

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 of)	
)	No. 98-072
)	
...)	Registration No. ...
)	FY ... /Audit No. ...

[1] RULE 166, RULE 245; RCW 82.04.065: B&O TAX -- RETAIL SALE -- NETWORK TELEPHONE SERVICES -- COMMISSIONS -- PAY-PHONE. Where the owner of pay telephone equipment received a commission from the long distance service provider for each call originating from its equipment, the income was taxable under the service and other activities tax classification.

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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 pay-telephone equipment owner protests additional business and occupation (B&O) taxes assessed in a tax assessment.¹

FACTS:

Okimoto, A.L.J. -- (Taxpayer) is a partnership . . . engaged in the business of providing pay-telephone service in hotels, convenience stores, and schools located throughout the states of Washington, Oregon, and Idaho. Taxpayer's books and records were examined by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1992 through December 31, 1995. The audit examination resulted in additional taxes and interest owing in the amount of \$. . . and Document No. . . . was issued in that amount on October 4, 1996. Taxpayer protested the entire amount and it remains due.

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

In Schedule 3 of the tax assessment, Audit reclassified income received from alternate operator service (AOS) companies from the retailing B&O tax classification to the service and other activities tax classification.

Taxpayer explained during the hearing that it owns pay-telephone equipment located at hotels, convenience stores, and schools. These phones are used for both local calls and operator assisted long-distance calls. Users of Taxpayer's equipment pay for telephone calls by either inserting coins, calling collect, or using a credit card. Telephone calls paid by coins are reported on total gross receipts collected and are not at issue. Taxpayer explained that it charges \$1.00 per five minutes on all long-distance telephone calls paid by coin and pays a long-distance carrier \$.10 per minute for providing the service.

On the other hand, when the telephone calls are paid by credit card, collect charges, or phone cards, Taxpayer has been reporting only the gross amounts received from the AOS under the retailing B&O tax classification. Taxpayer explained during the hearing that it contracts with an AOS to serve as its primary long-distance carrier. This means, unless the customer requests a different long distance carrier, it will automatically be routed to the primary AOS. Taxpayer explained that a normal long-distance telephone transaction occurs as follows. First, a customer will pick-up the receiver on one of Taxpayer's pay-telephones and gain access to the long distance operator. The customer gives the AOS operator its credit card, telephone number, or calls collect and is connected with its party. AOS monitors the call and bills its charges to the customer's telephone number or credit card or through collect charges.

For example, let's assume that the AOS's published tariff for a call is \$10.00. The AOS bills the customer through the local telephone company for \$10.00 plus retail sales tax. The local company remits the retail sales tax to the state on behalf of the AOS, retains \$.50 for its fee and forwards \$9.50 to the AOS. The AOS then pays the taxpayer a fee of \$1.76 per call. Audit has treated the \$1.76 per call received by Taxpayer as a commission and taxed it under the service and other activities tax classification.

Audit relied on Det. No. 89-378, 9 WTD 1 (1988) in support of its position that commission income earned from pay-phones is subject to tax under the service and other activities tax classification.

Taxpayer argues that the \$1.76 that it receives is, in fact, a wholesale charge to the AOS for providing access to the customer and should be taxed under the wholesaling tax classification.

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ISSUES:

1. Where the owner of pay-telephone equipment receives \$1.76 per call for each long-distance call originating from its equipment from the long-distance service provider, is that income taxable as a network telephone service?

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DISCUSSION:

- [1] Taxpayer believes that fees received from AOS companies are for network telephone services as defined in RCW 82.04.065 and must be considered retail sales under RCW 82.04.050(5). Audit believes, however, that they are commissions earned for originating and generating a customer's long-distance telephone call over Taxpayer's equipment. In general, commissions earned from the business activity of making sales of services for others are taxed under the "catchall" service and other activities tax classification.²

RCW 82.04.065, the tax definition upon which Taxpayer relies, states that network telephone service includes:

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.

See also, WAC 458-20-245 (Rule 245).

During the hearing, Taxpayer stated that a substantial number of Taxpayer's telephones are located in hotels or similar locations. To this extent, we find the Department's rule on taxation of hotels and similar businesses, WAC 458-20-166 (Rule 166), to be informative. It states:

(b) **Service and other business activities.** Commissions, amounts derived from accommodations not available to the public, and certain unsegregated charges are taxable under this classification.

(i) Hotels, motels, and similar businesses may receive commissions from various sources which are generally taxable under the service and other business activities classification. The following are examples of such commissions: . . .

(B) Commissions received from telephone companies for long distance telephone calls, where the hotel or motel is merely acting as an agent (WAC 458-20-159) and commission received from coin-operated telephones WAC 458-20-245 (Emphasis added.).

Rule 166 further explains that hotels can be taxed in two distinct ways depending upon the relationship between the customer, the hotel, and the long distance carrier. It states in pertinent part:

² Where there is no specific B&O tax classification the "catchall" service and other tax classification applies. RCW 82.04.290 and WAC 458-20-224 (Rule 224).

(d) **Telephone charges.** Telephone charges to guests, except those subject to service B&O tax as discussed above and in WAC 458-20-245, are retail sales. “Message service” charges are also retail sales.

If the hotel/motel is acting as an agent for a telephone service provider who provides long distance telephone service to the guest, the actual telephone charges are not taxable income to the hotel/motel. These amounts are advances and reimbursements (see WAC 458-20-111 and 458-20-159). Any additional handling or other charge which the hotel/motel may add to the actual long distance telephone charge is a retail sale.

(e) **Telephone lines.** If the hotel/motel leases telephone lines and then provides telephone services for a charge to its guest, these charges are taxable as retail sales. In this case the hotel/motel is in the telephone business. (See WAC 458-20-245.) The hotel/motel may give a resale certificate to the provider of the leased lines and is not subject to the payment of retail sales tax to the provider of the leased lines (Emphasis added.).

In this case, we must determine whether Taxpayer is buying and reselling the long distance charges to its customers in its own name or whether it is acting as an AOS’s agent in referring customers for which it receives a commission. If Taxpayer is buying and selling network telephone services in its own name, it is a network telephone service provider and taxable under the retailing and retail sales tax classification. WAC 458-20-245. If it is acting only as a seller’s agent in referring customers to the AOS, then it is taxable upon its gross commissions under the service and other activities tax classification. Rules 166 and 224.

For the following reasons, we believe that Taxpayer is acting only as a seller’s agent in referring customers to the AOS. First, the contract between the AOS and Taxpayer clearly refers to Taxpayer’s income as a commission. Second, the customer directly negotiates with the AOS for telephone services and not Taxpayer. Under the terms of the contract between Taxpayer and the AOS, the AOS shall “have the right to collect all call revenues generated at Site which are processed by [AOS].” Third, the rates are set primarily by the AOS and filed with the appropriate regulating body. Fourth, the customer’s long-distance telephone call is billed by the AOS to the customer and collected by customer’s local telephone company. Taxpayer is not involved in the collection process either directly or indirectly. Accordingly, we find that Taxpayer is the AOS’s agent in referring customers for which it receives a commission. Under Rule 166 Taxpayer is taxable on gross commissions received under the service and other activities tax classification. Taxpayer’s petition is denied on this issue.

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DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 28th day of May, 1998.