

Cite as Det. No. 19-0284R, 41 WTD 118 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for	)	<u>D E T E R M I N A T I O N</u>
Correction of Assessment of	)	
	)	No. 19-0284R
	)	
...	)	Registration No. ...
	)	

[1] WAC 458-20-15503; RCW 82.08.050, RCW 82.04.192: RETAIL SALES TAX – DIGITALLY AUTOMATED SERVICES – INTEGRATED SERVICE. The sale of an integrated service with multiple features and functions is subject to tax as a retail Digital Automated Service even though individual elements of the service could fit within specific exclusions. What is being sold is not the enumerated excluded service, which is rather a component part of the sale of the larger integrated service for which there is no applicable exclusion.

[2] 47 USC SEC. 151 NOTE, § 1105(5) (ITFA): INTERNET SERVICES – EXEMPTION. ITFA prohibits multiple or discriminatory taxes on electronic commerce. Services with similar components that are provided through different means and subject to different taxes, are not similar services in the context of establishing prohibited discriminatory taxation. In this case, imposing retail sales tax on the services at issue is not a prohibited tax on electronic commerce or a discriminatory tax precluded by ITFA.

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.

Kreger, T.R.O. – A company providing [electronic] account access services to credit unions seeks reconsideration of our determination affirming the assessment of tax on digital automated services (DAS), asserting that the services fit within a number of exclusions from DAS and that the taxation of these services is prohibited by the Internet Tax Freedom Act. We affirm our decision that the activities at issue were properly classified as DAS and that the taxation of the services at issue is not prohibited by the Internet Tax Freedom Act. The Taxpayer’s petition is denied.<sup>1</sup>

ISSUES

1. Under RCW 82.04.050(8), RCW 82.04.192(3), and WAC 458-20-15503, are an entity’s services provided electronically through one or more software applications, along with licenses

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

to use its software and other professional services provided exclusively therewith, taxable as DAS?

2. Is the taxation of the services as DAS prohibited as a discriminatory tax on electronic commerce under the Internet Tax Freedom Act (ITFA)?

### FINDINGS OF FACT

. . . (Taxpayer) is [an out of state] corporation engaged in the business of providing online financial services to member credit unions. The Taxpayer . . . offers a variety of online banking and information services to these member credit unions that would be financially prohibitive for the member credit unions to individually provide.

The Washington State Department of Revenue's (Department) Audit Division examined the Taxpayer's business activities for the period of January 1, 2012, through June 30, 2016, and identified additional tax due. The Taxpayer only protested a portion of the tax assessed. To allow the Taxpayer to file a petition for review for just the protested issues, the assessment was bifurcated. The unprotested tax was incorporated into Document No. . . . in the amount of \$ . . . , which the Taxpayer timely paid.<sup>2</sup> . . . The protested portion of the assessment was incorporated in Document No . . . in the amount of \$ . . . , of which the Taxpayer timely sought review.<sup>3</sup> Specifically, the Taxpayer disputed the classification of the sales of [Platform] and [Phone System] as retail taxable DAS. Our initial determination, issued on November 6, 2019, affirmed the taxation of the services at issue as DAS, found that the taxation of the services at issue was not prohibited by the Internet Tax Freedom Act, and that the Taxpayer has not established a basis to waive the penalties and interest imposed. The Taxpayer timely filed for reconsideration.

#### [Platform]:

[Platform] is the Taxpayer's online banking platform that allows member credit unions to provide a variety of online banking services to the member credit unions who in turn make these services available to individual credit union customers. . . . [Platform] allows credit union customers to conduct a variety of transactions, including: paying bills, accessing electronic account statements, making balance transfers, accessing credit card accounts, checking their available credit, reviewing account data, ordering statements for the preceding year, requesting replacement cards and PIN numbers, updating account contact information, requesting a current credit score, initiating inquiries about payments and transactions, and reporting a lost or stolen card. To provide this spectrum of services, [Platform] retrieves data from a variety of databases. The Taxpayer maintains a website that hosts and manages the data pulled for the selected options. Individual member credit unions set the preferences and options available for the individual credit unions.

The Taxpayer provided representative monthly billing statements for two member credit unions that included charges for [Platform] services. The billing statements include the following charges:

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<sup>2</sup> Document No. . . . comprised \$ . . . in retail sales tax, \$ . . . in retailing business and occupation (B&O) tax, a credit for (\$ . . . ) in service and other activities B&O tax paid, interest of \$ . . . , and an assessment penalty of \$ . . . .

<sup>3</sup> Document No . . . comprised \$ . . . in retail sales tax, \$ . . . in retailing B&O tax, a credit for (\$ . . . ) in service and other activities B&O tax, \$ . . . in use tax, \$ . . . in interest, and an assessment penalty of \$ . . . .

a fee per unique user, a custom programming fee, a monthly maintenance fee, and separate charges for cardholder statement requests, and reporting lost/stolen cards.

[Phone System]:

[Phone System] is the Taxpayer's automated phone system that allows customers to make inquiries, access account information, and activate credit cards. The system also routes customers to the appropriate customer service agents when the desired information was not obtained from automated responses. [Live agent] services are performed in-house by the Taxpayer's employees. The Taxpayer separately charges for card activation services, and [Phone System] calls.

The Taxpayer asserts on reconsideration that data processing is not merely one component of the service but rather the core function of the . . . [Phone System] service. In its reconsideration petition, the Taxpayer goes through an example transaction of a credit card activation/pin set up that it describes as follows:

[A]n account holder will dial into the [Phone System] from their phone to activate a credit card account and/or establish a pin code to access their account. The calls are connected via a VOIP platform to computer mainframes and servers located outside Washington. The [Phone System] service accepts a combination of voice telephone input and/or touch-tone keypad selections. During the call, the account holder is prompted to provide their credit card number. The account holder is further requested to provide additional information to authenticate their identity, based on customized criteria determined by the particular financial institution. The data provided by the account holder is converted to a form which can be sent to and processed by the computer mainframe to do a "look up" against the account holder's data which has been previously stored in the company's data base. Once the account holder's identity has been validated, the [Phone System] sends a request to the mainframe computer with the credit card number to activate the card.

In the event that an account holder's identity cannot be authenticated, the caller is transferred to a live agent. The live agent will use other questions to authenticate the account holder's identity and validate the information against the account holder's data which has been previously stored in the company's data base. Once the account holder's identity has been validated, the live agent sends a request to the mainframe computer with the credit card number to activate the card. Once the card is activated, the account holder can also set up a pin code to access the account.

Reconsideration petition, . . . .

The Taxpayer asserts that its [Platform] is excluded from the definition of DAS as a payment process service, or the loaning or transferring of money. Similarly, the Taxpayer asserts that the [Phone System] service is also excluded from the definition of DAS. The Audit Division conversely asserts that the services at issue were properly classified as DAS and include services and features beyond those involved in the asserted exemptions.

## ANALYSIS

Washington imposes a retail sales tax on all retail sales in the state of Washington. Chapter 82.08 RCW. Washington also imposes retailing B&O tax on persons engaged in the business of making retail sales in Washington. RCW 82.04.250(1). Included within the definition of “retail sale” are sales of the “right to access and use prewritten computer software.” RCW 82.04.050(6)(c). Also included within the definition of “retail sale” are sales of digital automated services or “DAS.” RCW 82.04.050(8)(a).<sup>4</sup> The term “digital automated service” is defined in RCW 82.04.192(3)(a) as “any service transferred electronically that uses one or more software applications.” WAC 458-20-15503 (Rule 15503) is the Department’s administrative regulation addressing digital products and it also addresses DAS. Rule 15503(203). . . . The retail sale of DAS includes any services provided by the seller exclusively in connection with the DAS, whether or not a separate charge is made for such services. RCW 82.04.050(8)(b).

Rule 15503 contains a general description of a DAS, which includes information access services such as those at issue here. The rule states:

**Digital automated services may include.** One or more software applications either prewritten or custom, as well as components that are similar to stand-alone digital goods. For example, an online information service may contain data, facts, or information the use of which is facilitated by one or more software applications that provide search capabilities and other functionality. Thus, digital automated services will include software and may include elements similar to stand alone digital goods, which operate together in an integrated fashion to provide an electronically transferred service.

Rule 15503(203)(a).

Data processing services are excluded from the category of DAS by RCW 82.04.192(3)(b)(xv), which provides:

. . . “data processing service” means a primarily automated service provided to a business or other organization where the primary object of the service is the systematic performance of operations by the service provider on data supplied in whole or in part by the customer to extract the required information in an appropriate form or to convert the data to usable information. Data processing services include check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities. Data processing does not include the service described in RCW 82.04.050(6)(c) . . . .

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<sup>4</sup> RCW 82.04.050(8)(a) provides:

The term [retail sale] also includes the following sales to consumers of digital goods, digital codes, and digital automated services:

- (i) Sales in which the seller has granted the purchaser the right of permanent use;
- (ii) Sales in which the seller has granted the purchaser a right of use that is less than permanent;
- (iii) Sales in which the purchaser is not obligated to make continued payment as a condition of the sale; and
- (iv) Sales in which the purchaser is obligated to make continued payment as a condition of the sale.

RCW 82.04.192(3)(b)(xv).

Rule 15503 also addresses this exclusion and provides:

Data processing services means a primarily automated service provided to a business or other organization where the primary object of the service is the systematic performance of operations by the service provider on data supplied in whole or in part by the customer to: (i) Extract the required information in an appropriate form, or (ii) to convert the data to usable information. Data processing services include check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities. Data processing does not include remote access prewritten software used by the customer to process their own data.

Rule 15503(303)(o).

Here, the services at issue provide access to and select information from a variety of databases containing customer account and transaction information and make that information available to the credit union customers via a website or over the telephone and so fit within the general DAS description. The Taxpayer . . . asserts that because the service it sells includes elements that fit within a number of specific DAS exclusions, these exclusions should apply to the service at issue.

We [conclude as we did in our initial determination regarding the [Platform] Service] that Taxpayer was not eligible for one of the DAS exclusions. The Taxpayer is not selling any of the enumerated excluded services or otherwise charging its member credit card unions for specific excluded services. Rather these services are but component parts of a larger, integrated service, which as detailed above constitute a retail sale of DAS. There is no applicable exclusion to address this type of service. Rather, the service fits generally into the definition of a DAS under RCW 82.04.192(3)(a) and Rule 15503(203)(a). None of the information provided shows the sale of a specifically enumerated exempt service. Accordingly, we affirm the Audit Division's conclusion that the [Platform] service is a DAS not covered by the enumerated exclusions and is taxable as such.

As to the [Phone System] service, the Taxpayer asserts on reconsideration that data processing is not merely one component of the service but rather the core function of the [Phone System] service. The Taxpayer asserts that this . . . service constitutes data processing under the statutory definition as "a primarily automated service provided to a business . . . where the primary object of the service is the systematic performance of operations by the service provider on data supplied in whole or in part by the customer to extract the required information in an appropriate form or to convert the data to usable information." RCW 82.04.193(3)(b)(xv).

The Taxpayer asserts that the [Phone System] service does not involve other services beyond data processing. We disagree. The Taxpayer's own example of credit card verification shows that [the Phone System] is either fully automated or may be routed to a live agent at some point in the process, which indicates that the [Phone System] service goes beyond the scope of extracting and processing information that would fit within the data processing exemption. Two of the examples

detailed in the section of Rule 15503 addressing the data processing exemption are helpful in addressing the [Phone System] service:

Example 20. Bango Corp., in preparation for litigation, hires Company to use its automated technology to search Bango's computers and gather documents relevant to the lawsuit. Company's service also provides software tools that allow Bango to categorize, copy, store, and notate the gathered documents. Company's service is not data processing. The services performed primarily involve gathering data, and providing software tools that allow the customer to categorize, copy, store and notate documents in preparation for litigation. Accordingly, Company is selling a digital automated service generally subject to retail sales tax and retailing B&O tax.

Example 21: Company provides check processing services to Wallo Corp., a bank operating in Washington. Company accepts scanned checks provided by Wallo and then uses its software and technology to extract the check dollar amount, account number, and verify the check has been signed. Company then provides this extracted and reformatted data back to Wallo allowing it to reconcile its customer's accounts. Company provides data processing services which are excluded from the definition of digital automated services. These services would generally be subject to service and other activities B&O tax.

Rule 15503(303)(o).

Similar to the automated technology addressed in example 20 – the [Phone System] service involves the performance of operations beyond the mere extraction and reformatting of data. The [Phone System] service involves use of voice recognition software, software to process and manage a variety of requests, as well as software to process information received and move the call through a variety of options, and options to categorize the call and store information generated during the call. These functions go beyond the extraction and processing of information comparable to the check processing services detailed in example 21 that are exempt data processing.

We conclude that the [Phone System] service is more similar to the automated technology addressed in example 20 than the more limited and focused data processing services detailed in example 21. Accordingly, the [Phone System] service goes beyond mere data processing and falls outside of the exemption. The Taxpayer's petition is denied on this issue.

On reconsideration, the Taxpayer also renews its assertion that taxation of these services is precluded by the Internet Tax Freedom Act (ITFA), Pub. L. 105-277. Congress enacted ITFA in 1998, providing a three-year moratorium against states and local governments levying "taxes on internet access." 47 U.S.C. § 151 note, § 1101(a)(1). Congress extended this moratorium in 2001 and 2004. Congress amended the act again in 2007, which further extended the moratorium until November 1, 2014. After further extensions, ITFA became permanent on February 24, 2016. Pub. L. 114-125.

ITFA also prohibits "multiple or discriminatory taxes on electronic commerce." 47 U.S.C. § 151 note, §1101(a)(2). The term "electronic commerce" is defined to mean any transaction that is

“conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration and includes the provision of Internet access.” ITFA, § 1105(4).

ITFA defines a discriminatory tax as:

- (A) any tax imposed by a State or political subdivision thereof on electronic commerce that—
  - (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means;
  - (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period;
  - (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means;
  - (iv) establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means; or
- (B) any tax imposed by a State or political subdivision thereof, if--
  - (i) the sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation; or
  - (ii) a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of--
    - (I) the display of a remote seller's information or content on the out-of-State computer server of a provider of Internet access service or online services; or
    - (II) the processing of orders through the out-of-State computer server of a provider of Internet access service or online services.

ITFA, § 1105(2).

In this case, the Taxpayer asserts that imposing retail sales tax on the services at issue as DAS is “tantamount” to a discriminatory tax on electronic commerce. We disagree. To find a discriminatory tax under ITFA, § 1105(2)(A)(i) and (iii) above, it must be established that that “similar” services be taxed differently in order for discrimination to exist under the ITFA.<sup>5</sup> However, the courts have held that the mere fact that an online transaction has a brick and mortar analog that is taxed differently, does not mean that the services are similar. Cases that analyze the discriminatory tax provisions do not support that imposing retail sales tax on DAS is a discriminatory tax. In *Village of Rosemont, Illinois v. Priceline.com, Inc.*, 2011 WL 4913262 (N.D. Illinois 2011) (*Priceline*), the court found different taxation of online travel companies than traditional travel companies did not present an ITFA discriminatory tax violation because the

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<sup>5</sup> [After the issuance of this determination, the Washington Court of Appeals decided *Gartner v. Dep’t of Revenue*, 455 P.3d 1179 (2020), which analyzes the ITFA as applied to a DAS.]

services operated differently. *See also Mayor & City Council of Baltimore v. Priceline.com Inc.*, 2012 WL 3043062 (D. Md. 2012). Thus, services with similar components that are provided through different means and subject to different taxes are not similar services in the context of establishing prohibited discriminatory taxation.

Similar to the manner in which the Taxpayer seeks to focus on discrete elements of the services at issue to classify them as excluded from the category of DAS, the Taxpayer again focuses on the taxation, or lack of taxation, for specific features or transactions that make up the services to attempt establish discrimination. The Taxpayer asserts that activating a credit card is not subject to tax when conducted by contacting a live customer service agent but is subject to tax when performed through the use of the [Phone System] service. We disagree with this example on several levels. Initially, we note that if a company with taxing nexus in Washington were selling customer services that offered credit card activation, the income from those services would also be subject to tax. Thus, the assertion that similar activities are not subject to tax is incorrect.

While traditional call center services and credit card processing or management activities would not be classified as a retail, these services are not at issue here. . . . [Phone System] is [an] automated phone system. Its non-digital equivalent could be software or “telecommunication services” both of which could be taxable as retail sales under RCW 82.04.050. However, this is unclear. Furthermore, it is difficult to imagine what a non-digital equivalent would be for [an] automated, electronic phone system. The Taxpayer asserts that the different classification of the two services is indicative of discrimination and that the only difference is one is performed electronically and the other through a live representative. Again, we disagree. While the services may involve similar components, the point is that they are provided through distinct and different activities, involve a different scope and range of activities, and are accessed in different ways, all of which support different classification. Under the *Priceline* decision, noted above, the fact brick and mortar services may involve similar elements or activities does not independently establish that the services are similar in the context of establishing a discriminatory tax. The court in *Priceline* found that the online service involved was not “similar” to other traditional services and therefore could be taxed differently without discriminatory effect under the ITFA. Similarly here, the fact that there is an in-person service that may offer some of the elements or tasks that can be provided by the [Phone System] service is not sufficient to categorize the electronic service as similar for purposes of establishing discrimination, because there are also applicable differences between the services at issue that support placing the activities in different tax classifications.

Here, the Taxpayer has not established that imposing retail sales tax on DAS is a prohibited tax on electronic commerce or discriminatory tax precluded by ITFA. We deny the Taxpayer’s petition on this issue.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 4th day of June 2020.