Cite as Det. No. 94-116, 15 WTD 26 (1995).

BEFORE THE INTERPRETATIONS 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. 94-116
. . .	)	Registration No. . . .
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RULE 195; RCW 82.04.065: RETAIL SALES TAX -- B&O TAX MEASURE -- MUNICIPAL TAXES -- CELLULAR PHONE SERVICE. Receipts attributed to municipal taxes imposed upon cellular phone companies and separately stated on their invoices were properly included in the gross proceeds of sales from providing telephone service in measuring Business & Occupation and retail sales taxes.

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:

An affiliate group of cellular phone companies protest the assessment of retail sales tax and business and occupation (B&O)

tax on the portion of their charges which they attribute to municipal taxes.[1]

FACTS:

Pree, A.L.J.-- The taxpayers are all cellular phone companies doing business in Washington.

In their petition, the taxpayers protested the assessment of retail sales tax and retailing B&O tax on the portion of the payments they received from customers which they attributed to municipal utility taxes. The taxpayers contend that the recovery of municipal taxes from their customers are excluded from the definition of "retail sale" and not taxable under the B&O tax. In the alternative, the taxpayers argue that "collecting and paying over municipal utility taxes" is properly classified as a miscellaneous service business rather than a retailing activity.

The taxpayers' positions are based on their assertions that they are engaged in the business of collecting municipal utility taxes and that activity is separate and distinct from providing "telephone service." They contend that any business activity should be subdivided into its parts, rather than the primary activity.

The taxpayers indicate that their customer agreements provide how the prices for cellular service are determined including a provision that states:

> Any applicable sale, use, public utility, gross receipts or other taxes imposed on us as a result of providing the Service or the unit to you will be added to your charges when imposed or required by law, and any such taxes, fees, or charges we pay will be reimbursed by you.

The taxpayers separately state these tax amounts on invoices to their customers. They outlined the steps in this process in a supplemental memorandum:

> I.A. Writing the computer programming for the customer billing process to allow for coding of customer records such that only selected customers and services are charged with municipal utility tax;[2]

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

[2] Excluded customers include those who have billing addresses outside a taxing jurisdiction and those who purchase

> I.B. Writing computer programming such that the tax rates for various municipalities may be encoded and tax calculated appropriately;
>
> I.C. Printing the amount of tax charged separately on customer invoices;
>
> I.D. Collecting tax and accounting for it internally as a "Tax Payable"; and
>
> I.E. Remitting the tax to the municipalities with periodic returns.

The taxpayers argue that these functions do not fall within the statutory definition of "network telephone service," nor within any other subdivision of the definition of retail sale. The taxpayers claim this activity is exempt under RCW 82.04.419. In the alternative, they claim that the activity falls within the catch-all "service and other business" classification of RCW 82.04.290.

The taxpayers ask us to focus on the definition of "business" under RCW 82.04.140 which provides:

> "Business" includes all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.

The taxpayers suggest that business activities can be distinguished based upon the "object" (or purpose) of the activity and who benefitted by the activity. Providing cellular service benefits both the taxpayers and their customers. Collecting municipal taxes does not benefit the customers because, the taxpayers state, "they receive no additional service for this expense." Under this reasoning, the taxpayers conclude these activities are distinct.

The taxpayers indicate that the Seattle tax is typical. Seattle Ordinance No. 5.48.050 imposes an occupation tax, providing in part:

> Upon everyone engaged in or carrying on a telephone business, a fee or tax equal to six and three-tenths percent (6.3%) of the total gross income from such business in the city . . .

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services at wholesale. Excluded services include interstate calls and equipment-related services.

The taxpayers state that they are not legally required to collect this tax from their customers. From that they reasoned that collection of these taxes is not incidental to providing cellular telephone service.

The taxpayers contend that the collection activity must be treated separate and distinct from the cellular telephone service relying on holdings in Washington Supreme Court cases which classified interest received differently than the underlying purchases. Rena-Ware Distribs., Inc. v. State, 77 Wn.2d 514, 463 P.2d 622 (1970); citing Clifford v. State, 78 Wn.2d 4, 469 P.2d 549 (1970); Department of Rev. v. J.C. Penney Co., 96 Wn.2d 38, 633 P.2d 870 (1981); and Weyerhaeuser v. Dept. of Rev., 106 Wn.2d 557, 723 P.2d 1141 (1986). The taxpayers also rely on an Appellate court holding that separate charges putting electrical lines underground did not fall within the definition of "light and power business." See City of Seattle v. State, 12 Wn. App. 91, 527 P.2d 1404 (1974).

The taxpayers seek to distinguish their argument from the holdings in Canteen Service, Inc. v. State, 83 Wn.2d 761, 522 P.2d 847 (1974) and Public Utility Dist. No. 3 v. State (PUD of Mason County), 71 Wn.2d 211, 427 P.2d 713 (1967). These cases held that the measure of tax included taxes imposed on the taxpayers that they passed on to their customers. Here the taxpayers argue that the issue is not the measure of tax, but the separation of activities.

ISSUE:

May the taxpayers exclude receipts that they attribute to collection of municipal utility taxes?

DISCUSSION:

There is no dispute that the taxpayers are engaged in providing cellular service. Nor is there a dispute that the activity is included in the definition of "network telephone service" under RCW 82.04.065. As such it falls under the definition of "Sale at Retail" under RCW 82.04.050(5). RCW 82.04.250 provides that the measure of tax with respect to such business shall be equal to the gross proceeds of sales of the business. RCW 82.04.070 defines "Gross proceeds of sales" as:

> . . . the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

The Washington Supreme Court interpreted similar language in Chapter RCW 82.16 to include municipal taxes. Public Utility Dist. No. 3 v. State (PUD of Mason County), 71 Wn.2d 211, 213, 427 P.2d 713 (1967).

The taxpayers received the total amount stated on their invoices. While they labeled and attempted to characterize a portion of their receipts as the collection of municipal taxes, the municipalities impose the taxes on the cellular service providers, not their cellular customers. They may not provide cellular services within those jurisdictions without incurring the municipal taxes.
WAC 458-20-195(c) (Rule 195) provides in part:

> (C) OTHER TAXES. The amount of taxes collected by a taxpayer, as agent for the state of Washington or its political subdivisions, or for the federal government, may be deducted from the gross amount reported. Such taxes are deductible under each tax classification of the Revenue Act under which the gross amount from such sales or services must be reported.
>
> This deduction applies only where the amount of such taxes is received by the taxpayer as collecting agent and is paid by the agent directly to the state, its political subdivisions, or to the federal government. When the taxpayer is the person upon whom a tax is primarily imposed, no deduction or exclusion is allowed, since in such case the tax is a part of the cost of doing business. The mere fact that the amount of tax is added by the taxpayer as a separate item to the price of goods he sells, or to the charge for services he renders, does not in itself, make such taxpayer a collecting agent for the purpose of this deduction.

(Emphasis supplied.)

Clearly, receipts for providing the cellular service are retail sales and no deduction may be taken for taxes imposed upon the taxpayers such as those under Seattle Ordinance No. 5.48.050. The taxpayers are legally obligated to pay the municipal taxes at issue. The legal incidence of a tax falls upon the person or entity who has the legal obligation to pay the tax. Canteen Service v. State, 83 Wn.2d 761, 762, 522 p.2d 847 (1974). However, the taxpayers are not seeking a deduction. Rather the taxpayers seek exclusion of those receipts that they attribute to be from collecting municipal taxes.

While the taxpayers may label the charges on their invoices as taxes imposed on their customers, clearly the municipal taxes included in the assessments were imposed upon the taxpayers for providing the cellular service to their customers, a retail sale.

The customers purchased the cellular service only. The municipal taxes separately stated on the invoices were not imposed on the customers. The taxpayers only passed these costs on to their customers in their invoices. Any business may itemize its expenses and pass them on to customers through increased charges attributable to those expenses. The retail receipts of the business, however, are still measured under RCW 82.04.070.

Each of the cases relied upon by the taxpayers as authority for separate classification of different activities provided by companies involved instances where the customers separately agreed to pay an additional charge for an additional service. The customers had the option of purchasing the retail item without the service activity. For instance in Rena-Ware, customers purchased cookware, a retail sale. If they opted to pay installments, the finance charges were classified under the catch-all service classification. Similarly, Clifford, J.C. Penny Co., and Weyerhaeuser[3] involved finance charges on sales where the buyers opted not to pay cash at the time of sale.

In Seattle v. State, the City provided electrical service. In addition, it offered a program whereby residents who desired an uncluttered vista could pay a portion of the costs of constructing the underground network. Obviously, like the finance charges, the electrical provider did not require the underground distribution construction merely because a customer received electrical service.

Here, merely by providing cellular phone service within a particular local jurisdiction, the taxpayers, not their customers, incurred the municipal taxes. The customers only indirectly paid those taxes through the private contractual arrangement dictated by the taxpayers. The cities did not impose the taxes at issue[4] on the cellular customers.

The municipal taxes were a necessary cost of the taxpayers providing cellular service. The taxes accrued from the performance of that service. Even by segregating those taxes on their invoices and increasing the charges to their customers, the taxpayers cannot change the fact that the municipalities imposed

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[3] Actually, in Weyerhaeuser all receipts were taxed under the same classification.

[4] While taxes may have been imposed directly on customers by some municipalities, the Audit Division indicates that those taxes were not included in the assessments. Further, when the taxpayers were given an opportunity to distinguish the taxes imposed by the various municipalities, they indicated that Seattle Ordinance No. 5.48.050 was typical.

those taxes on the cellular companies rather than their customers. Since these taxes were not imposed on their customers, their customers paid only to receive cellular service. All proceeds received from that service fall under the retailing classification with no deduction for the taxes imposed on the cellular companies.

This holding is limited to situations where:

1. The disputed "separate" activity was the collection of municipal taxes imposed on the cellular companies;

2. The tax accrued with the performance of the telephone service;

3. In order to receive cellular phone service, the cellular companies required their customers to pay the municipal taxes imposed on the cellular companies; and

4. The municipality imposes the taxes on the provider of the cellular service.

DECISION AND DISPOSITION:

The taxpayers' petition is denied.

DATED this 29th day of June, 1994.