

Cite as Det No. 10-0333, 30 WTD 94 (2011)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 10-0333
)	
...)	Registration No. . . .
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)	Document No. . . . / Audit No. . . .
)	Docket No. . . .
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RCW 82.04.065; RCW 82.04.297; RCW 82.04.050(5); Title 47 U.S.C. Sec. 151:
INTERNET SERVICE PROVIDER (ISP) – DIGITAL SUBSCRIBER LINE
INTERNET SERVICE (DSL) - An ISP selling DSL internet service is taxable as
an ISP. It should pay Service & Other B&O tax on its income received as an
ISP. For Washington State tax purposes, a DSL ISP's internet service charges
should not be bifurcated into a Service & Other B&O internet service component,
and a retailing telephone line transmission component

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.

Munger, A.L.J. – A telecommunications company and internet service provider protests the
assessment of retail sales tax on the digital subscriber line (DSL) component of its internet
service charges to customers. We hold that the DSL charge is the transmission component of
taxpayer's internet service charge and it may not be bifurcated and taxed as a separate activity.
On this issue we remand for recalculation based on the income received for these charges being
reclassified to Service & Other Activities B&O tax.¹

ISSUES

Whether an internet DSL service provider is subject to retail sales tax on the transmission phone
line component of its charges to its residential internet service customers.

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
Nonprecedential portions of this determination have been deleted.

FINDINGS OF FACT

[Taxpayer], is a local telephone company providing telephone services to [a Washington community]. The Department of Revenue (the Department) audited the Taxpayer for the period of January 1, 2003, through June 30, 2006, and issued an assessment totaling \$. . . . Taxpayer disputes . . . the reclassification of the DSL line portion of Taxpayer's internet income from Service & Other Activities B&O tax to retailing. . . .

Internet

The Taxpayer is a provider of internet services to its residential customers through its Digital Subscriber Line Internet access (DSL) services. Taxpayer's DSL services are provided over existing local telephone lines that Taxpayer provides to its business and residential customers. . . . During the audit period, the Taxpayer reported its income from its internet services under the Service & Other Activities classification. Audit determined that the Taxpayer should have been collecting retail sales tax on the DSL line portion of the internet charge to its residential customers. Audit also concluded that the DSL portion of the internet service was not a WUTC regulated telephone service and, accordingly, the Taxpayer's sales did not qualify for the RCW 82.08.0289 exemption from the retail sales tax for residential phone services.²

Taxpayer's internet DSL charges consist of two separate components consisting of (1) a "telecom component," which used the high-frequency portion of the local line and (2) the "internet component" which provided the actual access to the internet. The "telecom component" of a customer's DSL service is provided via the customer's existing telephone line. The internet transmission uses the high-frequency portion of the local telephone line. The low frequency portion of the local line is used for local telephone service. Consequently, a customer cannot receive DSL internet service without first purchasing a local exchange line (dial-tone) from Taxpayer.

[D]uring the audit period, the Taxpayer itemized the high-frequency DSL line portion of the internet service on its residential customer's bills as a separate charge in addition to an internet service charge. In 2004 to 2006, it billed for the DSL internet service as one lump sum charge. As an example of the DSL charges, the Taxpayer had a flat rate . . . charge for the line, and an ISP component [charge which varied] depending on the ISP package. Taxpayer reported Service & Other Activities B&O tax on the latter ISP portion, and the Taxpayer treated the . . . DSL line charge to residential customers as retail sales tax exempt under RCW 82.08.0289.

² Because this decision follows the Washington Supreme Court's interpretation of RCW 82.04.065 & .297 in *Community Telecable of Seattle v. City of Seattle*, 164 Wn.2d 35, 186 P.3d 1032 (2008), the Taxpayer's interpretation of the DSL line qualifying for the RCW 82.08.0289 retail sales tax residential phone exemption does not apply.

ANALYSIS

Under RCW 82.04.050(5) “the providing of telephone service, as defined in RCW 82.04.065, to consumers” is a retail sale. RCW 82.04.065(3)(1997) defined telephone service to include both competitive telephone service and network telephone service, which were defined under RCW 82.04.065(1997)³ as follows:

(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 telephone network, 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 telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. *“Network telephone service” includes the provision of transmission to and from the site of an internet provider via a telephone network, toll line or channel, cable, microwave, or similar communication or transmission system.* “Network telephone service” does not include the providing of competitive telephone service, the providing of cable television service, the providing of broadcast services by radio or television stations, nor the provision of internet service as defined in RCW 82.04.297, including the reception of dial-in connection, provided at the site of the internet service provider. (Emphasis added.)

RCW 82.04.297 defines “Internet services” as:

(1) The provision of internet services is subject to tax under RCW 82.04.290(2).

(2) "Internet" means the international computer network of both federal and nonfederal interoperable packet switched data networks, including the graphical subnetwork called the World Wide Web.

(3) "Internet service" means a service that includes computer processing applications, provides the user with additional or restructured information, or permits the user to interact with stored information through the internet or a proprietary subscriber network. "Internet service" includes provision of internet electronic mail, access to the internet for information retrieval, and hosting of information for retrieval over the internet or the graphical subnetwork called the World Wide Web.

³ The definitions of “internet access” and “internet” in RCW 82.04.297 were amended in 2009 to mirror the Federal definition found in the internet tax freedom act, Title 47 U.S.C. Sec. 151 note, as existing on July 1, 2009. RCW 82.04.065 was also amended after the audit, and per RCW 82.04.065(27)(f), an internet service is not a telecommunications service.

Internet services are not subject to retail sales tax. As we stated in Det. No. 02-0144, 22 WTD 182 (2003):

Retail sales tax is levied upon retail sales in Washington. RCW 82.08.020. The sale of telephone service to consumers is a retail sale. RCW 82.04.050(5) . . . , but telephone service does not include internet service. RCW 82.04.065. In contrast, the provision of internet services is subject to B&O tax under RCW 82.04.290(2) as other business or service activities and is not subject to retail sales tax.

The issue in the present case is whether the “telecom component” of the DSL internet services charge should be split off from the internet services portion and taxed separately as a network telephone service. A similar issue was recently addressed and decided by the Washington State Supreme Court in *Community Telecable of Seattle v. City of Seattle*, 164 Wn.2d 35, 186 P.3d 1032 (2008) (*Comcast*). *Comcast* involved a cable company that provided high-speed cable Internet service to customers located in Seattle. The service allowed subscribers to connect to the Internet at a faster rate than traditional dial-up service, which used a telephone connection instead of a cable connection. Through its cable Internet service, Comcast provided its subscribers with “access to e- mail over the Internet, access to chat rooms, access to the World Wide Web, and access to sites on the Web where Comcast customers can download music and other content.” *Comcast* at 37. Following an audit, the city of Seattle (City) assessed a telephone utility tax against Comcast contending that the portion of its Internet service charge attributable to the high-speed cable connection should be taxed as a telephone business at the 6% city telephone utility tax rate instead of the lower 0.415% city service B&O tax rate. Comcast appealed contending that the assessment of utility taxes on high-speed cable Internet access was barred by state and federal law.

Initially, the Washington Court of Appeals ruled in the City’s favor by bifurcating Comcast’s Internet charge into two separately taxable components. First, the court held that Comcast’s internet services portion of its charge was taxable at the city service B&O tax rate. Next, the court held that the portion of Comcast’s charge for the transmission of data from the customer’s location to and from the site of the internet service provider via a cable transmission system was a separate activity and fully taxable at the city telephone utility tax rate.

On appeal to the Washington State Supreme Court, that Court specifically rejected the Court of Appeal’s bifurcation analysis and ruled in favor of Comcast. While holding that Comcast’s internet service was a single service consisting of an internet component, in addition to a transmission component, the Court stated: “Under our holding, a telephone business offering Internet services cannot be charged a telephone tax for those services, but may still be charged a telephone tax for providing telephone services-just as Comcast may still be charged a cable television tax for providing cable television. The plain language of RCW 82.04.065(2) means simply that the transmission component of cable Internet services cannot be taxed separately from those very services.” *Comcast* at 44.

Here, both parties have attempted to bifurcate the transmission component from the internet component in [Taxpayer's] charges as a DSL internet service provider (ISP) to its customers.⁴ *Comcast* clearly prohibits this sort of splitting out of the transmission component of an internet service charge to the end user. Neither *Comcast* nor the statutes cited therein make a distinction between the different means (cable, DSL & dial-up) of providing an internet service. We find that the transmission component of the DSL internet service that the Taxpayer provides as an ISP is just that, part of an internet service, not a separately taxable telecom service.⁵

Therefore, we conclude that Taxpayer's charge for DSL internet service to its customers, including any transmission component, is a single business activity. As such, per *Comcast*, Taxpayer's entire charge for internet service is properly taxable under the Service & Other Activities B&O tax classification. Taxpayer's petition is partially granted on this issue. The assessment should be recalculated to include Service & Other Activities B&O tax on the DSL line component, and the retail sales tax portion of the assessment should be modified accordingly.

DECISION AND DISPOSITION

The petition is partially granted as to the retail sales tax assessment on the DSL line income. The file is remanded to the Department's Audit Division for recalculation of the tax owing based on the charges being subject to the Service & Other B&O tax

Dated this 1st day of November, 2010.

⁴ The Taxpayer does this by asserting the charge is a sales tax exempt home telephone charge, and Audit by treating it as an internet related telecom service subject to the retail sales tax.

⁵ See ETA 3047.2009, issued February 2, 2009 for a discussion of the taxation and history of the application of the Internet Tax Freedom Act, "ITFA" (47 U.S.C. § 151 note), as it relates to the state taxation of telecom provider's sales to ISPs. By contrast here, the Taxpayer is an ISP, and the tax issue involves the bifurcating of its internet service charge to the end user, not its own purchases of telecom services. Per RCW 82.04.297, (and as further described in ETA 3047), Washington's Service & Other Activities B&O tax (RCW 82.04.290(2)) applies to the charge for internet services sold by an ISP. This continues to be permitted under the ITFA.