the revenue pool of interstate carriers under Rule 245, that Rule specifically provides that "Persons who are not members of the interstate or intrastate division of revenue pool but who receive shared interstate or intrastate revenue through a member of the division of revenue pool, are liable for business and occupation tax on the income received." Because the taxpayer is not a member of the revenue pool, it is liable for B&O tax on its gross revenues without any deduction for a payment to others who are also not members of the pool.

The taxpayer also cannot deduct the payments to the long distance carriers as an advance or reimbursement on behalf of its clients. In general Rule 111 addresses when payments may be deducted as an advance or as a reimbursement. In relevant part it provides:

> The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.
>
> The word "reimbursement" as used herein, means money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client.
>
> The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.
>
> There may be excluded from the measure of tax amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.
>
> The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the

> taxpayer in carrying on the business in which the taxpayer engages.

In order for there to be an advance or reimbursement under this rule, the payments by the taxpayer must: 1) be made as part of the regular and usual custom of the taxpayer's business or profession, 2) be for services to the customer which the taxpayer does not or cannot render, and 3) not involve fees or costs for which the taxpayer is personally liable, either primarily or secondarily, except as the customer's agent. Rho Co. v. Department of Rev., 113 Wn.2d 561, 567-568, 782 P.2d 986 (1989), citing, Christensen v. Department of Rev., 97 Wn.2d 764, 769, 649 P.2d 839 (1982).

Here the taxpayer is billed directly for the long distance carrier's charges and it remains primarily or secondarily liable for those charges. It cannot deduct those payments as an advance on behalf of its clients.

DECISION AND DISPOSITION:

The taxpayer's petition is denied. The instructions from the auditor for future reporting are correct, subject to the further clarification regarding local calls charged to a residential number.

DATED this 14th day of April, 1994.