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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

v.

CITY OF SEATTLE,

Respondent

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AMICUS CURIAE MEMORANDUM IN SUPPORT OF
PETITION TO REVIEW

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I. INTRODUCTION

In 1997, the State of Washington enacted the Internet Tax Moratorium (“ITM”) and in 1998, the United States Congress enacted the Internet Tax Freedom Act (“ITFA”), both of which explicitly limit the ability of states and localities to impose certain taxes on Internet access services. The federal and state legislation were immediate reactions to attempts by Tacoma and other localities to impose burdensome and discriminatory local telephone taxes on Internet access services.¹ Local telephone taxes are typically imposed at a rate that is 10 times higher than taxes imposed on general business.² The Court of Appeals decision allowing the City of Seattle to impose its telephone utility tax on cable modem service violates the plain language of the Washington ITM and ITFA, and should be reviewed by this Court.

¹ See Opening Statement of Rep. Chris Cox, Chairman, House Republican Policy Committee at the House Judiciary Committee Subcommittee on Commercial and Administrative Law, In Support of the Internet Tax Freedom Act (July 17, 1997) (“The city of Tacoma, Washington ... earned nationwide attention -- and opprobrium -- last year when it declared its intent to impose a 6% gross receipts tax on providers of Internet access to customers within its jurisdiction. (The city council later voted to repeal the tax).”.)

² Compare Seattle’s telephone utility tax of 6% with its B&O tax of .415%. Seattle Muni. Code §§ 5.48.050A & 5.48.50.

Amici seek clarification that the local telecommunications taxes that Seattle and other Washington localities seek to broadly apply to Internet access services are precluded by state and federal law. Both the Washington ITM and ITFA were intended to ensure that access to the Internet remained free from burdensome taxation. This matter is of particular importance because of the broad local and federal effects that this decision may have on the taxation of existing and new and emerging technologies. The Court of Appeals decision is the highest-level decision concerning the application of ITFA, and as a result, Amici are concerned that this decision, if not reviewed, will lead other states and localities to illegally tax Internet access. Permitting Seattle to tax Internet access in violation of the protections afforded by the U.S. Congress and the Washington legislature will lead to significant harm to Washington consumers and companies.³

³ While the Court of Appeals' ruling addressed the application of Seattle's telephone utility tax to the taxpayer's cable modem service, the implication of this ruling for other broadband offerings cannot be ignored. Cable modem service is but one of several technologies that are being used to meet the growing consumer demand for Internet access services. Telephone companies have deployed a competing technology known as digital subscriber line (DSL) service to provide broadband access over their networks. Other types of networks -- including satellite, wireless, and electric power networks -- are being, or may soon be, upgraded to enable the provision of broadband services to consumers. The potential impact of the Court of Appeals' ruling to these service offerings warrants the attention of this court.

II. INTERESTS OF AMICI

Amici filing this brief are Microsoft, AOL LLC, Time Warner Cable, Verizon, Earthlink, and the National Cable & Telecommunications Association (collectively “Amici”). Amici corporations are private companies that sell Internet access and other products and services of which Internet access is an essential component. The National Cable & Telecommunications Association (“NCTA”) is a private, non-profit corporation that, among other things, provides legislative representation, training and technical assistance to its members—which include cable television system operators serving over 90% of the cable subscribers in the United States.

III. ARGUMENT WHY REVIEW SHOULD BE GRANTED

A. This Court Should Grant Review Because the Court of Appeals Erred by Determining that ITFA Did Not Preempt Seattle’s Utility Tax on Cable Modem Service

1. ITFA Applies to the Seattle Utility Tax, which Does Not Qualify for ITFA’s Grandfather Clause

The Court of Appeals erroneously held that Seattle’s tax is not preempted by ITFA on the erroneous ground that a portion of the taxpayer’s cable modem service is a “data transmission service” and Seattle’s tax on data transmission service qualifies for ITFA

grandfathering. This dissection of the taxpayer's Internet access service is wrong for two reasons: (1) the cable modem service cannot be re-characterized or broken-up for purposes of applying ITFA; and (2) Seattle's imposition of its tax on data transmission services does not qualify as a grandfathered tax under ITFA.

The Court of Appeals reached its decision through the following questionable reasoning: (1) Neither the Seattle ordinance nor the Seattle rules expressly impose the telephone utility tax on cable modem service; (2) Seattle imposed its telephone utility tax on "data transmission services" prior to October 1, 1998, but Seattle did not impose its telephone utility tax on Internet access service; (3) the taxpayer's cable modem service consists of Internet access service and data transmission service; and (4) Seattle's imposition of a tax on "data transmission service" prior to October 1, 1998 qualifies the Seattle tax for ITFA grandfather clause, such that it can be imposed on the taxpayer's cable modem service. However, the taxpayer does not offer Internet access service separately from data transmission (or vice-versa), and the taxpayer does not distinguish between Internet service and data transmission in its books and records, its billing, or its marketing material.

“Internet access service” is a defined term in ITFA that must be applied in every case to determine whether a tax qualifies for the ITFA grandfather clause. 47 U.S.C. § 151. The Court of Appeals did *not* acknowledge or apply this definition.

A tax can only be grandfathered under ITFA if the tax was “generally imposed and actually enforced” on *Internet access service* before October 1, 1998. 47 U.S.C. § 151. ITFA defines Internet access service as

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 consumers. Such term *does not include telecommunications services*. 47 U.S.C. § 151 (emphasis added).

ITFA defines “telecommunications service” by reference to the regulatory “meaning given such term in section 3(46) of the Communications Act of 1934” [47 U.S.C. §153(46)]. 47 U.S.C. § 151. Therefore, ITFA references the Communications Act of 1934 (the “Communications Act”) in determining the definition of telecommunications and Internet access services.

The Federal Communications Commission (“FCC”), which is the administrative agency responsible for interpreting and enforcing the Communications Act, has concluded that it is inappropriate to dissect Internet access service for determining its regulatory classification. *In re Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, 17 FCC Rcd. 4798 (2002). Moreover, in that order the FCC concluded that cable companies providing Internet access are not telecommunications service providers because cable modem service is not a telecommunications service. The FCC’s Order was upheld as a reasonable interpretation of the federal statute by the United States Supreme Court in *National Cable & Telecom. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967 (2005). Despite the FCC’s rejection of breaking-up cable modem service into components, the Court of Appeals in the instant case declined the taxpayer’s request to consider *Brand X*, because, in its view, the decision “is not binding on a Washington court interpreting Washington law.” *See Community Telecable of Seattle, Inc. v. City of Seattle, Dept. of Admin.*, 36 Wash. App. 169, 181, 149 P.3d 380, 386 (Wash. App. Div. 1 2006).

Brand X is relevant to determining whether the ITFA grandfather clause applies to the Seattle telephone utility tax. The matter in dispute in *Brand X* was whether cable modem service should be classified as an

“information service” that uses a “telecommunications” component to perform the transmission function or whether the cable modem service can be viewed as including a separate “telecommunications service,” which cable companies offer to subscribers. The FCC found that the cable modem service was a single integrated service. Although, the lower court in *Brand X* had held that every broadband service includes both an information service and a telecommunications service offering, the U.S. Supreme Court upheld the FCC’s rejection of this approach.

Similarly, because the taxpayer’s Internet access service does not include a separate telecommunications service offering, it cannot be labeled a telecommunications service for purposes of applying ITFA and its grandfather clause.⁴ The Court of Appeals dissection of the taxpayer’s service into two components for purposes of establishing the eligibility for grandfather status is in direct conflict with federal law and should be reviewed by this court.

⁴ The Court of Appeals decision may also have been unduly influenced by labeling the tax as applying to data transmission services and not Internet access. However, it is well settled that labels of taxes are not the appropriate basis for analysis. *Trinova Corp. v. Mich. Dep’t of Treas.*, 498 U.S. 358, 374 (1991) (“labeling the SBT a tax on ‘business activity’ does not permit us to forgo examination of the actual tax base and apportionment provisions. ‘A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes.’”) (quoting Jenkins, *State Taxation of Interstate Commerce*, 27 TENN. L. REV. 239, 242 (1960)) (internal quotes omitted).

In sum, the term "telecommunications service" as contained in the Communications Act is expressly incorporated into ITFA and therefore is controlling in this case. Congress gave the FCC the authority to interpret the term "telecommunications service." The U.S. Supreme Court has upheld the FCC's interpretation that cable modem service does not include a separate telecommunications service. The FCC's interpretation of the term "telecommunications service" as contained in the Communications Act is the definition which must be used in applying ITFA. The Court of Appeals decision below is in direct conflict with the FCC's interpretation of this term.

2. *Taxpayer's Service is Internet Access under ITFA, and is Thus Protected from Seattle's Tax.*

The Court of Appeals declined to consider whether the taxpayer's service qualifies for protection from Seattle's telephone utility tax under ITFA. As set forth above, cable modem service is an Internet access service as defined by ITFA, and as such is protected from the imposition of the Seattle telephone utility tax.

B. *Seattle's Tax Is Preempted by the Washington ITM*

This court should also review the Court of Appeals' conclusion that the Washington ITM does not preempt Seattle from imposing its

telephone utility tax on cable modem service. The Washington ITM generally prohibits localities from imposing any tax on “Internet service” other than a generally applicable business tax or fee. RCW 35.21.717. In order to circumvent the Washington ITM and allow Seattle to impose a tax on cable modem service, the Court of Appeals again bifurcated the taxpayer’s cable modem service into two components—Internet access and data transmission. As discussed above, the hypothetical dissection of cable modem service into two components has no basis in federal law, and should be rejected as an unreasonable interpretation of the Washington ITM.

C. This Court Should Accept Review to Establish the Primary Activity Test as the Proper Analytical Framework for the Taxation of Mixed Services.

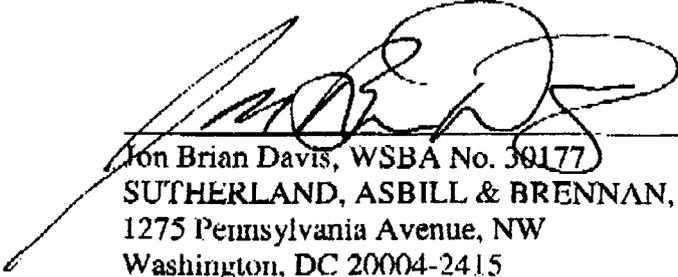
The Court of Appeals held the Seattle tax authorities can ignore the true regulatory and legal form and substance of the non-itemized sale of cable modem service, and bifurcate the transaction into the hypothetical sale of two services: taxable “network telephone service” and non-taxable Internet access.

To impose this hypothetical bifurcation, the Court of Appeals ignored the application of the “primary activity” test, which the Washington Department of Revenue applies as the pervasive interpretive

standard for mixed service contracts.⁵ The taxpayer's "primary activity" is the provision of "internet access." The subscriber is purchasing, and the taxpayer is selling, Internet access service for one non-itemized price.

IV. CONCLUSION

The Court of Appeals decision allowing the City of Seattle to impose its telephone utility tax on cable modem service violates the plain language of ITFA and the Washington ITM, and should be reviewed by this Court. For the foregoing reasons, and for the reasons stated in the petition, the petition for review should be granted.



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⁵ See Det. No. 03-0170, 24 WTD 393 (2005). (In general, with a contract not subject to bifurcation, the Department "looks to the 'primary activity' (Det. No. 92-183ER, 13 WTD 96 (1993)) or the 'predominate nature' (Det. No. 91 163, 11 WTD 203 (1991)) of the activities to determine the B&O tax classification of the income. See generally Det. No. 98-012, 17 WTD 247 (1998). The test has also been characterized as a 'true object test'.")