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**IN THE SUPREME COURT  
OF THE STATE OF WASHINGTON**

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

*Petitioners,*

vs.

City of Seattle,

*Respondent,*

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STATE OF WASHINGTON

**Answer to Petition for Review**

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**TABLE OF CONTENTS**

	<u>Page(s)</u>
I. INTRODUCTION .....	1
III. STATEMENT OF THE CASE .....	2
IV. ARGUMENT.....	4
A. Comcast Is Not Entitled To Review Under The Considerations Stated In RAP 13.(4)(b).....	4
B. Comcast Is Subject To Seattle’s Utility Tax Because Comcast Engages In Telephone Business In The City. ....	5
C. 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. ....	6
D. The City Requires Companies That Engage In Telephone Business And That Also Provide Internet Services To Pay The Telephone Utility Tax Based On The Revenue Attributable To The Telephone Business Activities.....	10
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.....	11
1. The Federal Internet Tax Freedom Act does not apply to the City’s telephone utility tax.....	11
2. The City is authorized to tax telephone business.....	13
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.....	14
4. The City’s telephone utility tax is subject to the ITFA grandfather clause because the City generally collected the telephone utility tax. ....	16
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.....	16

G. The Brand X Case Does Not Prohibit The City From Imposing Its Telephone Utility Tax On Data Transmission In The City .....	18
H. The Court Of Appeals Correctly Held That The City Is Not Barred From Taxing Comcast Under RCW 35.21.714. ....	19
V. CONCLUSION.....	20

**TABLE OF AUTHORITIES**

**Page(s)**

**CASES**

*Concentric Network Corp. v. Commonwealth of Pennsylvania*, 897 A.2d 6,  
15 (Penn. 2006)..... 15, 18

*National Cable & Telecommunications Ass'n v. Brand X Internet Services*,  
\_\_\_ U.S. \_\_\_, 162 L. Ed. 2d 820, 125 S. Ct. 2688 (2005)..... 19

*Pacific Telephone and Telegraph Co. v. City of Seattle*, 172 Wash. 649,  
21 Pac. 721 (1933)..... 14

*Western Telepage v. City of Tacoma*, 140 Wn.2d 599, 998 P.2d 884 (2000)  
..... 14

**STATUTES**

47 U.S.C.A. § 151 (note) § 1101(a) (2001) ..... 12

47 U.S.C.A. § 151 (note) § 1101(a) (2004) ..... 12

IFTA (2001), § 1101 (a)..... 13

IFTA (2001), § 1101 (d) ..... 13, 14

IFTA (2001), § 1101 (d)(1)..... 15

IFTA (2001), § 1101 (d)(2)..... 16

ITFA (2001) § 1104(2)(A)(iv) ..... 17

ITFA (2003) § 1105(2)(A)(iv) ..... 17

RCW 35.21.714 ..... 14, 19

RCW 35.21.717 ..... 7, 8

RCW 35.21.870(1)..... 14

RCW 35.22.280(32)..... 14

RCW 35.22.570 ..... 14

RCW 82.04.065 ..... 8, 9, 10, 15

RCW 82.04.065(2)..... 9

RCW 82.04.297 .....	7, 9
RCW 82.04.297(3).....	8

**COURT RULES**

RAP 13.4(b).....	2, 4, 7, 20
------------------	-------------

**ORDINANCES**

SMC 5.30.060C .....	6
SMC 5.45.050 .....	17
SMC 5.45.050G .....	7
SMC 5.48.020B .....	11
SMC 5.48.050A .....	3, 5, 7, 10, 17

**MISCELLANEOUS**

Excise Tax Advisory 2029.04.25.....	10, 15
Seattle Business Tax Rule 5-44-155(6) .....	14

## I. INTRODUCTION

Defendant/Respondent City of Seattle ("City") asks the Supreme Court to deny the petition for review submitted by plaintiffs/respondents Community Telecable of Seattle, Inc., Comcast of Washington I, Inc., and Comcast of Washington IV, Inc. ("Comcast"). Comcast owns a cable transmission network leading to many homes and businesses in Seattle. In addition to transmitting cable television over the network, Comcast also uses the network to transmit data that allows their customers to use the internet.

The City of Seattle imposes a telephone utility tax on companies that transmit data over cable networks in Seattle. The City assessed the utility tax against Comcast for engaging in this business in Seattle and Comcast appealed the tax assessment. The parties brought cross-motions for summary judgment and the trial court denied the City's motion and granted Comcast's motion. In a unanimous opinion written by Judge Coleman, the court of appeals reversed the trial court and granted summary judgment in favor of the City. (Court of Appeals No. 57491-4-I.)

The court of appeals correctly ruled that Comcast operates a cable transmission system in the City. The operation of this system is a telephone business and is subject to the City's telephone utility tax. The court of appeals correctly held that the Washington State moratorium on taxing internet service providers does not apply to Comcast's activities in the City.

Comcast cannot avoid the telephone utility tax by bundling internet service revenue with telephone business revenue. In addition, the court of appeals properly ruled that, under the federal Internet Tax Freedom Act, the tax is non-discriminatory and is permitted under the grandfather clause of the Act. The court of appeals' decision does not meet the criteria for review under RAP 13.4(b) and this Court should deny Comcast's petition for review.

### **III. STATEMENT OF THE CASE**

Comcast transmits cable television services and internet services to homes and businesses in Seattle. CP 176, ¶¶ 8-9. 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. Comcast 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.

The transmission of the internet signal to and from a Comcast customer's house runs 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. 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.

The City 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.

The City determined that Comcast was not correctly reporting the tax owed the City and 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 subsequently issued tax assessments to Comcast on July 25, 2003 and assessed its utility tax against Comcast CP 404-436.

Without question, Comcast's use of its cable transmission system in the City constitutes a "telephone business" as defined by the Seattle Municipal Code. 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. Comcast cannot avoid the City's telephone utility tax by bundling the billing for its data transmission services with internet services. The undisputed facts establish that Comcast operated a transmission system in the City and is therefore subject to the telephone utility tax. The court of appeals correctly ruled in favor of the City and denied Comcast's cross-motion for summary judgment.

#### **IV. ARGUMENT**

A. Comcast Is Not Entitled To Review Under The Considerations Stated In RAP 13.(4)(b).

Comcast argues that it is entitled to review under all of the considerations governing review in RAP 13.4(b). In reality, none of the considerations apply here. This case involves a tax appeal by a cable modem provider. The federal grandfather clause issue is based on unique facts that

will not likely exist in other jurisdictions. The court of appeals' decision in this case does not conflict with decisions of this Court or other decisions of the court of appeals. The decision here does not involve significant state or federal constitutional issues. The court of appeals decision correctly applied unambiguous state and federal statutes and does not involve an issue of substantial public issue that should be determined by this Court.

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

The court of appeals decision interpreting Seattle's tax code is not in conflict with any state or federal cases and is not a significant issue requiring review by the Supreme Court. The City of Seattle's telephone utility tax is a tax on the privilege of engaging in "telephone business" in the City. SMC 5.48.050A. CP 219. 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 City defines "telephone business" to include activities other than traditional telephone service and includes the business of providing data transmission over a cable system. 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.

C. 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.

The court of appeals' interpretation of the State Internet Tax Moratorium is consistent with the plain language of the statute and

provides no basis for review under RAP 13.4(b). Under the City's tax code, two separate taxes apply to Comcast's in-city activities. Comcast's operation of a cable transmission system is subject to the six percent telephone utility tax under SMC 5.48.050A. And the providing of internet services is subject to the City's business and occupations ("B&O") service tax at a rate of .415 percent under SMC 5.45.050G. The undisputed facts establish that Comcast transmits data via a cable transmission system in the City. Comcast, which considers itself an internet provider, transmits to and from the site of an internet provider via its transmission system. (Comcast Court of Appeals Brief, pp. 4-5.) These activities are covered by the definition of "telephone business" and subject to the City's utility tax.

Comcast contends that it is exempt from the City's utility tax under the State Internet Tax Moratorium, RCW 35.21.717. The State Internet Tax Moratorium, 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.

Comcast wants the Court to ignore the legislature's distinction in the State Internet Tax Moratorium between data transmission and internet services. The legislature specifically permitted taxation of telephone business. In RCW 82.04.065, the State defines "telephone business" as the "business of providing network telephone service." The definition of "network telephone service" includes data transmission and excludes "internet service":

"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(2) (emphasis added). The statute distinguishes between telephone business and internet service and allows a City to tax the data transmission activities defined as telephone business.

Comcast's activities are covered by the definition 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 "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. 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.

The court of appeals interpretation of the State Internet Tax Moratorium is consistent with the interpretation published by the Washington Department of Revenue ("DOR"). The DOR issued an

Excise Tax Advisory on February 24, 2006 that disagrees with Comcast's argument and confirms that the 1997 amendment to RCW 82.04.065 explicitly includes data transmission used to provide customers with internet services. Excise Tax Advisory 2029.04.25. (Appendix A to City's Court of Appeals Reply Brief.) The Advisory states:

This includes services used to connect an ISP to the Internet backbone or to ISP customer locations, such as the provision of transmission capacity over dial-up connections, coaxial cables, fiber optic cables, T-1 lines, frame relay service, digital subscriber lines (DSL), wireless technologies, or other means.

Washington has traditionally taxed the sale of these network telephone services to a consumer under the retailing classification of the business and occupation (B&O) tax and required the seller to collect retail sales tax. In 1997, RCW 82.04.065 was amended to explicitly include "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" as taxable network telephone service.

ETA, p. 1. The DOR agrees that network telephone services include data transmission over cable networks. 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 activity.

D. The City Requires Companies That Engage In Telephone Business And That Also Provide Internet Services To Pay The Telephone Utility Tax Based On The Revenue Attributable To The Telephone Business Activities.

The City is not unfairly imposing its telephone utility tax on Comcast while taxing internet service providers at the lower B&O tax rate. The City simply requires that Comcast apportion its gross income between telephone business and internet services. Comcast is attempting to avoid the telephone utility tax by combining income from different taxable activities. The City's tax code prevents this by defining "gross income" as "the value proceeding or accruing from the sale of tangible property or service" and includes receipts "however designated." SMC 5.48.020B. Under this definition, a company cannot evade taxes by designating its revenue in a particular way on its books or in its customer bills. The utility tax is based on income "however designated." SMC 5.48.020B. Comcast cannot avoid the telephone utility tax by charging one price for bundled transmission services and internet services. Under the Seattle Municipal Code, if a taxpayer engages in an activity covered by the utility tax and another activity covered by the B&O tax, the City taxes each activity separately. (CP 43-45.)

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.

Comcast is asking this Court to override Congress' intent to preserve taxes such as Seattle's that were in effect prior to 1998. The court of appeals correctly held that 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).<sup>1</sup>

The City's telephone utility tax is 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 . . .

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<sup>1</sup> There have been three different versions of the ITFA since its enactment in 1998. (All versions at CP 441.) 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.

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. The court of appeals decision on this point is based on the undisputed facts regarding Seattle’s tax code and practices prior to 1998. This decision does not grant a blanket exemption to other jurisdictions.

2. The City is authorized 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 is authorized by statute.

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. 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. 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).

Similarly, the DOR stated in its Excise Tax Advisory that the State's taxation of data transmission to internet customers is covered by the ITFA grandfather clause. Excise Tax Advisory 2029.04.25, p. 2. The DOR concluded that taxpayers received notice by virtue of the amendments to the definition of network telephone service in RCW 82.04.065. ETA, p. 2.

The Pennsylvania Supreme Court ruled that Pennsylvania's sales and use taxes qualified for the grandfather clause under ITFA. *Concentric Network Corp. v. Commonwealth of Pennsylvania*, 897 A.2d 6, 15 (Penn. 2006). In *Concentric*, the taxpayer, an internet service provider, purchased data transport services and equipment to transmit internet services to its customers. The taxpayer objected to the imposition of the sales and use tax on its purchases. The court ruled that the taxes were permissible under the ITFA because "the tax code provisions in question were generally imposed and actually enforced prior to October 1, 1998." *Concentric*, 897 A.2d at 15. The court relied on Pennsylvania's publication of a policy and tax code provision that stated that "telecommunications services were taxable under the sales and use tax." *Concentric*, 897 A.2d at 15. Similarly, the City of Seattle generally

imposed and actually enforced its taxes prior to 1998. Thus, the court of appeals application of the ITFA grandfather clause is consistent with interpretations of the same statute by the DOR and the Pennsylvania court.

4. 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. Accordingly, the ITFA moratorium does not apply to the City’s telephone utility tax or to the B&O service 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. 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.<sup>2</sup>

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

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<sup>2</sup> 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.

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 utility tax.

The court of appeals interpretation of ITFA is consistent with the interpretation of the Pennsylvania Supreme Court in *Concentric Network Corp. v. Commonwealth of Pennsylvania*, 897 A.2d 6, 15 (Penn. 2006). In *Concentric*, the taxpayer made the reverse argument made by Comcast here. Concentric contended that the code “gave a preference to cable based and facilities based Internet service providers to the detriment of non-facilities based Internet service providers.” *Id.* at 14. The court rejected the argument and stated:

Moreover, Taxpayer pays sales and use tax because it uses other companies’ wirelines to provide its services. . . . In short, the tax at issue here results not from a discriminatory tax on electronic commerce but from Taxpayer’s business decisions.

*Concentric*, 897 A.2d at 15. The court ruled that Concentric was not subject to discrimination under the ITFA merely because Concentric paid sales and use tax on the purchase of data transmission services which other ISPs did not have to purchase.

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

The court of appeals decision does not conflict with *National Cable & Telecommunications Ass’n v. Brand X Internet Services*, \_\_\_ U.S.

\_\_\_, 162 L. Ed. 2d 820, 125 S. Ct. 2688 (2005). The *Brand X* case 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 in *Brand X* did not address the issue of how states and cities can tax companies that provide cable modem service.

H. The Court Of Appeals Correctly Held That The City Is Not Barred From Taxing Comcast Under RCW 35.21.714.

Comcast challenges the court of appeals application of RCW 35.21.714 and argues that the City cannot tax Comcast because Comcast provides an intrastate service. First, Comcast never raised this issue in its complaint and the issue is not properly before the court. CP 3-8. Despite failing to raise this issue in its complaint, Comcast raised the issue in a footnote in its brief to the trial court and the court of appeals. (Comcast Brief, p. 2; CP 139.) Comcast did not properly raise this issue and failed to cite any legal authority to support its argument. The Supreme Court should not now accept review of this argument.

In addition, the court of appeals correctly held that the City is not barred from imposing its tax by RCW 35.21.714. The City is imposing its

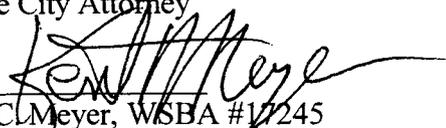
tax on Comcast's use of a transmission network in the City that transmits data from the customers' house to the head end in Burien to the Westin Hotel. The City is not imposing tax on charges for interstate services. Finally, Comcast quotes only a portion of the statute in its petition. The court of appeals reviewed the relevant portion of the statute and correctly ruled in favor of the City.

#### V. CONCLUSION

The court of appeals' decision is a straightforward interpretation of federal and state statutes and does not meet the criteria for review under RAP 13.4(b). The City imposes a telephone utility tax on companies that operate a data transmission system in the City. Comcast cannot escape the tax by bundling internet service revenue with its telephone business revenue. Neither the state nor the federal internet tax statutes prohibit the City's telephone utility tax. This Court should deny Comcast's petition.

DATED this 8 day of February, 2007.

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City of Seattle

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**CERTIFICATE OF SERVICE**

I, certify that on this date I caused a copy of appellant City of \_\_\_\_\_  
Seattle's Answer to Petition for Review to be filed with the court and  
served by legal messenger on:

Randy Gainer  
Davis Wright Tremaine LLP  
1501 Fourth Avenue, Suite 2600  
Seattle, WA 98101-1688

Signed at Seattle, Washington, this 2<sup>nd</sup> day of February, 2007.

  
\_\_\_\_\_  
Marisa Johnson

