

Cite as Det. No. 98-202, 19 WTD 771 (2000)

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 and Refund of)	
)	No. 98-202
)	
...)	Registration No. . .
)	FY. . . /Audit No. . . .

[1] RULE 108: RETAIL SALES TAX -- MEASURE -- DISCOUNTS -- PRODUCTIVITY/VOLUME -- COMMISSIONS. Productivity discounts based on the number of reservations booked on a reservation system and used to offset monthly equipment, software and communication charges are not true discounts and cannot be deducted from the measure of the tax.

...

[3] RULE 155: RETAIL SALES TAX -- SERVICE B&O -- COMPUTER SERVICES -- INFORMATION SERVICES -- ON-LINE ACCESS -- TELEPHONE LINE CHARGES. Charges for having on-line access to a reservation system are a service activity even though a portion of the charges is for the telephone lines used to convey the information or service to the customer.

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.¹

NATURE OF ACTION:

A travel agency protests the assessment of use tax assessed on computer equipment, access charges and support licenses in an audit report.²

FACTS:

¹ Nonprecedential portions of this determination have been deleted. See RCW 82.32.410.

² Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Okimoto, A.L.J. -- . . . (Taxpayer) operates a travel agency located in . . . Washington. Taxpayer's books and records were examined by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1993 through December 31, 1996. The audit examination resulted in a \$. . . credit owing to Taxpayer and Document No. . . . was issued in that amount on October 8, 1997. Taxpayer protested the assessment of use taxes imposed on charges for computer equipment and other services performed by a reservation service.

Schedule 4 – Use and/or Deferred Sales Tax Due on Lease

Audit explained in its audit report that use tax was due on:

. . . the value of the lease of computer equipment which has been leased to you by [System] for your use in making travel reservations through them. The lease charges were reduced by credits to you for the number of reservations made by you through their system. Retail sales tax is due on the full value of the lease. See WAC 458-20-155 Attached. The amount received as a reduction from the cost of the lease is commission revenue to you and should be reported the same as your other commission revenue, under the Travel Agent classification for Business & Occupation tax.

Taxpayer makes several arguments. First, Taxpayer points out that it received a productivity discount³ that was applied to lease charges that totally or substantially offset monthly charges made by [System]. Taxpayer argues that if use tax is due, it should be computed based on the cash exchanged between the two companies and not the originally invoiced amounts.

. . .

Finally, Taxpayer pointed out that only \$. . . of its monthly charge was for computer hardware. Taxpayer stated that it also paid \$. . . for software license & support and \$. . . for a communication support fee. Taxpayer explained that the communication support fee was a charge for having access to System's reservation system and database. This monthly charge also included the cost of telephone lines necessary to connect Taxpayer's terminals to the reservation system.

ISSUES:

1) When computing use taxes owed on tangible personal property, does the amount of productivity discounts granted reduce the measure of tax?

. . .

³Under the Production Credit Agreement dated February 14, 1992, Taxpayer received a \$1 credit against its monthly charges for each car rental or hotel booking made through System.

3) Are software charges and charges for having on-line access to a reservation system subject to use and/or deferred retail sales tax?

DISCUSSION:

WAC 458-20-108 (Rule 108) is the Department's rule on discounts. It states in part:

(5) DISCOUNTS. The selling price of a service or of an article of tangible personal property does not include the amount of bona fide discounts actually taken by the buyer and the amount of such discount may be deducted from gross proceeds of sales providing such amount has been included in the gross amount reported.

(a) Discounts are not deductible under the retail sales tax when such tax is collected upon the selling price before the discount is taken and no portion of the tax is refunded to the buyer.

(b) Discount deductions will be allowed under the extracting or manufacturing classifications only when the value of the products is determined from the gross proceeds of sales.

(c) Patronage dividends which are granted in the form of discounts in the selling price of specific articles (for example, a rebate of one cent per gallon on purchases of gasoline) are deductible. (Some types of patronage dividends are not deductible. See WAC 458-20-219.)⁴

[Footnote added.]

[1] Volume discounts are reductions in the sales price of the article purchased based on the quantities of items actually purchased. The example in Rule 108(5)(c) allowing a one-cent per gallon rebate is one type of volume discount. Such discounts constitute a reduction in the original sales price and may be deducted from the gross proceeds of sale. In contrast, Taxpayer's productivity discount is not computed based on the volume of products or services purchased (since the number of leased computer units remains fixed) but instead is computed based on the amount of business generated by each leased terminal. In this respect, the productivity discount is similar to a commission for services rendered and not a true discount.

Indeed, Taxpayer explained during the hearing that System allows airlines, hotels, and car rental agencies to utilize its reservation system. In exchange, System receives a monetary fee from hotels and rental car agencies for each reservation booked through its reservation system. Therefore, the greater number of reservations booked by Taxpayer through its leased computer terminals, the more fees generated for System. It is the generation of these fees that allows System to credit/offset charges against Taxpayer's leased equipment liability. Under these facts, we find that these fees constitute commission income received by Taxpayer for the service of booking Taxpayer's clients through the reservation system. Deductions for bona fide discounts are not available where a purchaser is required to provide any significant service to the seller in

⁴WAC 458-20-219 (Rule 219) has been repealed. WSR 92-23-021 (filed November 10, 1992).

return for the reductions. See, Det. No. 83-180, 11 WTD 5 (1983). Accordingly, we find that Taxpayer's productivity discounts are not true discounts within the meaning of Rule 108, and they may not be deducted from Taxpayer's monthly lease charges to reduce its use tax liability⁵. Taxpayer's petition is denied on this issue.

...

[3] Taxpayer also argues that the software application and communication support charges are not for tangible personal property and, therefore, exempt from use tax. WAC 458-20-155 (Rule 155) is the rule explaining the proper tax application for computer software and computer services. It states in part:

The term "standard, prewritten program," sometimes referred to as "canned" or "off-the-shelf" software, means software which is not originally developed and produced for the user.

...

The retail sales tax applies to all amounts taxable under the retailing classification of business and occupation tax explained earlier. Providers must collect the sales tax from users of computer systems, hardware, equipment, and/or standard, prewritten software and materials delivered in this state. This includes outright sales, leases, rentals, licenses to use, and any other transfer of possession and the right to use such things, however physically packaged, represented, or conveyed. (Emphasis ours.)

The software application received by Taxpayer was not originally developed or produced for the Taxpayer. It was previously designed and only incidentally adapted to Taxpayer's computer equipment. Consequently, we find that it is a standard, prewritten program within the meaning of Rule 155 and fully subject to the retail sales tax.

The communication support charge is another matter. Rule 155 also explains how data information and information services are to be taxed. It states in part:

SERVICE: Persons who charge for providing information services or computer services (other than retailing or wholesaling as defined above) are subject to the service and other activities classification of business and occupation tax measured by the gross income of such business. This includes charges for custom program development, charges for on-line information and data, and charges in the nature of royalties for the reproduction, use, and reuse of patented systems and technological components of hardware or software, whether tangible or intangible.

⁵ We further note that RCW 82.12.010(1) allows the Department to impose use tax based on sales of similar products where the item was "...acquired by lease...or is sold under conditions wherein the purchase price does not represent the true value..."

The tax classifications and distinctions explained above will prevail regardless of how the federal government or other tax jurisdictions may classify these transactions for other tax purposes. (Emphasis ours.)

Rule 155 further defines the following terms:

The term "information services" means every business activity, process, or function by which a person transfers, transmits, or conveys data, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium. The term does not include transfers of tangible personal property such as computer hardware or standard prewritten software programs. Neither does the term include telephone service defined under RCW 82.04.065 and WAC 458-20-245.

The term "computer services" means every method of providing information services through the use of computer hardware and/or software.

Taxpayer explained that it pays \$. . . per month for the privilege of being on line and having access to System's reservation system. This reservation system allows it to receive current information on airline, hotel, and rental car availability and prices. In addition, the reservation system allows Taxpayer to actually book the reservation with the service provider. We believe that this business activity falls within the definition of "information services" within the meaning of Rule 155. Since System provides these information services through the use of computer hardware and/or software, they constitute "computer services" and are taxed under the service and other activities tax classification. See, Det. No. 90-86, 9 WTD 165 (1990); Det. No. 87-346, 4 WTD 267 (1987).

Although Audit apparently contends that telephone line charges included in the \$... monthly payments convert the entire charge to network telephone services, we disagree. In Det. No. 90-128, 9 WTD 280-1 (1990), the Department considered the proper tax classification of telephone line charges related to a data processing service. In finding that itemized telephone line charges were only incidental to the data processing services being rendered, we stated:

[1] In carving out an exception for telephone service from the definition of information services, the Department has drawn a distinction between those persons who are engaged in the business of furnishing a particular medium over which data is transmitted and those furnishing the data or information services being transmitted. Those engaged in the business of providing the means by which data is communicated are treated as making a sale, while those furnishing the data or processing it are providing a personal service.

As in the present case, the line is not always clear as to whether a transaction is a sale or a service. The examination must focus upon the real object of the transaction sought by the taxpayer's customers and not just its component parts. Rule 155 addresses this issue by providing in part:

Liability for sales tax or use tax depends upon whether the subject of the sale is a product or a service. If information services, computer services or data processing services are performed, such that the only tangible personal property in the transaction is the paper or medium on which the information is printed or carried, the activity constitutes the rendering of professional services, similar to those rendered by a public accountant, architect, lawyer, etc., and the retail sales tax or use tax is not applicable to such charges. (Emphasis supplied.)

Here, it is clear that the furnishing of the telephone lines is not the object of the transaction, but merely incidental to the personal services being rendered. 9 WTD at 280-3,4.

In this case, we similarly believe that the true object of the \$. . . monthly communication charge is for the ability to access the information in System's reservation system and to make the reservation with the service providers on behalf of Taxpayer's client. These services are information services and since the services are rendered through computer hardware or software, they fall within Rule 155's definition of "computer services". We further find that the telephone line charges are merely incidental to the information services being supplied by System and may not be bifurcated and separately taxed from the object of the transaction. Taxpayer's petition is granted on this issue.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part and denied in part. Taxpayer's file shall be remanded to Audit for the proper adjustments consistent with this determination.

Dated this 30th day of November 1998.