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No. 57491-4

**DIVISION I OF THE COURT OF APPEALS
FOR THE STATE OF WASHINGTON**

Community Telecable of Seattle, Inc., Comcast of Washington I, Inc., and
Comcast of Washington IV, Inc.,

Respondents,

vs.

City of Seattle,

Appellant,

Corrected
Appellant's Opening Brief

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TABLE OF CONTENTS

	<u>Page(s)</u>
I. ASSIGNMENTS OF ERROR.....	1
II. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR	2
III. STATEMENT OF THE CASE	2
IV. ARGUMENT.....	10
A. Comcast Is Subject To Seattle’s Utility Tax Because Comcast Engages In Telephone Business In The City.....	10
B. The City’s Assessment Is Presumed Correct And Comcast Has The Burden Of Proof On Appeal To The Superior Court.	12
C. Comcast Refused To Produce The Excite@home Contracts During The Audit And Is Therefore Barred Under SMC 5.55.060 From Challenging The Assessment Based On The Audit.	13
D. The City Is Not Prohibited By The State Internet Tax Moratorium From Imposing Its Utility Tax On Comcast’s Telephone Business Activities In The City.	16
1. Comcast’s telephone business activities are subject to the City’s utility tax regardless of whether Comcast also provided internet services.	16
2. The City has, pursuant to Rule 155, permitted companies that engage in telephone business and that provide internet services to pay the telephone utility tax based only on the revenue attributable to the telephone business activities.....	20
3. Comcast operated the transmission system in Seattle and Excite@home provided internet services to Comcast’s customers in Seattle.	23

E. The City Is Allowed To Tax Plaintiffs’ Data Transmission Activities Under The Federal Internet Tax Freedom Act Because The City Imposed Its Tax Prior To 1998.....	23
1. The Federal Internet Tax Freedom Act does not apply to the City’s telephone utility tax.....	23
2. The City is authorized by the State to tax telephone business.	26
3. Comcast had a reasonable opportunity to know by virtue of a rule or other public proclamation that the City applied its telephone utility tax to companies transmitting internet services.....	26
4. The 1995 Memorandum of Understanding between the City and Comcast provided notice to Comcast that the City applied its telephone utility tax to companies transmitting internet services.	29
5. The City’s telephone utility tax is subject to the ITFA grandfather clause because the City generally collected the telephone utility tax.	30
F. The City Telephone Utility Tax Is Not Discriminatory Under The ITFA Because It Is Imposed Upon And Legally Collectible From Companies Engaged In Telephone Business In The City.....	33
G. The City Telephone Utility Tax Does Not Tax “Internet Access” As Defined By The ITFA.....	36
H. The Brand X Case Does Not Prohibit The City From Imposing Its Telephone Utility Tax On Data Transmission In The City	37
V. CONCLUSION.....	39

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES

National Cable & Telecommunications Ass'n v. Brand X Internet Services, __ U.S. __, 162 L. Ed. 2d 820, 125 S. Ct. 2688 (2005) 37, 38

STATE CASES

City of Spokane v. J-R Distributors, Inc., 90 Wn.2d 722, 726, 585 P.2d 784 (1978) 15

Dep't of Ecology v. Campbell & Gwinn, L.L.C., 146 Wn.2d 1, 9, 43 P.3d 4 (2002) 3

General Motors v. City of Seattle, 107 Wn. App. 42, 57, 25 P.3d 1022 (2001) 13

Lacey Nursing Ctr., Inc. v. Dep't of Rev., 128 Wn.2d 40, 905 P.2d 338 (1995) 15

Longview Fibre Co. v. Cowlitz County, 114, Wn.2d 691, 790 P.2d 149 (1990) 15

Pacific Telephone and Telegraph Co. v. City of Seattle, 172 Wash. 649, 653, 21 Pac. 721 (1933) 26

Seattle FilmWorks, Inc. v. Department of Revenue, 106 Wn. App. 448, 24 P.3d 460 (2001) 3

U.S. Tobacco Sales v. Dep't of Rev., 96 Wn. App. 932, 982 P.2d 652 (1999) 3

Western Telepage v. City of Tacoma, 140 Wn.2d 599, 998 P.2d 884 (2000) 26

FEDERAL STATUTES

47 U.S.C.A. §151 (note) §1110(a) (2001); 115 Stat. 703 (2001) 24

47 U.S.C.A. §151 (note) §1110(a) (2004); 118 Stat. 2615 (2004) 24

STATE STATUTES

RCW 35.21.717	16, 17, 20, 26
RCW 35.21.714	26
RCW 35.21.870(1)	26
RCW 35.22.280(3)	26
RCW 35.22.570	26
RCW 7.24.110	14
RCW 82.04.065	17, 18, 19
RCW 82.04.297(32)	17
RCW 82.32.070(1)	15

ORDINANCES

SMC 5.30.060	11, 18, 21, 31
SMC 5.45.050	8, 35
SMC 5.48.020	12, 21, 27, 30
SMC 5.48.050	7, 8, 10, 11, 12,
SMC 5.55.060	9, 13, 14

SMC 5.55.140 12

SMC ch. 3.02 27

MISCELLANEOUS

1B Wash. Prac. § 72.3 (1997) 12

Laws of 1997, ch. 304, §§ 2,5 17

Seattle Business Tax Rule 5-44-155 20, 21, 22, 23

I. ASSIGNMENTS OF ERROR

- A. The trial court erred in granting Comcast's motion for summary judgment and denying the City's motion, thereby ruling that the City's Telephone Utility Tax on Comcast's telephone business activities in Seattle is prohibited by the State Internet Tax Moratorium.
- B. The trial court erred in granting Comcast's motion for summary judgment and denying the City's motion, thereby ruling that the City's Telephone Utility Tax on Comcast's telephone business activities is prohibited by the federal Internet Tax Freedom Act's ban on discriminatory taxation of internet access.
- C. The trial court erred in granting Comcast's motion for summary judgment and denying the City's motion, thereby ruling that the City's Telephone Utility Tax on Comcast's telephone business activities is prohibited by the federal Internet Tax Freedom Act, including the Act's ban on taxes on internet access.
- D. The trial court erred in granting Comcast's motion for summary judgment and denying the City's motion, thereby ruling that the City's Telephone Utility Tax does not apply to Comcast's telephone business activities in the City.
- E. The trial court erred in granting Comcast's motion for summary judgment and denying the City's motion, thereby ruling that the grandfather clause of the federal Internet Tax Freedom Act does not permit the City to impose its Telephone Utility Tax on Comcast's telephone business activities.
- F. The trial court erred in granting Comcast's motion for summary judgment and denying the City's motion, thereby ruling that Comcast's telephone business activities in the City constitute "internet access" under the federal Internet Tax Freedom Act.
- G. The trial court erred in granting Taxpayer's motion for summary judgment and in failing to grant the City's motion for summary judgment.

II. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

- A. If the undisputed facts show that Comcast engages in telephone business in the City as defined by the Seattle Municipal Code, should Comcast pay the City's telephone utility tax? (Assignments of Error A-G.)
- B. Does the State Internet Tax Moratorium prohibit the City from imposing its Telephone Utility Tax on Comcast's telephone business activities? (Assignments of Error A, D, G.)
- C. Does the federal Internet Tax Freedom Act's prohibition on discriminatory taxes apply to the City's Telephone Utility Tax? (Assignments of Error B, C, G.)
- D. Does the grandfather clause of the federal Internet Tax Freedom Act apply to the City's Telephone Utility Tax? (Assignments of Error C, E, G.)
- E. Does the federal Internet Tax Freedom Act's prohibition of taxes on internet access apply to the City's Telephone Utility tax? (Assignments of Error C, F, G.)

III. STATEMENT OF THE CASE

A. Standard of Review

Defendant/Appellant City of Seattle ("City") and respondents Community Telecable of Seattle, Inc., Comcast of Washington I, Inc., and Comcast of Washington IV, Inc. ("Comcast") filed cross-motions for summary judgment. CP 128, 152.¹ Summary judgment is appropriate if there are no genuine issues of material fact, and the moving party is entitled

¹ Plaintiffs' names have changed since the mid-1990's due to a series of mergers and acquisitions that do not affect the tax issues raised in this lawsuit. CP 130-131, 153. Plaintiffs will be referred to in this brief as "Comcast."

to judgment as a matter of law. CR 56(c). The appellate court reviews the trial court's decision de novo. *U.S. Tobacco Sales v. Dep't of Rev.*, 96 Wn. App. 932, 982 P.2d 652 (1999). Construction of a statute or a regulation is a question of law that this court reviews de novo. *Seattle FilmWorks, Inc. v. Department of Revenue*, 106 Wn. App. 448, 24 P.3d 460 (2001); *Dep't of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wn.2d 1, 9, 43 P.3d 4 (2002).

B. Introduction

Comcast owns a cable transmission network leading to many homes and businesses in Seattle. In addition to transmitting cable television over the network cables, Comcast also uses the cable network to transmit data that allows their customers to use the internet. The City of Seattle imposes a utility tax on companies that transmit data over cable networks in Seattle. The City assessed the utility tax against plaintiffs for engaging in this business in Seattle and plaintiffs appealed the tax assessments. The parties brought cross-motions for summary judgment and the trial court denied the City's motion and granted Comcast's motion.

C. Facts

Comcast transmits cable television services and internet services to homes and businesses in Seattle. CP 176, ¶¶ 8-9. Comcast and its predecessor corporations entered into franchise agreements with the City for the right to run cable to customers in Seattle. CP 184-186. As a result,

Comcast owns a transmission system in Seattle that includes cable running to individual properties and a network of fiber optics, cables, and other equipment to transmit between its Seattle customers and Comcast's "head end" in Burien, Washington. CP 188-189, 193-194, 202-205.

In addition to providing cable television signals over its Seattle cable network, Comcast also offers its customers the ability to use the cable network for a high-speed broadband internet connection. CP 176, 190-192, 200-201, 208. The use of the cable network for this purpose began in approximately early 1998. CP 199. In September 1995, in anticipation of the use of the cable network to as a connection to the internet, Comcast and the City entered into a memorandum of understanding as part of cable refranchise discussions. CP 479. The Memorandum states that "TCI [Comcast's predecessor] will offer commercial internet access service in Seattle as one of its earliest cities." CP 486. The Memorandum indicates that the parties contemplated that Comcast's use of its network to transmit internet services in Seattle would be subject to the City' telephone utility tax:

[T]elecommunications and Internet service shall be taxed at the city rate for telecommunications services (currently 6 %). No franchise fee will be collected on this revenue.

CP 491. As shown by this 1995 memorandum, Comcast had notice that its telecommunications services would be subject to the City's telephone utility tax.

Comcast provides its internet customers with a device for their home called a "cable modem" that allows its customers to use the cable network for the internet. CP 190-192, 201-202. The actual pathway to the customer's house for the internet is through the same cable as for television service. CP 191. The transmission of the internet signal to and from the customer's house is through coaxial cable that leads to a pole outside the house, then through fiber optic cable to hubs in Seattle, and from there through fiber optic cable to Comcast's head end in Burien, Washington. CP 132-133, 188-189, 193-194, 202-205. From Burien the signal travels by fiber optic cable to a facility at the Westin Building in Seattle. CP 132-133, 193-194, 202-205. The signal leaves the Westin Building by fiber optic cable. CP 132, 204-205. Comcast owns all of the cable, fiber optics and other transmission equipment from the outside of the customer's house to the head end in Burien. CP 176, 187, 189, 194.

Comcast's customers receive, through the network, internet services such as e-mail and the ability to use a browser to access web pages on the world wide web. CP 194-195, 206-207. Comcast has entered into contracts with other entities to provide such internet services to Comcast's customers.

During much of the audit period, Comcast's customers received internet services from a company known as Excite@home. CP 40, 252-253. Excite@home had contracts with Comcast during the audit period that allowed Excite@home to provide internet services to Comcast's customers. CP 257-403. Under the contracts Excite@home agreed to provide internet services and all equipment necessary to provide those services other than the equipment provided by Comcast between the subscriber's home and the head end. CP 258, 262-265, 296-306. In exchange for providing this equipment and services to Comcast's subscribers, Excite@home agreed to split with Comcast certain subscriber revenues. CP 298-299. Comcast received 65% of these revenues and Excite@home received 35%. CP 298-299. In effect, Comcast provided the final portion of the transmission system from the subscriber's home to the head end and Excite@home provided other infrastructure and the internet services received by the subscribers.

Excite@home declared bankruptcy in 2001 and in November 2001 ceased providing internet services to Comcast's customers. CP 40, 252-255. Comcast then used a variety of other entities to provide the services that Excite@home had provided. CP 255-256. Comcast used its cable network in Seattle to transmit internet services from Excite@home and other providers to Comcast's customers.

The City's imposes a telephone utility tax on entities engaged in the business of transmitting data over a network in Seattle. Seattle Municipal Code ("SMC") 5.48.050A. CP 219. Such businesses must pay a tax of six percent of the revenue from that business. Comcast's use of its cable network in Seattle to transmit data provided by Excite@home and other internet service providers is subject to the telephone utility tax imposed by SMC 5.48.050A.

Comcast has not correctly reported and paid the utility tax due the City. In fact, for more than fifteen months, despite instructions to the contrary, Comcast paid a tax with a higher rate than the utility tax. Prior to March 15, 2002, Comcast paid tax to the City for its cable modem services under the cable television provision of the Seattle Municipal Code, SMC 5.48.050H. CP 176. Under the Seattle Municipal Code, cable television activities are taxed at a higher rate, ten percent, than the six percent telephone utility tax under SMC 5.48.050. CP 219. After the Director of the City's Revenue and Consumer Affairs Division discovered that Comcast was paying the cable television tax instead of the telephone utility tax, the Director instructed Comcast in a December 26, 2000 letter to pay the six percent telephone utility tax. CP 45, 505. Despite the Director's instructions, Comcast continued to pay the higher cable television tax until March 15, 2002. CP 45, 176, 505. On April 29, 2002, Comcast informed

the Director that in the future it would pay neither the telephone utility tax nor the cable television tax. CP 46. Instead, Comcast informed the City that it would pay only the .415 percent Business and Occupations (“B&O”) tax rate imposed on service activities under SMC 5.45.050. CP 46. The City did not agree with Comcast’s conclusion and repeated in a May 9, 2002 letter its instructions that Comcast should report cable modem revenue under the telephone utility tax. CP 46, 507.

After Comcast again refused to comply with his reporting instructions, the Director notified Comcast on June 18, 2002 that the City would conduct an audit of Comcast’s business activities in Seattle. CP 46, 510. The City conducted the audit and confirmed the City’s position that Comcast was subject to the telephone utility tax for its telephone business activities in the City. Accordingly, the City issued tax assessments to Comcast on July 25, 2003. CP 404-436. The City assessed its utility tax against Comcast for engaging in the telephone business in Seattle in 2001 and 2002 (the “audit period”). CP 404-436. The assessments included a credit to reimburse Comcast for the period during which it had incorrectly paid the ten percent cable television tax. CP 41, 405, 416, 427.

During the audit, the City requested that Comcast provide copies of its contracts with Excite@home to assist the City in determining the business relationship between the companies, the services offered by the

companies, and the payments from Comcast for the internet services provided by Excite@home. CP 40, 46-47. The auditor requested on a number of occasions copies of Comcast's contracts with Excite@home and with the entities that replaced Excite@home. CP 40. Plaintiffs refused to provide copies of these contracts. CP 40, 46-47, 405-406, 416-417, 427-428. The City exercised its right under SMC 5.55.060D to conclude the audit and issue an assessment without the information the taxpayers refused to provide. CP 40, 46-47, 405-406, 416-417, 427-428. Because Comcast failed to provide information requested by the City, the assessments taxed all of Comcast's cable modem revenue under the telephone utility tax. Comcast appealed the tax assessment.

Without question, Comcast's use of its cable transmission system in the City constitutes a "telephone business" as defined by the Seattle Municipal Code. Consequently, Comcast is subject to the City's telephone utility tax. Comcast contends that because it provides internet services in addition to data transmission, it is not liable for the City's utility tax under State and Federal laws. As discussed below, Comcast cannot avoid the City's telephone utility tax by bundling the billing for its data transmission services with other internet services, especially services provided by Excite@home and other entities. The undisputed facts establish that Comcast operated a transmission system in the City and is therefore subject

to the telephone utility tax. The trial court erred by denying the City's motion for summary judgment and by granting Comcast's cross-motion.

IV. ARGUMENT

A. Comcast Is Subject To Seattle's Utility Tax Because Comcast Engages In Telephone Business In The City.

The City of Seattle's telephone utility tax is a tax on the privilege of engaging in the "telephone business" in the City. SMC 5.48.050A. CP 219. The tax is not an income tax. Instead, it is imposed on anyone engaged in "telephone business" in the City. *Id.* The tax is imposed:

Upon everyone engaged in or carrying on a telephone business, a fee or tax equal to six (6) percent of the total gross income from such business provided to customers within the City . . .

SMC 5.48.050A. CP 291. The tax code states that the tax is imposed on anyone engaged in carrying on a "telephone business." The City defines "telephone business" to include activities other than traditional telephone service and includes the business of transmitting data over a cable. The definition states:

"Telephone business" means the providing by any person of access to a local telephone network, local telephone network switching service, toll service, cellular or mobile telephone service, coin telephone services, pager service 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. The term includes cooperative or farmer line telephone companies or

associations operating exchanges. The term also includes the provision of transmission to and from the site of an internet provider via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system.

"Telephone business" does not include the providing of competitive telephone service, or providing of cable television service, or other providing of broadcast services by radio or television stations.

SMC 5.30.060C (emphasis added). CP 215-216. The relevant language for Comcast is that "telephone business" includes "the providing of . . . data, or similar communication or transmission for hire via a . . . cable, or similar communication or transmission system." SMC 5.30.060C. CP 215-216. In addition, the definition of telephone business specifically includes the "provision of transmission to and from the site of an internet provider via a . . . cable . . . or similar communication or transmission system." *Id.*

Comcast engaged in telephone business when it used its cable system to transmit data over its cable transmission system. Comcast transmitted to and from the site of an internet provider by transmitting from its customers' homes to Comcast's facility in Burien and to the Westin building. Thus, Comcast's data transmission activities are subject to the telephone utility tax imposed by the City under SMC 5.48.050A.

In tax law, Comcast's act of engaging in telephone business is considered the "incident" of the tax, or the taxable activity. The

“incident” of the tax, along with the “rate” and the “measure,” are the three basic elements of a tax system:

To any tax system, there are three basic elements. First, there must be an incident that triggers the tax; a taxable incident is an identifiable activity that the legislature has designated as taxable. The second element, the tax measure, is the base upon which the amount of tax is determined. Finally, there is the tax rate that is multiplied by the tax measure, to determine the amount of the tax due.

1B Wash. Prac. § 72.3 (1997). Here, the incident of the tax is the engaging in “telephone business” by transmitting data over a cable system in the City or by transmitting to and from the site of an internet provider. SMC 5.48.050A. The “measure” of the tax is the “total gross income” from telephone business. *Id.* The City’s tax code defines “gross income” broadly as “the value proceeding or accruing from the sale of tangible property or service.” SMC 5.48.020. The rate of the tax is six percent of the total gross income from the business. SMC 5.48.050A. The City’s tax assessment imposed a tax on Comcast’s telephone business activities in the City during the audit period. CP 405, 416, 427.

B. The City’s Assessment Is Presumed Correct And Comcast Has The Burden Of Proof On Appeal To The Superior Court.

Challenges to the City’s tax assessments are governed by SMC 5.55.140B, which states that the assessment is prima facie correct, that the taxpayer bears the burden of proof in all appeals, and that the taxpayer has the burden of establishing the correct amount of tax. SMC 5.55.140B. CP

214. A reviewing tribunal “gives considerable deference to the construction of an ordinance by those officials charged with its enforcement.” *General Motors v. City of Seattle*, 107 Wn. App. 42, 57, 25 P.3d 1022 (2001). Thus, Comcast has the burden of proof and the court gives deference to the City’s construction of its tax code.

Comcast does not dispute the financial data on which the City based its tax assessment. Instead, Comcast contends, on a variety of theories, that it is not subject to the City’s utility tax. The City’s cross-motion for summary judgment established, based on undisputed facts, that Comcast is liable for the assessed tax.

C. Comcast Refused To Produce The Excite@home Contracts During The Audit And Is Therefore Barred Under SMC-5.55.060 From Challenging The Assessment Based On The Audit.

A taxpayer that does business in Seattle is required to make its business records available for inspection to the City’s auditors. SMC 5.55.060A. CP 210. A taxpayer who refuses to provide records in an audit cannot later challenge a tax assessment for that time period. The Seattle Municipal Code states:

Any person who fails, or refuses a Department request, to provide or make available records . . . shall be forever barred from questioning in any court action, the correctness of any assessment of taxes made by the City based upon any period for which such records have not been provided, made available or kept and preserved . . .

SMC 5.55.060D. CP 211. Here, Comcast refused to produce its contracts with Excite@home or with Excite@home's successors. CP 40. The City needed to review those contracts to determine the nature of services provided by Comcast and the nature of services provided by other entities. CP 46-47 Plaintiffs refused to provide the agreements and the City was forced to complete its audit without the information contained in the agreements. Under SMC 5.55.060, Comcast cannot now challenge the assessed tax for that audit period.

Comcast objected for the first time to SMC 5.55.060D in its summary judgment response brief. This provision states that a taxpayer that refuses to provide records in an audit cannot later challenge the tax assessment. The City stated in its July 25, 2003 assessment letters that Comcast was subject to SMC 5.55.060 for its failure to produce the Excite@home contracts. CP 405, 416, 427 Comcast did not challenge SMC 5.55.060 in its complaint or in its cross-motion and cannot raise it for the first time in its response brief.

Furthermore, Comcast failed to comply with RCW 7.24.110, which requires that if a party alleges that a municipal ordinance is unconstitutional in an action for declaratory judgment, "the attorney general shall also be served with a copy of the proceeding and be entitled

to be heard.”² The State Department of Revenue relies on an almost identical provision in RCW 82.32.070(1) and has a right to be heard on Comcast’s contentions that SMC 5.55.060 violates due process and unconstitutionally limits the court’s jurisdiction.

Finally, SMC 5.55.060 is a constitutional exercise of the power to tax that the legislature granted to Seattle. Comcast based its argument on The court in *City of Spokane v. J-R Distributors, Inc.*, 90 Wn.2d 722, 726, 585 P.2d 784 (1978) acknowledged that a city is allowed to exercise the authority granted by the legislature. Unlike the ordinance at issue in *Spokane*, the Seattle ordinance does not prescribe rules regarding the admissibility of evidence or dictate practice and procedure in court. Instead, SMC 5.55.060 is an integral part of the power to tax and establishes the amount of tax owing based on the taxpayer’s conduct. Washington courts have enforced other such tax reporting and enforcement provisions.³ The Court should not permit Comcast to evade its duty to provide financial records under SMC 5.55.060.

² Comcast sent the Attorney General a copy of its complaint at the outset of the case. CP 762. But the complaint did not contain the allegation that SMC 5.55.060 was unconstitutional. CP 3. Thus, Comcast never notified the Attorney General of the constitutional challenge to a municipal ordinance.

³ See, e.g., *Longview Fibre Co. v. Cowlitz County*, 114, Wn.2d 691, 790 P.2d 149 (1990); *Lacey Nursing Ctr., Inc. v. Dep’t of Rev.*, 128 Wn.2d 40, 905 P.2d 338 (1995).

D. The City Is Not Prohibited By The State Internet Tax Moratorium From Imposing Its Utility Tax On Comcast's Telephone Business Activities In The City.

1. Comcast's telephone business activities are subject to the City's utility tax regardless of whether Comcast also provided internet services.

Comcast attempts to avoid the City's telephone utility tax by bundling transmission charges with charges for internet service. Comcast contends that because it provided internet services to its customers directly or through contracts with other entities, it is exempt from the City's utility tax under the State Internet Tax Moratorium, RCW 35.21.717. Comcast is incorrect. The undisputed evidence shows that Comcast engaged in telephone business in Seattle and is therefore liable for the telephone utility tax regardless of what other services Comcast provided. Comcast cannot avoid the telephone utility tax by bundling the customer charges for its telephone business with charges for internet services. This bundling does not transform the nature of Comcast's activities.

The State Internet Tax Moratorium on which Comcast relies, RCW 35.21.717, imposes limits on taxes on internet services, but does not apply to telephone business. Under RCW 35.21.717, the state restricted a city's right to impose new taxes on internet service:

Until July 1, 2006, a city or town may not impose any new taxes or fees specific to internet service providers. A city or town may tax internet service providers under generally applicable business taxes or fees, at a rate not to exceed the

rate applied to a general service classification. For the purposes of this section, "internet service" has the same meaning as in RCW 82.04.297.

RCW 35.21.717. The statute applies to "internet service," which is defined in RCW 82.04.297(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.

This definition does not cover the telephone business activities that are covered by the City's telephone utility tax.

The State specifically distinguishes between telephone business and internet service and preserves the ability of cities to tax telephone business. In the same legislative bill that created the Internet Tax Moratorium, the Washington Legislature amended the definition of "network telephone service" to distinguish telephone business from internet service.⁴ Laws of 1997, ch. 304, §§ 2, 5. In RCW 82.04.065, the state defines network telephone service to include data transmission, including transmission to and from the site of an internet provider:

⁴ The term "network telephone service" is relevant because the State defines "telephone business" as including "network telephone service." RCW 82.04.065(4).

"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.

RCW 82.04.065 (emphasis added).⁵ The statute specifically distinguishes between telephone business and internet service. The statutes allow a City to tax the data transmission activities defined as telephone business. The State Internet Tax Moratorium does not apply to cities' taxation of activities defined as telephone business.

Comcast's activities are covered by the general and specific descriptions of network telephone service in RCW 82.04.065. First, Comcast provides data transmission over a cable system in accordance with the first part of the definition. Second, Comcast provides

⁵ The City's definition of "telephone business" in SMC 5.30.060 is essentially the same as the State's definition of network telephone service.

“transmission to and from the site of an internet provider” via a cable transmission system as described in the second portion of the definition. The undisputed facts show that Comcast provides a transmission system from its customers’ homes or businesses to Comcast’s facility in Burien and then to the Westin Hotel. Comcast is subject to the City’s telephone utility tax for operating this transmission system in Seattle. The fact that Comcast bundles the charge for the use of the system with charges for other services does not exempt Comcast from the tax.

Comcast argues that the definition of network service provider does not apply because “there is no separate ‘internet service provider’ to which Comcast transmits data.” CP 645. Comcast also contends that the definition of network telephone services only applies to transmissions to dial-up internet providers. CP 646. First, the definition of network telephone services does not require a separate entity as an internet service provider. Under the plain language of RCW 82.04.065, the definition applies to any entity engaged in the described conduct. Second, the definition is not limited to transmissions to dial-up providers. Indeed, the definition is broadly worded to include transmission over a variety of transmission systems, including “a telephone network, toll line or channel, cable, microwave, or similar communication or transmission system.” RCW 82.04.065.

The telephone utility tax applies because Comcast is not acting as an internet service provider when it uses its cable system in Seattle to transmit data. When engaged in data transmission activities, Comcast is engaging in telephone business under SMC 5.48.050A and is subject to the City's tax on that business activity.

Comcast contends that it is not subject to the tax because it provides internet services as well as providing a transmission system. Under Comcast's interpretation of RCW 35.21.717, any telephone business could avoid the telephone utility tax simply by offering its customers internet services such as email and access to the web. In fact, according to Comcast's argument, any water or electric utility could avoid the utility tax by offering internet services to its customers and bundling the charges. This would be an absurd interpretation of RCW 35.21.717. In reality, RCW 35.21.717, by definition, does not apply to telephone business and therefore does not apply to the City's telephone utility tax.

2. The City has, pursuant to Rule 155, permitted companies that engage in telephone business and that provide internet services to pay the telephone utility tax based only on the revenue attributable to the telephone business activities.

The City has enacted a rule that requires companies that provide both internet services and telephone services to apportion their revenue between those services. Seattle Business Tax Rule 5-44-155 ("Rule 155")

(attached as Ex. H.)⁶ The effect of Rule 155 is that a company that provides both internet and telephone services is subject to the telephone utility tax rate based only on the revenues attributable to the telephone business. The company would also be subject to the lower B&O services tax rate for the revenue from its internet services.

The City has enforced Rule 155 so that if a telephone business, internet service provider, or internet access provider business provides lines or infrastructure usage to an end user, the telephone utility tax is due. CP 44. A company that owns transmission capability through wires, cable, microwave or other medium are telephone businesses under SMC 5.30.060C and are subject to the telephone utility tax under SMC 5.48.050. CP 44.

The majority if not all of the telephone businesses the City has audited since 1995 have subsidiary companies which provide their internet

⁶ Rule 155 states: Providers of information services on the internet, or on other electronic networks, are subject to the service classification on their gross "Service" charges. An internet provider located in Seattle must insure payment of the Seattle public utility tax on their telephone access charges for the telephone lines, microwave, or other method of electronic transmission. Non-payment of the public utility tax on the aforementioned telephone access charges will indicate to the City that the internet provider is holding itself out to be in the telephone business (see SMC 5.48.020). In such a case, the gross charges by the internet provider to their clients will be apportioned between the public utility tax and the service business and occupation tax classification based on the ratio of telephone line costs (or similar costs) to the total costs of doing business.

services and account separately for that revenue, or they were otherwise willing to break out the internet service charge from their transmission charges so that each activity could be taxed under its proper classification. CP 45. Under Rule 155, all companies carrying on a telephone business that involve the transmission of internet-related data are taxed on the same basis. Companies that provide data transmission service and also provide internet services such as e-mail or web pages, are required to apportion the revenue related to each activity. CP 44.

During the audit, the City attempted to obtain Comcast's contracts with Excite@home in order to determine the amount of revenue related to the internet services received by Comcast's customers. CP 46-47. Comcast refused to provide those agreements and the City was forced to finalize the audits without that information. If Comcast had provided the contracts with Excite@home and its replacement, and had verified that those companies provided internet services to plaintiffs' customers, then the City likely would have allowed plaintiffs to deduct from their revenues the portion of those revenues that were paid to Excite@home and its successor for providing internet services. CP 46-47. This would have been consistent with Rule 155 and the City's practice of basing the telephone utility tax on the revenues from telephone business.

Under both Rule 155 and the telephone utility tax in SMC 5.48.050A, a company that engages in telephone business in the City is required to pay the telephone utility tax. A company cannot avoid the utility tax by providing other services or by bundling its telephone business revenue with revenue from internet services.

3. Comcast operated the transmission system in Seattle and Excite@home provided internet services to Comcast's customers in Seattle.

Comcast engaged in telephone business in Seattle and Excite@home provided internet services. Comcast provided the portion of the transmission network from the subscriber's home to the head end. Excite@home provided nearly all the internet services transmitted over Comcast's local network. Comcast's activities in Seattle consisted of operating its local transmission network. Comcast did not operate as an internet service provider.

E. The City Is Allowed To Tax Plaintiffs' Data Transmission Activities Under The Federal Internet Tax Freedom Act Because The City Imposed Its Tax Prior To 1998.

1. The Federal Internet Tax Freedom Act does not apply to the City's telephone utility tax.

The Federal Internet Tax Freedom Act ("ITFA") does not affect the City's ability to tax Comcast's telephone business. The ITFA provides exceptions for cities, such as Seattle, that imposed and enforced taxes

prior to October 1998. 47 U.S.C.A. § 151 (note) § 1101(a) (2001); 47 U.S.C.A. § 151 (note) § 1101(a) (2004). There have been three different versions of the ITFA since its enactment in 1998. The original 1998 version established a moratorium on new taxes on “internet access” and contained a grandfather clause for eligible taxes prior to October 1, 1998. 47 U.S.C.A. § 151 (note) § 1101(a) (1998) (All versions attached at CP 441.) Congress then amended the ITFA in 2001 by extending the moratorium on new taxes to November 1, 2003, but keeping the same grandfather clause for certain taxes prior to October 1, 1998. 47 U.S.C.A. § 151 (note) § 1101(a) (2001); 115 Stat. 703 (2001). Congress passed the third version of the ITFA in 2004, but gave it a retroactive effective date of November 1, 2003. 118 Stat. 2615 (2004). The third version contained the same grandfather clause for eligible taxes imposed prior to October 1998. 47 U.S.C.A. § 151 (note) § 1104(a) (2004). Because the audit period in this case is 2001-2002, the first and second versions apply to the audit period and the third version applies after November 1, 2003. The same grandfather clause applies to all periods.

The City’s telephone utility tax and the service B&O tax are both eligible for the grandfather clause exemption in the ITFA, 47 U.S.C.A. § 151 (note) § 1101(a) (2001) (hereafter “ITFA (2001)”). The City is eligible for the grandfather clause exemption because the City imposed

and actually enforced the telephone utility tax prior to October 10, 1998.

The ITFA (2001) states:

(a) Moratorium. – No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending on November 1, 2003 -

(1) taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998 . . .

IFTA (2001), § 1101 (a). The ITFA defines the terms “generally imposed and actually enforced” to mean that the law was authorized by statute and that either notice was given or that the tax was generally collected:

For purposes of this section, a tax has been generally imposed and actually enforced prior to October 1, 1998, if, before that date, the tax was authorized by statute and either--

(1) a provider of Internet access services had a reasonable opportunity to know by virtue of a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services; or

(2) a State or political subdivision thereof generally collected such tax on charges for Internet access.

IFTA (2001), § 1101 (d). Here, the City’s telephone utility tax is exempt from the ITFA because prior to 1998, the tax was authorized by statute

and the City gave notice of the tax by rule. The City also generally collected the tax.

2. The City is authorized by the State to tax telephone business.

First, cities in Washington are authorized by statute to impose taxes such as the City's telephone utility tax and B&O service tax. *See* RCW 35.22.280(32); RCW 35.22.570; RCW 35.21.714; RCW 35.21.870(1); *Pacific Telephone and Telegraph Co. v. City of Seattle*, 172 Wash. 649, 653, 21 Pac. 721 (1933) (power to license for any lawful purpose includes power to impose tax on telephone business); *Western Telepage v. City of Tacoma*, 140 Wn.2d 599, 998 P.2d 884 (2000)). Thus, the City's telephone utility tax and service B&O tax are both authorized by statute. Comcast contends that the State Internet Tax Moratorium terminated the City's taxing authority in 1997. CP 651. As discussed above, the State never withdrew the authority to tax telephone business and the City of Seattle's tax applies to telephone business.

3. Comcast had a reasonable opportunity to know by virtue of a rule or other public proclamation that the City applied its telephone utility tax to companies transmitting internet services.

The next requirement under the ITFA (2001) is that an internet access provider ("IAP) have notice by rule or other proclamation "that such agency has interpreted and applied such tax to Internet access

services.” IFTA (2001), § 1101 (d). The City amended Seattle Business Tax Rule 5-44-155(6) in 1995 to advise internet companies that provided data transmission services that they were subject to the telephone utility tax and that internet services were subject to the B&O service tax. CP 43, 439. The Seattle Business Tax Rules are passed according to the procedures in SMC ch. 3.02. Prior to adoption, amendment or repeal of a rule, the department is required to publish in a newspaper and hold a public hearing, as well as provide a draft to anyone who requests one. The final rules are available from the City Clerk, the RCA Division, and since the mid-1990’s on the City’s web site. Rule 5-44-155 was amended in 1995 in accordance with this procedure. CP 44.

By enacting Rule 155 the City notified the public that the City imposed its telephone utility on companies that transmitted data related to the internet. Rule 155 states:

Providers of information services on the internet, or on other electronic networks, are subject to the service classification on their gross "Service" charges. An internet provider located in Seattle must insure payment of the Seattle public utility tax on their telephone access charges for the telephone lines, microwave, or other method of electronic transmission. Non-payment of the public utility tax on the aforementioned telephone access charges will indicate to the City that the internet provider is holding itself out to be in the telephone business (see SMC 5.48.020). In such a case, the gross charges by the internet provider to their clients will be apportioned between the public utility tax and the

service business and occupation tax classification based on the ratio of telephone line costs (or similar costs) to the total costs of doing business.

Rule 155 (emphasis added). The City notified the public in Rule 155 that it would apportion an internet provider's revenue based on its transmission costs and other costs of doing business. Through Rule 155, the City met the notice requirement of IFTA (2001), § 1101 (d)(1).

Comcast argues that Rule 155 does not satisfy the grandfather clause because the City repealed the rule on December 31, 2001. CP 652. The repeal of Rule 155 in 2001 does not affect the application of the grandfather clause under the ITFA. The ITFA required a city to have provided notice prior to 1998. IFTA (2001), § 1101(d)(1). Here, the City provided notice through its amendment of Rule 155 in 1995. The Rule remained in effect for the next six years, including the first year of the audit period. CP 658. The City continued to rely on the rules for guidance and placed a statement to that effect on its web site. CP 658. Thus, Rule 155 provided notice prior to the 1998 enactment of the ITFA that the City applied its telephone utility tax to companies that transmitted data related to the internet.

Comcast also claims that Rule 155 does not satisfy the grandfather clause because the Rule is invalid and discriminatory. CP 651-652. This is incorrect. Rule 155 states that the City would enforce its tax code so

that companies engaged in both providing telephone business and internet services would be required to pay the telephone utility tax and the internet service tax. The revenues are apportioned between the two activities.

Comcast bases its argument on only one sentence of the rule and ignores the remainder. Also, contrary to Comcast's argument, Rule 155 does not discriminate against different types of internet service providers. Under Rule 155, a company that engages in both the telephone business and providing internet services will be taxed on both activities. Companies engaged in only one activity will be taxed only on that activity. CP 658. There is no discrimination. Comcast's attacks on Rule 155 do not eliminate the fact that as early as 1995 the Rule notified businesses that the City applied its telephone utility tax to companies transmitting internet services.

4. The 1995 Memorandum of Understanding between the City and Comcast provided notice to Comcast that the City applied its telephone utility tax to companies transmitting internet services.

In addition to notice through Rule 155, Comcast had notice in the 1995 Memorandum of Understanding with the City that the telephone utility tax would apply to its the use of its cable network for internet purposes. The Memorandum stated: "[T]elecommunications and Internet service shall be taxed at the city rate for telecommunications services

(currently 6 %).” CP 491. As shown by this 1995 memorandum, the parties contemplated that the cable franchisee would be subject to the telephone utility tax.

Comcast argues that the Memorandum did not provide notice because it was not legally binding and because the tax provision was not included in the subsequent franchise agreement. Neither of these arguments change the fact that the City provided notice in 1995 that the use of the cable network to transmit internet services would be subject to the telephone utility tax. The fact that the tax issue was not addressed in the franchise agreement does not excuse Comcast from paying taxes that were in effect during the term of the franchise. A government cannot by contract excuse a business from complying with the tax laws or any other laws. The Memorandum simply shows that, in addition to Rule 155, the City notified the public and Comcast that companies engaged in the telephone businesses were subject to the telephone utility tax.

5. The City’s telephone utility tax is subject to the ITFA grandfather clause because the City generally collected the telephone utility tax.

The ITFA grandfather clause also applies to taxes that a City “generally collected.” IFTA (2001), § 1101 (d)(2). The ITFA states that it applies to taxes that met the notice requirement or were generally collected. *Id.* The City’s tax is valid under either section. As stated

above, the City met the notice requirement. And, prior to October 1, 1998, the City generally collected its telephone utility tax on internet-related transmissions and its service B&O tax on internet service. CP 44-45. The City enforced Rule 155 and the utility and B&O taxes prior to October 1998. CP 44-45. Accordingly, the ITFA moratorium does not apply to the City's telephone utility tax or to the B&O service tax

Comcast alleges that because the City did not specifically instruct Comcast to pay the telephone utility tax on cable modem revenues until December 26, 2000, the City was not generally enforcing its telephone utility tax prior to October 1998. This argument ignores the undisputed facts. The City notified plaintiffs directly in the 1995 Memorandum of Understanding that cable modem activities would be subject to the utility tax. CP 491. The City notified Summit, the only other cable company operating in Seattle, in 1996 that its cable modem activities were subject to the utility tax. CP 502-503. The City amended Rule 155 in 1995 to state that transmission of internet services was subject to the telephone utility tax. Since prior to 1998, the City has enforced the tax code so that a company that owns transmission capability through wires, cable, microwave or other medium are considered a telephone businesses under SMC 5.30.060C and are subject to the telephone utility tax under SMC 5.48.050. CP 44.

When the City learned that Comcast was paying the higher cable TV tax on its cable modem service instead of the telephone utility tax, the City instructed Comcast that the cable modem revenues should be included in the measure of the telephone utility tax and should not be included in the measure of the cable TV tax. CP 45. Comcast refused to follow this instruction and continued to pay the higher tax. For much of the audit period, Comcast's tax payments were in excess of the tax due under the telephone utility tax. Therefore, the City placed the excess tax payments in a trust account to be credited against plaintiff's tax obligations. CP 45-46.

The fact that Comcast chose to report the incorrect (and excessive) tax does not mean that the City failed to generally collect its telephone utility tax. The City collected the tax from other companies using networks to transmit internet services and also collected the service B&O tax from internet service providers. CP 44-45. Like many tax systems, the City's tax system is a self-reporting tax system. CP 47. Under this type of tax system, the City relies on the taxpayers to comply with the tax code. The City selects a small percentage of the taxpayers for audit or investigation. CP 47. Here, once the City learned that Comcast was reporting under the incorrect code provision, the City instructed Comcast to report correctly. CP 45-46, 505. When Comcast refused, the City

audited Comcast and restated its reporting instructions. CP 405, 416, 427 510. As a result, the City credited Comcast for the extra tax paid.

The City promptly audited Comcast after Comcast stopped paying taxes that were sufficient to cover its telephone utility tax obligations. The City has generally collected its telephone utility tax on companies using transmission networks to transmit internet services since prior to October 1998. The fact that Comcast, a single taxpayer, misreported the tax prior to the audit does not mean that the City was not generally collecting the tax.

F. The City Telephone Utility Tax Is Not Discriminatory Under The ITFA Because It Is Imposed Upon And Legally Collectible From Companies Engaged In Telephone Business In The City.

The City's telephone utility tax is not barred by the ITFA's moratorium on discriminatory taxes because the tax applies to all companies engaged in telephone business in the City. Similarly, the service B&O tax applies to all companies providing internet services in the City. The City's taxes do not fit any of the definitions of "discriminatory tax" under the ITFA, which states:

The term "discriminatory tax" means--

(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;

ITFA (2001) § 1104(2); ITFA (2003) § 1105(2).

The first three subsections defining discriminatory tax apply to other types of “electronic commerce” under the ITFA and do not apply to this case, which involves Comcast’s use of its transmission network. The first three subsections apply to transactions and are intended to apply to a city’s attempt to tax transactions occurring over the internet differently than other transactions. *Id.* The City’s telephone utility tax is not a tax on transactions. The utility tax is a tax on the privilege of engaging in

business in the City. SMC 5.48.050A. Thus, the first three subsections of the definition of discrimination do not apply here.⁷

The fourth subsection of the ITFA's definition of discriminatory tax does not affect the City's telephone utility tax or B&O service tax. Under the fourth subsection, a tax is discriminatory if it "establishes a classification of internet access service providers" and imposes a higher tax rate on those providers. ITFA (2001) § 1104(2)(A)(iv); ITFA (2003) § 1105(2)(A)(iv). The City's taxes are permissible because the telephone utility tax applies uniformly to all companies engaged in telephone business in Seattle. The tax is based on the gross income from that business. Similarly, the City's service B&O tax applies to companies providing internet services in the City. SMC 5.45.050; Rule 155. The tax is based on the gross income from providing internet services. Neither of these taxes creates a separate class of internet access service providers that are taxed at a higher rate. All companies in Seattle that engage in telephone business are subject to the telephone utility tax and all companies that provide internet services are subject to the B&O tax.

⁷ Even if these sections did apply to this case, the City's taxes would not be affected. The City uniformly applies its telephone utility tax to companies engaged in the telephone business. The service B&O tax applies uniformly to companies providing services, such as internet services. There is no discrimination.

G. The City Telephone Utility Tax Does Not Tax "Internet Access" As Defined By The ITFA.

The City's ability to tax Comcast's data transmission activities in Seattle is not affected by the ITFA because those activities do not fall under the definition of "internet access" under the ITFA. The first and second versions of the ITFA, which governed the entire audit period in this case, exclude telecommunications services from the definition of "internet access" in effect during the audit period:

The term "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. Such term does not include telecommunications services.

IFTA (2001), § 1104 (5). Based on this definition, the ITFA does not apply to taxes on data transmission activities such as the City's telephone utility tax. The ITFA applies to providers of internet services or companies that enable customers to access the content and services on the internet. The definition does not include the transmission activities of cable companies such as Comcast. Thus, the ITFA does not affect the City's ability to impose a tax on Comcast's telephone business activities in the City.

H. The Brand X Case Does Not Prohibit The City From Imposing Its Telephone Utility Tax On Data Transmission In The City

Comcast cites *National Cable & Telecommunications Ass'n v.*

Brand X Internet Services, __ U.S. __, 162 L. Ed. 2d 820, 125 S. Ct. 2688 (2005) in support of the claim that Comcast is not subject to the telephone utility tax. But the *Brand X* case involved the regulation of cable companies and did not involve the ITFA or the taxation of cable modem companies. The case involved the regulation of cable companies under the Telecommunications Act and did not involve taxation. The Court in *Brand X* addressed the issue of the “proper regulatory classification under the Communications Act of broadband cable Internet service.” *Brand X*, 125 S. Ct. at 2696.

The Court explained that companies classified as “telecommunications carriers” are subject to regulations under the Telecommunications Act but that the same regulations do not apply to “information-service providers.” *Brand X*, 125 S. Ct. at 2696. One of the most significant regulations that applies solely to telecommunications carriers is the requirement that they make their transmission lines available to competing ISPs. *Brand X*, 125 S. Ct. at 2710. Thus, cable companies have an incentive to avoid being classified as telecommunication carriers and being required to open their lines to competitors.

The Court ruled that under the Telecommunications Act, cable modem service should be classified as an “information service” rather than a “telecommunications service.” *Brand X*, 125 S. Ct. at 2702. As such, cable modem service was not subject to the same regulations as telecommunications services. The Court in *Brand X* did not address the issue of how states and cities can tax companies that provide cable modem service.

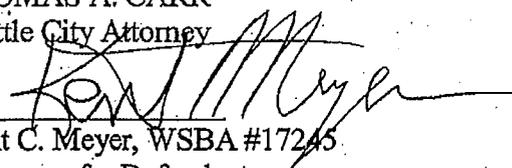
The connection between *Brand X* and taxation relied upon by Comcast is the cross-reference in the ITFA’s definition of “telecommunications service.” Under the ITFA, the term “telecommunication service” is given the same meaning it has under the Communications Act of 1934. ITFA (2001) § 1104(9); ITFA (2003) § 1105(9). The effect of this cross-reference is that cable modem service is not included in the definition of “telecommunications service” under the ITFA. However, this exclusion from the definition does not affect the City’s ability to impose its telephone utility tax. The fact that the FCC has decided not to classify cable modem service as a “telecommunications service” for regulatory purposes does not mean that the City is prohibited from taxing the use of a transmission network to transmit internet services.

V. CONCLUSION

Comcast owns and operates a cable transmission system in the City. Comcast transmits data over its system and receives revenue from its customers for the use of the system. The City imposes a telephone utility tax on companies that operate a data transmission system in the City. Comcast operates such a system and is therefore subject to the telephone utility tax. Comcast cannot escape the tax by contracting with a third party to provide internet services or by bundling its internet service revenue with its telephone business revenue. Finally, neither the state nor the federal internet tax statutes prohibit the City's telephone utility tax. The material facts are undisputed. Comcast is liable for the tax as a matter of law. The trial court erred in granting Comcast's motion for summary judgment and in denying the City's motion. This court should reverse the trial court.

DATED this 12 day of April, 2006.

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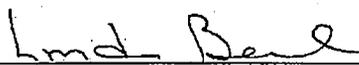
CERTIFICATE OF SERVICE

I, certify that on this date I caused a copy of appellant City of
Seattle's Brief to be filed with the court and served by first class U.S.

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Signed at Seattle, Washington, this 12th day of April, 2006.



Linda Beal