

Cite as 4 WTD 191 (1987)

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

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment)	
)	No. 87-328
)	
)	Registration No. . . .
. . .)	Tax Assessment No. . . .
)	
)	
)	

[1] **RULE 245, RCW 82.04.065 AND RCW 82.08.0289:** B&O TAX -- RETAIL SALES TAX -- TELEPHONE ANSWERING SERVICE -- TELEPHONE CALLS -- CROSS CONNECTION OF. The patching by a telephone answering service of parties on different telephone lines so that they can speak to each other is a switching activity subject to Retailing B&O and retail sales tax. Where the charge for such service is made to a residential customer, however, the transaction is exempt of retail sales tax.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: December 10, 1986

NATURE OF ACTION:

Petition by a telephone answering service protesting the reclassification of certain income from the Service and Other Activities business and occupation tax classification to the Retailing classification.

FACTS AND ISSUES:

Dressel, A.L.J. -- . . . (taxpayer) is a telephone answering service. Its books and records were examined by the Department of Revenue (Department) for the period January 1, 1982 through September 30, 1985. As a result the above-captioned tax assessment was issued for state excise taxes and interest totaling \$30,229.

Of that amount \$14,074 is contested in this appeal on the basis set forth hereafter.

The specific activities at issue have been described by the auditor as "cross connects." These occur in the following manner. A taxpayer answering service operator answers an incoming telephone call. The operator determines that it is the type of call that should go on through to the answering service customer or the caller insists that it go through to the answering service customer. The operator then calls the customer on another telephone line. The two calls are "patched" together by the operator using a computer so the original caller speaks directly to the customer.

Income derived from the above-described activity was reported by the taxpayer for state excise tax purposes under the Service and Other Activities (Service) category of the business and occupation (B&O) tax. The Department's auditor, however, perceives this activity as a retail sale and reclassified the income as Retailing B&O. She reasoned that the cross connects constitute engaging in the telephone business or rendering telephone service which is tax-classified as Retailing B&O and subject to retail sales tax under WAC 458-20-245 (Rule 245).

The condensed version of the taxpayer's argument is: (1) the cross connect function is not telephone service or business according to the statute and rule and (2) even if it is, it is exempt of retail sales tax because the activity is rendered on behalf of residential, as opposed to business customers.

The issue for our determination, then, is whether the cross connection of telephone calls is a retail sale and, if so, whether it is exempt of retail sales tax.

DISCUSSION:

"Retail sale" is defined at RCW 82.04.050. Section 5 of this statute states, "The term [retail sale] shall also include the providing of telephone service, as defined in RCW 82.04.065, to consumers." (Brackets and emphasis added.) RCW 82.04.065 reads:

"Competitive telephone service", "network telephone service", "telephone service", "telephone business". (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.

(3) "Telephone service" means competitive telephone service or network telephone service, or both, as defined in subsections (1) and (2) of this section.

(4) "Telephone business" means the business of providing network telephone service, as defined in subsection (2) of this section. It includes cooperative or farmer line telephone companies or associations operating an exchange.

[1] Section (1) of RCW 82.04.065 doesn't apply here because the activity at issue does not involve the providing of equipment or apparatus. If cross connecting is to qualify as "telephone service,"¹ it must do so under section (2) of the statute which defines "network telephone service."

The taxpayer has submitted a detailed, well-written memorandum in which it goes to great lengths in arguing that it does not provide persons with access to a local telephone network when it performs its cross connecting function and that it, therefore, does not render network telephone service. It suggests that both the caller and the taxpayer's customer in a cross connect situation get access to the local telephone network simply by picking up their phones and getting a dial tone. We agree. The taxpayer doesn't provide such access because both the caller and the person called already have it.

That fact, however, is not dispositive of the issue. Besides providing access to a local telephone network, "network telephone service," as defined in RCW 82.04.065(2) also includes the providing of a "local telephone network switching service." In our judgment that is what the taxpayer is doing when it engages in its

¹Defined at section (3) of RCW 82.04.065.

cross connect function. It is assuming a role analogous to that of an old-time switchboard operator by making it possible for two parties on different telephone lines to talk to each other. The only real difference is that the taxpayer uses a computer to accomplish the connection whereas the old-time operator did it with jacks and wires. Either way it's a switching service and, in the present case, is done for callers and customers on the "local telephone network." It therefore qualifies as "network telephone service" under RCW 82.04.065(2), as "telephone service" under RCW 82.04.065(3), as "telephone business" under RCW 82.04.065(4), and as a retail sale under RCW 82.04.050(5). As retail sale, cross connects are subject to the Retailing B&O rate specified in RCW 82.04.250.

In most cases transactions subject to Retailing B&O are also subject to retail sales tax. The statute which imposes the sales tax reads:

RCW 82.08.020 Retail sales tax imposed. (1) There is levied and there shall be collected a tax on each retail sale in this state equal to six and five-tenths percent of the selling price.

(2) The tax imposed under this chapter shall apply to successive retail sales of the same property.

(3) The rate provided in this section applies to taxes imposed under chapter 82.12 RCW as provided in RCW 82.12.020.

Chapter 82.08 RCW, however, also contains numerous exemptions, one of which is:

RCW 82.08.0289 Exemptions----Certain network telephone service. (1) The tax levied by RCW 82.08.020 shall not apply to sales of:

(a) Network telephone service, other than toll service, to residential customers.

(b) Network telephone service which is paid for by inserting coins in coin-operated telephones.

(2) As used in this section:

(a) "Network telephone service" has the meaning given in RCW 82.04.065.

(b) "Residential customer" means an individual subscribing to a residential class of telephone service.

(c) "Toll service" does not include customer access line charges for access to a toll calling network. (Emphasis added.)

Cross connecting has been determined to be network telephone service. It is not toll service in the case at hand, so is exempt of retail sales tax under the statute immediately preceding if sold to residential customers. Residential customers are those who subscribe to a residential class of telephone service. It is our understanding that a significant number of the taxpayer's customers who are "cross connected" are of the residential variety. We are, therefore, granting the taxpayer's petition as to those customers provided that the taxpayer has sufficient documentation to differentiate between residential and business customers.

We also observe that the exemption statute speaks in terms of sales to residential customers. As a consequence, the telephone number to which the cross connect charge is billed should be used to determine whether or not the charge is exempt. If the customer assigned to that number subscribes to a business class of telephone service as to that number, retail sales tax applies. If the customer assigned to that number subscribes to a residential class of telephone service as to that number, sales tax does not apply. The status of the two numbers which are connected is irrelevant unless the cross connect charge is actually levied against one of them because, in that case, a sale will have been made to that number.

All cross connects including those to residential customers are subject to Retailing B&O even though the residential sales are exempt of sales tax. That is, the cross connects billed from July 1, 1983 to the end of the audit period are so subject.² Prior to that date telephone businesses were required to pay public utility tax. This fact has been noted by the auditor in her report and is properly reflected in the present assessment.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part.

DATED this 13th day of October 1987.

²See WAC 458-20-245 (Rule 245).