

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)
For Correction of Assessment) FINAL
and Refund of) DETERMINATION
)
) No. 87-328A
)
. . .) Registration No. . . .
) Tax Assessment No. . . .
)
)

- [1] RULE 245, RCW 82.04.050 & RCW 82.04.065: SEGREGATED TELEPHONE SERVICE CHARGES -- NETWORK TELEPHONE SERVICE -- SWITCHING SERVICE -- CROSS CONNECTION SERVICE A system which connects local telephone access lines to reroute telephone calls constitutes a "local telephone network switching service" under RCW 82.04.065(2). Segregated charges for providing such cross connections and switches are retail sales by a telephone service provider, subject to sales tax and Retailing B&O under RCW 82.04.050.
- [2] RULE 245, RCW 82.04.050 & RCW 82.04.065: NON-SEGREGATED TELEPHONE SERVICE CHARGES -- SERVICE B&O Telephone answering service businesses are taxed under the Service category of B&O for unsegregated receipts derived mainly from answering or message taking, even though some undifferentiated retail "telephone service" receipts may be included.
- [3] PROSPECTIVE APPLICATION Prospective effect of new rule application appropriate.

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: . . .

DEPARTMENT REPRESENTED BY:

Garry G. Fujita, Assistant Director
Edward L. Faker, Sr. Administrative Law Judge

DATE OF HEARING: May 11, 1988

NATURE OF ACTION:

Petition by a telephone answering service protesting a) the reclassification of certain income from the Service to Retailing category of the business and occupation tax and b) the imposition of retail sales tax thereon.

FACTS AND ISSUES:

Faker, Sr. A.L.J. -- . . . , (taxpayer) is a telephone answering service engaged in various services including "cross connecting" customer calls to service subscribers via separate telephone lines.

Income derived from the "cross-connecting" activities were being reported by the taxpayer under the Service category of the business and occupation tax (B&O). Following audit of taxpayer's records for the period of January 1, 1982 through September 30, 1985, the taxpayer was assessed for unreported Retailing B&O and for retail sales taxes on receipts derived from cross connecting as a form of retail "telephone service" activity. After credit was given for erroneously reported and paid Service B&O, the net assessment (now in dispute) totalled \$. . . , prior to any interest additions thereto.

The taxpayer appealed the assessment arguing that it was the result of Department of Revenue (Department) misunderstandings as to the taxpayer's activities, misapplications of the law, and unfairness in that it worked undue taxpayer financial hardship. On October 13, 1987, the Department issued Determination No. 87-328, ruling that the reclassification to Retailing B&O and the imposition of retail sales tax on non-residential service subscribers was correct.

The taxpayer now brings this matter on for Director review.

DISCUSSION:

[1] We specifically uphold the Administrative Law Judge on his rulings that the taxpayer's activities of switching and cross connecting telephone communications constituted retail "telephone service". Further, we determine that imposition of the Retailing category of the business and occupation tax and

of retail sales tax is appropriate for such services under RCW 82.04.050 and RCW 82.04.065.

Telephone network switching services are precisely the functions which the taxpayer provides through its cross connecting system. It is immaterial whether such services are electronically or manually provided. In such cases it is the end result of the activity which determines its nature as a switching service. The common and ordinary meaning of the terms "telephone network switching service," as that language is used in RCW 82.04.065, as well as the technical meaning of these terms within the industry, are clear and unambiguous. The taxpayer's system results in accessing and switching telephone lines and cross connecting calling and called parties.

We fully recognize that the taxpayer itself does not own or operate telephone lines or operate communications or transmissions systems equipment for hire. However, the definition of "network telephone service" of RCW 82.04.065(2) encompasses more activities than those of traditional telephone companies. It includes several business activities which may be performed by persons, manually or electronically, without entailing the ownership or operation of a traditional telephone system.

Some telephone answering businesses provide and bill for retail "telephone services" of like or similar kind to those outlined above. If the service provider itemizes and/or separately bills the service subscribers for such switching, cross connecting or comparable services, the service provider will be liable for retail sales tax and for business and occupation tax under the Retailing classification on receipts so derived.

[2] Generally, however, many telephone answering businesses are engaged in more traditional service activities such as phone answering, message taking, etc. Ordinarily, such businesses are taxed in the Service category for B&O taxes.

Those same businesses may incidentally engage in activities which, under strict scrutiny, would be considered a type of retail "telephone service".

So long as those incidental retail "telephone services" do not predominate in the telephone answering service business nor appear as itemized charges, billings or accountings to the service subscriber, taxation in the Service category of the

business and occupations tax on gross receipts will remain appropriate.

[3] Finally, we recognize that the Department has not previously ruled with finality upon this matter of first impression. This case arises in an industry of rapid and radical technological change, and the methods by which the "telephone services" included in RCW 82.04.065 may be examined, reviewed, and evaluated are not easily circumscribed.

In the interest of fairness and due notice, to the taxpayer and to the public, the Department has determined that the aforesaid application of RCW 82.04.050 and RCW 82.04.065, as well as WAC 458-20-245 (Rule 245), will be prospective only. This application has been formulated to achieve industry wide uniformity and consistency in the application of excise taxation. It is in the best interests of the public and will promote the efficient and uniform administration of law.

As to the petitioner in this case, the Department will accept the taxpayer's reporting and payment of B&O tax under Service and Other Business Activities on its gross receipts for all past periods up to the date of this Final Determination. In the future, so long as the taxpayer does not concentrate its efforts in retail "telephone service" activities and does not separately bill or charge therefor, it may continue to report and pay B&O tax under the Service and Other Business Activities classification.

DECISION AND DISPOSITION:

Taxpayer's petition is sustained. This matter is remanded to audit for cancellation of the balance owing

DATED this 12th day of July 1989.