

Cite as 9 WTD 280-1

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

|                                 |   |   |
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| In the Matter of the Petition   | ) | <u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> |
| <u>N</u>                        |   |   |
| For Correction of Assessment of | ) |   |
|                                 | ) | No. 90-128  |
|                                 | ) |   |
| . . .                           | ) | Registration No. . . .  |
|                                 | ) | . . . /Audit No. . . .  |
|                                 | ) |   |

**[1] RULES 138, 155, 245 and RCW 82.04.065:** INFORMATION AND COMPUTER SERVICES -- FURNISHING TELEPHONE LINES FOR DATA TRANSMISSION -- SERVICE B&O TAX. Charges to customers for "dedicated" telephone lines furnished by taxpayers for use in connection with on-line data processing services rendered by taxpayer are subject to Service B&O tax. Providing telephone lines is incidental to service activity and is not "network telephone service" as defined by RCW 82.04.065 and Rule 245.

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: . . .

DATE OF TELEPHONE CONFERENCE: . . .

NATURE OF ACTION:

Taxpayer seeks a correction of assessment from an audit determination that taxpayer's furnishing dedicated telephone lines to its customers in connection with data processing services falls within the B&O Service classification.

FACTS AND ISSUES:

Heller, A.L.J. (successor to Potegal, A.L.J) -- The taxpayer is engaged in the business of providing data processing services . . . . The taxpayer is the owner of computer software and hardware which it makes available to its customers for use in connection with the performance of its services. The taxpayer furnishes the customer with a telephone modem device which allows the customer to have on-line access to a central processing unit located on the taxpayer's premises. The transmission of data between the taxpayer and its customers occurs over "dedicated" telephone lines which the taxpayer purchases from the telephone company.

The agreement between the taxpayer and its customers provides that the customer is to bear the expense (as assessed by the taxpayer) of all terminal devices, maintenance, telephone lines and modems. In accordance with this arrangement, the taxpayer separately bills the customer for the cost of the telephone lines. The taxpayer refers to this income as "Network Charges". Believing that the furnishing of the telephone lines constitutes a retail sale under Washington law, the taxpayer also collects retail sales tax from the customer which it remits to the Department of Revenue ("Department"). The taxpayer reports its income from data processing services under the Service classification of the business and occupations tax. However, the taxpayer reports its Network Charges as taxable under the Retailing classification as a "telephone service."

An audit of the taxpayer conducted for the period beginning . . . and ending . . . resulted in a reclassification of taxpayer's Network Charges from Retail to the Service classification. This reclassification resulted in an assessment in the amount of \$ . . . plus accumulated interest.<sup>1</sup> The taxpayer appeals this assessment.

#### TAXPAYER'S EXCEPTIONS:

The taxpayer argues that providing dedicated telephone lines to its customers constitutes the furnishing of "network telephone service" as that term is defined in RCW 82.04.065 and WAC 458-20-245. According to the taxpayer, it purchases eight dedicated lines from . . . and in turn leases the lines

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<sup>1</sup>The taxpayer was assessed \$ . . . as the amount of Service B&O tax on Network Charges. This amount was offset by a credit of \$ . . . resulting from Retailing B&O tax reported in error for a total tax due of \$ . . . .

for a flat fee to customers in fifty locations. The taxpayer asserts that this "network telephone service" is a separate product from the furnishing of computer services which is not used by all of its customers. Because those customers using the "product" are the consumers of the telephone service, the taxpayer concludes that the fees charged for the service is retailing income and taxable as such.

#### DISCUSSION:

WAC 458-20-155 ("Rule 155") is the duly adopted administrative regulation which governs the taxation of information and computer services. Rule 155 provides in pertinent part:

Persons rendering information or computer services and persons who manufacture, develop, process, or sell information or computer programs are subject to business and occupation taxes and retail sales or use taxes as explained in this rule.

. . .

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. (Emphasis supplied.)

It is this exception from the coverage of Rule 155 relating to telephone service which the taxpayer argues is applicable here.

In order for the furnishing of telephone lines to be taxable under the retailing classification of the business and occupations tax, the taxpayer must be making retail sales. RCW 82.04.250. A sale at retail means every sale of tangible personal property to consumers and includes "the providing of telephone service, as defined in RCW 82.04.065. . . ." RCW 82.04.050(5).

RCW 82.04.065 defines telephone service as either "competitive telephone service" or "network telephone service." The taxpayer claims that the furnishing of dedicated lines to its customers is network telephone service. According to RCW 82.04.065, 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.

WAC 458-20-245 includes a similar definition. The taxpayer is apparently relying upon the reference to "the providing of . . . data, or similar communication or transmission for hire" to support its position.

[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. The representative form of agreement used by the taxpayer which was submitted in support of the petition is instructive in this regard. The agreement repeatedly refers to "services" or "data processing services" in describing the taxpayer's obligations to the customer. Several pages of the agreement are devoted exclusively to a detailed description of the types of data processing services to be rendered and the manner in which these services are to be performed. The only reference to the telephone lines is contained in the provision dealing with the customer's obligation to bear the cost of the same in connection with the "on-line availability" of the data processing services.

WAC 458-20-138 ("Rule 138") is the administrative regulation which defines personal services. Rule 138 has this to say about costs incidental to the rendering of personal services:

There must be included within gross amounts reported for tax all fees for services rendered and all charges recovered for expenses incurred in connection therewith, such as transportation costs, hotel, restaurant, telephone and telegraph charges, etc. (Emphasis supplied.)

We cannot accept the taxpayer's argument that because less than all customers contract for on-line services, the telephone lines are a separately furnished product. This argument misses the point. The relevant inquiry is whether the transactions which include the Network Charge are sales or services. The fact that certain customers choose not to contract for on-line service has no bearing on this issue. By focusing on the real objective sought by the taxpayer's customers, we have concluded that the taxpayer's Network Charges should be taxed under the Service classification. For purposes of the retail sales tax, the taxpayer is the consumer of the telephone service and as such is obligated to pay the tax on its purchases. Since the taxpayer has previously collected retail sales tax on the fees charged for telephone service, it is entitled to a credit to the extent these taxes have been refunded to customers.

#### DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED the 27th day of March 1990.