

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>
Tax Ruling of	)	
	)	No. 97-157
	)	
...	)	Registration No. . . .
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	)	
	)	

- [1] RULE 102, RULE 245; RCW 82.04.050: -- RETAIL SALES TAX -- PURCHASE FOR RESALE -- DOMINION & CONTROL -- FIBER-OPTIC CABLE -- BAND WIDTHS. An owner of fiber-optic cable may not purchase the cable without payment of retail sales tax even though it rebills its customers for use of the cable in separately identifiable band widths and on a monthly basis. Under these circumstances, the owner does not relinquish possession and dominion and control of the cable to its customers.
- [2] RULE 102, RULE 245; RCW 82.04.050: -- RETAIL SALES TAX -- PURCHASE FOR RESALE -- DOMINION & CONTROL -- FIBER-OPTIC CABLE -- FIBER PAIRS. An owner of fiber-optic cable may not purchase the cable without payment of retail sales tax even though it rebills its customers for use of the cable in fiber pairs on a monthly basis. Under these circumstances, the owner does not relinquish possession and dominion and control of the cable to its customers.
- [3] RULE 245; RCW 82.04.065: -- RETAIL SALES TAX -- COMPETITIVE TELEPHONE SERVICES -- FIBER-OPTIC CABLE. An owner of fiber-optic cable is not engaged in competitive telephone services when it rebills the use of that cable in increments of band widths or fiber pairs to telephone companies. It is engaged in providing network telephone services and is subject to retail sales tax on all equipment utilized to provide that service, including the fiber-optic cable.

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 owner of an underground fiber-optic cable that is used to transmit telecommunication signals appeals a Taxpayer Information & Education (TI&E) ruling that it must pay retail sales tax on the cable and its underground installation.<sup>1</sup>

#### FACTS:

Okimoto, A.L.J. -- Taxpayer is purchasing a fiber-optic cable and related equipment. It has hired a contractor to install the cable into an underground conduit running from Washington to Canada. Taxpayer had previously acquired the necessary property easements or other rights. Taxpayer will utilize the cable to transmit telecommunication signals for large telecommunication service providers.

Taxpayer explained during the hearing that the contractor must first dig a trench in the right-of-way purchased from railroad companies and other property owners. The contractor then places a zinc plastic conduit into the trench. Once the conduit is in place, the contractor inserts the fiber-optic cable. By placing the cable into a plastic conduit Taxpayer can remove the cable at the end of an easement and/or to repair it if it malfunctions.

Taxpayer's network consists of a 48-fiber communications fiber-optic cable linking Canada and Washington. Taxpayer has many access points along the cable where its customer may send or pick-up data transmissions. It is the customer's responsibility to get its data to one of the access points along Taxpayer's cable network and to also pick-up that data at an access point near the customer's destination. Taxpayer is only responsible for transmitting the customer's data while it is on Taxpayer's fiber-optic cable.

Taxpayer indicated that each of the forty-eight fibers is permanently connected to the fiber-optic cable and cannot be removed from the rest. Taxpayer further explains that it takes two fibers (one pair) to operate a single transmission system. Each pair of fibers is hooked up to a computerized black box that controls the input and output of the fiber pairs. This black box allows Taxpayer to split each transmission on a single fiber-optic pair into a fixed number of separate and identifiable band widths (for discussion purposes we will assume twenty-four separate band widths).

Taxpayer explained that band widths are separately identifiable spaces that move consecutively along a fiber-optic pair during data transmissions. For example, if a customer leases the first band width on a fiber-optic pair then his data will be on the first band width and the twenty-fifth band width of that pair and every twenty-fourth band width thereafter. Similarly, a customer

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

who leases the second band width will have his data transmitted on the second and twenty-sixth band width and every twenty-fourth band width, thereafter.

Each fiber-optic pair has twenty-four separate band widths being transmitted along the pair at any given time. The customer's data does not become commingled with other data because Taxpayer is able to identify the data being transmitted on each band width by codes implanted on the front end of each customer's data transmission. Taxpayer's black box implants the identifying codes. Data in each customer's band width is transmitted along the fiber-optic cable until it reaches a regenerator site, where the original signal is enhanced and forwarded along to the next regenerator site. Once a customer's data reaches its destination on Taxpayer's cable, a second black box reads the code and recompiles customer's data into its original form. The black box then downloads customer's data at the second access point and transmits it to that customer's final destination.

Taxpayer first argues that its purchase and installation of fiber-optic cable is exempt from retail sales tax because it is being purchased strictly for resale. Taxpayer states in its petition:

Telephone service providers will typically lease a band width on the fiber optic cable from [Taxpayer] on a monthly basis. The area on the fiber optic cable is capable of being split into specific pieces of band width. A specific dedicated band width on the fiber optic cable will be leased to the specific customer. The specific band width that is being leased to a specific customer is used exclusively by that customer and is not available for use by [Taxpayer] or by any other customer. The customers will attach their own equipment at the location where the signal enters the cable and also at the location where the signal will exit the cable. This equipment interfaces with [Taxpayer]'s equipment that converts the signal to a form that is compatible with fiber optic cable and controls the band width being used by the customer. [Taxpayer] will be responsible for making certain that there is no degradation of the signal between the location where the signal enters the fiber optic cable and the location where it leaves the cable.

Taxpayer relies on WAC 458-20-211 (Rule 211) for the proposition that: "Persons who purchase tangible personal property that will be resold may give a resale certificate and are not subject to the payment of retail sales tax on the purchase."

Taxpayer contends that it will "simply lease band widths on the fiber optic cables to others and is itself not engaged in network telephone service as that term is defined in WAC 458-20-245."

Taxpayer further contends that:

[Taxpayer]'s customers/lessees will assume dominion and control over a specific band width of a fiber optic cable. This takes the form of a monthly lease, [Taxpayer] will have no responsibility for the transmission of the customer's signal over the cable. Neither [Taxpayer] nor any of its other customers will have use of the specific area of the cable that is being leased to a specific customer. Each customer will have exclusive access and

control over the band width on the cable it leases. The customer is responsible for attaching its own equipment to the cable and for the transmission and retrieval of signals over the cable. A specific band width on the cable can only be used by the specific customer to whom it is leased.

In the alternative, Taxpayer argues that its purchase of the fiber-optic cables should be exempt from tax because it is providing competitive telephone services within the meaning of WAC 458-20-245 (Rule 245) by re-leasing the fiber-optic cable to telephone companies.

Finally, and also in the alternative, Taxpayer argues that even if fiber-optic pairs cannot be purchased for resale when sold by individual band widths, they still should be considered as being purchased for resale when individual cable fiber-optic pairs are leased exclusively to one customer. Taxpayer argues that these individual customers would assume dominion and control over these fiber-optic pairs during a monthly lease period, thus entitling Taxpayer to purchase the cable without paying retail sales tax..

TI&E denied Taxpayer's ruling request. TI&E did not believe that Taxpayer's rebilling of fiber-optic cable by band width was a true lease because the lessee would not actually take possession of the property and exercise dominion and control over it.

#### ISSUES:

- 1) May an owner of fiber-optic cable purchase the cable without payment of retail sales tax when it resells band widths of the cables on a monthly basis?
- 2) May an owner of fiber-optic cable purchase the cable without payment of retail sales tax when it resells fiber-optic pairs of the cable on a monthly basis?
- 3) Is Taxpayer's purchase of the fiber-optic cables exempt from retail sales tax because it is providing competitive telephone services within the meaning of Rule 245?

#### DISCUSSION:

RCW 82.04.050 defines the term "sale at retail" or "retail sale" to include:

- (1). . .every sale of tangible personal property . . . other than a sale to a person who (a) purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person, . . .
- (4) The term shall also include the renting or leasing of tangible personal property to consumers and the rental of equipment with an operator.

WAC 458-20-211 (Rule 211) implements RCW 82.04.050(4) and states:

(3) A true lease, rental, or bailment of personal property does not arise unless the lessee or bailee, or employees or independent operators hired by the lessee or bailee actually takes possession of the property and exercises dominion and control over it. Where the owner/lessor of the equipment or the owner's/lessor's employees or agents maintain dominion and control over the personal property and actually operate it, the owner/lessor has not generally relinquished sufficient control over the property to give rise to a true lease, rental, or bailment of the property.

In general, a lease, rental, or bailment of tangible property requires the relinquishment of possession and control over the item by one party and the acceptance of such possession and control by the other party. Duncan Crane v. Department of Revenue, 44 Wn. App. 684, 689, 723 P.2d 480 (1986); Collins v. Boeing Co., 4 Wn. App. 705, 711, 483 P.2d 1282 (1971). Whether possession and control has in fact been transferred is a question of fact. As stated in Collins:

Whether there is a change or acceptance of possession depends on whether there is a change or acceptance of actual or potential control in fact over the subject matter. . . . In determining whether control exists, it is relevant to consider the subject matter's amenability to control, steps taken to effect control, the existence of power over the subject matter, the existence of power to exclude others from control, and the intention with which the acts in relation to the subject matter are performed.

Collins at 711.

In order for Taxpayer to be eligible to give a resale certificate, it must rent or lease the fiber-optic cable to its customers without intervening use. WAC 458-20-102. This can only be done if Taxpayer relinquishes possession and dominion and control of the fiber-optic cable to another person, thereby making a sale at retail. WAC 458-20-211.

Taxpayer clearly does not relinquish possession and dominion and control when it subsequently bills customers for the use of its cable by band width. On the contrary, we believe Taxpayer maintains complete possession and dominion and control over the cable during the entire transmission process. Furthermore, Taxpayer is responsible for both inputting the data into the fiber optic pairs and for encoding identifying information in front of the customer's data prior to transmission. All these services are performed by Taxpayer's black box. In addition, we note that at any one time, twenty-four separate customers can be using a single fiber-optic pair to transmit their respective messages. Under these circumstances, none of these twenty-four customers has possession and dominion and control over any portion of the fiber-optic cable at any one time, much less over an extended period of time. Accordingly, Taxpayer's petition is denied on this issue.

Nor do we believe the answer changes if Taxpayer were to lease a single fiber-optic pair to one customer exclusively. The fact remains that possession and dominion and control of that single fiber-optic pair remains primarily with Taxpayer. Although the customer may attach its own

computerized equipment to the single fiber-optic pair at both the origination point where the data is inputted, and at the destination point where that data is retrieved, the cable itself remains under the possession and dominion and control of Taxpayer. In addition, the black box that actually inputs the data into the cable is owned and operated by Taxpayer, as is all the relay and regenerator equipment between Washington and Canada. We also presume that Taxpayer is solely responsible for maintaining the fiber-optic cable in a functional and working order. Finally, we note that the single fiber-optic pair that Taxpayer may have reserved for the use of a single customer cannot be removed from the existing fiber-optic cable by the customer. It, therefore, cannot be placed under that customer's physical control. It must remain in the conduit along with the other component parts of the fiber-optic cable including the remaining forty-six fibers being leased by band width. Based on these facts, we find that Taxpayer does not transfer possession and dominion and control of the cable to its customers. Accordingly, Taxpayer's petition is denied on this issue.

We also do not believe that the fiber-optic cable is exempt because Taxpayer is providing competitive telephone services. RCW 82.04.065 provides:

(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.

We believe that the telecommunications equipment or apparatus referred to in the statute is the apparatus that allows access to the telecommunications system, such as telephones or faxes. Taxpayer, on the otherhand, is simply providing network telephone service within the meaning of RCW 82.04.065. Therefore, the fiber-optic cable is treated and taxed in the same manner as a telephone company's telephone lines or wires that are used to transmit a telecommunications signal. This type of equipment is fully subject to the retail sales tax. See WAC 458-20-245. Accordingly, Taxpayer's petition is denied on this issue.

#### DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 7th day of August, 1997.