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King County Superior Court Case No. ~~012-2005-0135A~~
05-2-33667-6 SEA

**COURT OF APPEALS, DIVISION I
STATE OF WASHINGTON**

QWEST CORPORATION,

Plaintiff/Respondent,

vs.

CITY OF BELLEVUE,

Defendant/Petitioner.

QWEST CORPORATION'S RESPONSE BRIEF

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I. INTRODUCTION

Appellee Qwest Corporation (“Qwest”) filed a complaint in this action seeking a declaratory judgment on the legal question of whether the City of Bellevue (“City” or “Bellevue”) is permitted to levy its utility occupation tax (“UOT”) on interstate access charges imposed pursuant to federal regulations and found in federal telephone access service tariffs. The Superior Court correctly decided that under Washington law, the City is not permitted to tax these charges. This was an entirely legal issue that was appropriately resolved on Qwest’s cross-motion for summary judgment. Moreover, it is a legal determination that the City does not dispute.

The City repeatedly states, exactly as the trial court found, that “Washington prohibits cities from imposing taxes on charges for ‘access to, or charges for, *interstate* services.’” Appellants Brief (“App.Br.”) at 9 (City’s emphasis), *see also e.g.* App. Br. at 23. This is the same declaratory ruling that Qwest sought in the complaint and that the Superior Court granted. CP 6 (¶ 17).

Nonetheless, both before the trial court and in its opening brief, the City attempts to misstate the issue as raising a question of fact. The City contends that this case concerns the right of the City to assess tax to “certain charges,” which the City implies are not accurately identified as

access charges. App.Br. at 3. The City insinuates, without a hint of support in the record, that Qwest has misrepresented these “certain charges” in its accounting records. *See e.g.* App.Br. at 7 (questioning the “true nature of [Qwest’s] CALC charges”).

The City’s attempt to create a factual dispute is futile because Qwest’s complaint does not seek a factual determination either about whether the data it provided to the City in the tax audit is accurate or whether the City’s classification of that data is accurate. Qwest does not seek the Court’s declaration of the integrity of its accounting records (which, as a matter of fact, the City never questioned, and on which the City unqualifiedly relied when it issued its assessment against Qwest). Rather, Qwest seeks the Court’s declaration that as a matter of law the City cannot tax charges for access to interstate services. The Superior Court correctly declared that it cannot.¹

In addition, because Qwest’s declaratory judgment action invoked the Superior Court’s original jurisdiction, the Superior Court acted within its discretion when it decided to retain jurisdiction over this case, which

¹ The City flatly misstates the Superior Court’s holding when it says that the court “erred in holding that the City of Bellevue may not levy its utility occupation tax upon *what Qwest refers to as* CALCs...”. App.Br. at 8 (emphasis added). The Superior Court’s order is a holding about the legal right of the City to tax interstate access charges, irrespective of what Qwest or the City calls them. Virtually the entire argument the City makes on appeal is premised on this fundamental misstatement of the Superior Court’s holding.

involves important issues of public policy and raises only issues of statutory interpretation that are within the traditional competence of a court of law.

Similarly, because Qwest's complaint raised purely legal issues, the Superior Court properly denied Bellevue's motion for a continuance to conduct fact discovery.

II. RESPONSE TO ASSIGNMENTS OF ERROR

1. The Superior Court correctly granted Qwest's cross-motion for summary judgment on March 29, 2006 and correctly denied the City of Bellevue's motion for reconsideration on April 28, 2006.
2. The Superior Court correctly concluded as a matter of law that customer access line charges imposed pursuant to 47 C.F.R. Part 69, and private line, frame relay and ATM access charges, purchased under a Federal Communications Commission tariff, are charges for access to, or charges for, interstate services.
3. The Superior Court correctly ruled that the City of Bellevue may not impose its utility occupation tax on customer access line charges, private line, frame relay and ATM access charges, or on interstate services, or on federally tariffed charges.
4. The Superior Court did not abuse its discretion in denying the City of Bellevue's Rule 56(f) motion for a continuance.
5. The Superior Court did not abuse its discretion by denying the City's motion to dismiss.

III. RESPONSE TO ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Under Washington law, Bellevue is prohibited from levying its utility occupation tax on customer access line charges, and federally tariffed private line, frame relay and ATM access charges, regardless of whether these charges relate to services that originate and terminate within the state of Washington.
2. The issue of whether customer access line charges, and private line, frame relay and ATM access charges are charges for access to interstate service is a question of law, not a question of fact.
3. The City of Bellevue is not entitled to impose its utility occupation tax on federally tariffed charges.
4. The Superior Court did not abuse its discretion when it denied the City of Bellevue the opportunity to conduct fact discovery on the issues in this case because the proposed fact discovery was irrelevant to the legal issues dispositive of this case.
5. The Superior Court correctly denied the City of Bellevue's motion to dismiss because it had original jurisdiction over the case and it was within its discretion to exercise jurisdiction over the case under the doctrine of primary jurisdiction.

IV. COUNTERSTATEMENT OF THE CASE

Qwest is a Colorado corporation that provides interstate and intrastate network telecommunications services to customers in the City of Bellevue, Washington. CP 4. Qwest is subject to regulation by the Federal Communications Commission ("FCC") and the Washington Utilities and Transportation Commission ("WUTC") with respect to

telephone services provided to customers located in Bellevue, Washington. CP 4 (¶ 5). The FCC has exclusive jurisdiction over and regulates Qwest's *interstate* telecommunications activity. CP 5 (¶ 7). The WUTC has exclusive jurisdiction over and regulates Qwest's *intrastate* telecommunications activity in Washington. CP 5 (¶ 8).

A. Regulatory Background

Local telephone services in Washington are generally regulated by the WUTC. *See* RCW 80.36.100. Interstate telephone services involve interstate commerce and are under the exclusive regulatory jurisdiction of the FCC. 47 U.S.C. § 152. This split in regulatory jurisdiction is based on the services provided and not the physical situs of the equipment involved in providing the services. Because telephone service works only because of connection to a common network, there is a part of each local telephone system that also falls under the jurisdiction of the FCC. In *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930), the United States Supreme Court recognized that interstate and intrastate telecommunications providers must use the same local facilities to connect end users to the telecommunications network. The Supreme Court held that because use of local facilities is a necessary element of the national network required to provide interstate telephone service, a percentage of local facility costs

had to be borne by interstate service charges within the exclusive jurisdiction of the FCC.

Until 1984, the interstate service costs of the local telephone company's facilities were covered through a division of interstate toll charges and were thus based on usage of the telephone network. *See N.A.R.U.C. v. FCC*, 737 F.2d 1095, 1104 (D.C. Cir. 1984). However, the FCC became concerned that heavy users would find alternative modes of communication and bypass the national telephone network, and also recognized a need to revise this structure as a result of the break-up of AT&T. *See* 48 Fed.Reg 10319 (March 11, 1983). To address these concerns, the FCC began to require that all local subscribers pay a flat monthly charge to pay for some of the cost of maintaining a local telephone plant that is necessary for interstate service. *See South Central Bell Tel. Co. v. Celauro*, 735 S.W.2d 228, 230 (Tenn. 1987) (citations omitted); *see also N.A.R.U.C.*, 737 F.2d at 1104.

As part of the break-up of AT&T in 1984, the FCC established a new system of interstate communication service charges to compensate local exchange carriers ("LECs") for transmitting interstate telecommunications over the LECs' local networks and for providing local service subscribers with access to the interstate telecommunications network. CP 5 (¶ 9). One element of this system is an end user access

charge paid by the end users to the LEC. CP (¶ 10). This charge is referred to as a “customer access line charge” or “CALC.” It is also sometimes referred to as an “end user common line” charge or “EUCL.” 47 C.F.R. § 69.152. The CALC is authorized by the FCC and is regulated under Qwest’s FCC tariff on interstate access services as compensation for Qwest’s transmitting interstate telecommunications over its local network: *i.e.* as compensation for providing access to interstate services. CP 5 (¶ 10); CP 341-358; *see also* 47 C.F.R. Part 69.

Specifically, the CALCs at issue in this case are authorized by the FCC, pursuant to 47 C.F.R. Part 69, to compensate local exchange carriers such as Qwest for the interstate functions of their local networks. Pursuant to this federal regulation, the CALC is an “access charg[e] for interstate or foreign access services provided by [local] telephone companies.” 47 C.F.R. § 69.1. The FCC regulates the CALC charges through Qwest’s FCC access services tariff. CP 341-358. Qwest is required by federal law to collect the CALC from its customers regardless of whether a customer ever makes an interstate call; the charge is imposed as compensation for the customer’s ability to *access* the interstate network. 47 C.F.R. §§ 69.152(a), 69.1(a)-(b) and 69.5(a).

Similarly, Qwest provides various types of dedicated communication connections such as private line transport, frame relay,

and ATM products. Qwest's customers can use these dedicated lines to access a local network, an interstate network, or for mixed use. Where the use is mixed, a determination must be made whether the services are for intrastate or interstate access and thus whether they are within federal or state regulatory jurisdiction. This determination is controlled by federal law. 47 U.S.C. § 152. Federal law determines whether a charge is regulated by the FCC tariff as compensation for access to interstate service or by the WUTC tariff as compensation for intrastate service, depending on the quantity of interstate traffic over the line as represented by the customer. Where the customer declares that 10% or more of the use is interstate, the connections are regulated under Qwest's interstate access tariff (FCC Tariff No. 1), which provides for compensation for access to interstate services. CP 358 (providing that a line the customer indicates will be used for at least 10% interstate transmission comes under the FCC's jurisdiction.). Where the customer declares the interstate use is under 10%, the connections are regulated under Qwest's Washington Private Line Transport Services Tariff as filed with the WUTC, which compensates for intrastate services only. CP 358-407. In the first case, the service is subject to exclusive regulation by the FCC, while in the second case, it is regulated by the WUTC. The charges for private line, frame relay and ATM services assessed by Bellevue are regulated under

Qwest's FCC access services tariff, as compensation for services that provide access to the interstate telephone network, including connection to services provided by long-distance carriers. CP 358-407. As governed by federal law, charges for these services purchased from Qwest's interstate access tariff compensate Qwest for providing access to interstate services, which interstate services may or may not be provided by Qwest.

B. The Audit

On November 12, 2004, Qwest was formally notified that Bellevue would conduct an audit review of the Utility Occupation Tax ("UOT") and Business and Occupation ("B&O") tax owed by Qwest. CP 274-275. During the course of its audit, Bellevue advised Qwest that it would levy the UOT on CALCs and the charges for federally tariffed private line transport service, frame relay service and ATM service, despite the fact that these access charges are established and regulated by the FCC as compensation for providing access to and transmitting interstate telecommunications. In a letter dated July 25, 2005, Assistant City Attorney Patrice C. Cole admitted that the City has no authority to tax interstate services. CP 285-287. In her letter, Ms. Cole specifically acknowledged that "the FCC provides the ability for local exchange carriers to charge CALC charges for the purpose of funding the interstate functions of their local network [...]." CP 285. Nonetheless, she advised

Qwest that the City would tax all proceeds from the CALCs because these revenues were supposedly charged for “intrastate” service. CP 284. In several letters, Bellevue and Qwest discussed their disagreement over the taxability of the access charges, but were unable to resolve their disagreement. CP 278-292. On September 7, 2005, Bellevue informed Qwest by letter that it disagreed with Qwest’s position and would move forward with its audit. CP 288-292.

As discussed fully below, state law prohibits cities from imposing a tax on charges for access to interstate services, as well as on charges for interstate services. CP 5 (¶ 11); *see also* RCW 35.21.714 and 35A.82.060. According to its terms, the Bellevue City Code (“BCC”) also does not impose UOT on charges for access to interstate services or charges for interstate services. CP 5 (¶ 130 ; *see also* BCC § 4.10.050(C). Thus, consistent with state and city law, Qwest has properly not previously paid Bellevue the UOT on charges for access to interstate services or charges for interstate services, including CALCs and the other federally tariffed access service charges described above. CP 6 (¶ 15).

C. Procedural Background

On October 11, 2005, Qwest filed the complaint in this action in an effort to obtain clarification of the scope of taxation permitted by Washington law. *See* Complaint, ¶ 1 (“This is a declaratory judgment

action challenging the legality of the imposition of Bellevue utility occupation tax (“Bellevue utility tax”) on or measured by customer access line charges (“CALCs” and other charges regulated by the Federal Communications Commission as interstate service.”) As of October 11, 2005, Bellevue had not issued an assessment against Qwest in regard to the CALCs and other federally tariffed access service charges. Bellevue subsequently issued an assessment against Qwest which addressed many issues beyond the taxability of the interstate access charges. CP 40-41.

On November 23, 2005, Qwest filed a notice of appeal with the Bellevue hearing examiner, which addressed several disputes that arose during the City’s audit of Qwest. CP 30-76. To preserve its right to challenge taxation of the CALCs and other federally tariffed access charges in the event the Superior Court declined jurisdiction, Qwest included this issue in its administrative appeal. However, as a result of the Superior Court’s ruling, the Bellevue hearing examiner was able to eliminate this issue from the proceeding through its grant of Qwest’s partial summary judgment motion. *See* App. Br. at Ex. 6. The parties are currently conducting discovery on the remaining issues in the tax challenge, unhindered by the uncertainty regarding the taxability of interstate access charges that would have existed without the Superior Court’s ruling.

On December 9, 2005, the City filed a motion to dismiss the complaint on the grounds that Qwest failed to exhaust its administrative remedies. CP 77-84. Qwest opposed this motion based on the Superior Court's original jurisdiction over the case and its broad discretion to retain jurisdiction under the doctrine of primary jurisdiction, as well as in the interest of public policy and judicial efficiency. Qwest also cross-moved for summary judgment. CP 320-336. In response to Qwest's motion, the City filed a Rule 56(f) motion for continuance, seeking to delay resolution of the legal issues before the Superior Court until the City could conduct fact discovery. CP 157-165. In light of the pure questions of law presented by Qwest's motion, the Superior Court denied the City's request for a continuance. CP 221-222.

The Superior Court heard the City's motion to dismiss and Qwest's cross-motion for summary judgment together at a hearing held on March 10, 2006. On March 29, 2006, the trial court denied the City's motion and granted Qwest's cross-motion. CP 253- 254; CP 251-252. The City filed a motion for reconsideration on April 7, 2006. CP 255-266. The Superior Court denied the City's motion on April 28, 2006. CP 269-270.

V. ARGUMENT

A. Standard of Review

The Court reviews the Superior Court's ruling on Qwest's cross-motion for summary judgment *de novo*. See *Kruse v. Hemp*, 121 Wn.2d 715, 722, 853 P.2d 1373 (1993). When a motion for summary judgment is properly supported, the burden shifts to the opposing party to present specific facts showing a genuine issue for trial. CR 56(e); *Overton v. Consol. Ins. Co.*, 145 Wn.2d 417, 38 P.3d 322 (2002). Specific facts must be presented through evidence that would be admissible at trial. *Wilson v. Steinbach*, 98 Wn.2d 434, 438-39, 656 P.2d 1030 (1982). A party cannot avoid summary judgment with conclusory allegations, speculative statements, or argumentative assertions. *McMann v. Benton County, Angeles Park Comtys., Ltd.*, 88 Wn.App. 737, 946 P.2d 1183 (Div. 3, 1997).

Appellate courts generally review the Superior Court's denial of the City's motion for reconsideration for an abuse of discretion. See *Lian v. Stalcik*, 106 Wn.App. 811, 823-24, 25 P.3d 467 (Div. 3 2001). However, because the City's motion for reconsideration was based on an error of law, if the Court reverses the Superior Court's motion for summary judgment, the City's appeal of its motion for reconsideration would become moot. Because the Court reviews a summary judgment

order by a more stringent standard than a motion for reconsideration, as a matter of law the Court could not affirm the Superior Court's order granting summary judgment while reversing its order on the motion for reconsideration. The Court should review both of these orders concurrently.

The Court reviews denial of a motion to dismiss and motion for continuance for an abuse of discretion. *See Colwell v. Holy Family Hosp.*, 104 Wn.App. 606, 615, 15 P.3d 210 (Div. 3 2001); *Manteufel v. Safeco Ins. Co. of America*, 117 Wn.App. 168, 175, 68 P.3d 1097 (Div. 2 2003); *Reeves v. City of Wenatchee*, 130 Wn.App. 153, 155, 121 P.3d 777 (Div. 3 2005).

B. The Superior Court Correctly Granted Summary Judgment On Qwest's Declaratory Judgment Claim

1. Washington Statute Prohibits Bellevue From Taxing Charges For Access To Interstate Services

Article VII, Section 9 and Article IX, Section 12 of the Washington State Constitution permit the legislature to grant municipal authorities the power to levy and collect taxes for local purposes. Const. art. VII, § 9, art. IX, § 12; *see also King County v. City of Algona*, 101 Wn.2d 789, 791, 681 P.2d 1281 (1984). However, these constitutional provisions are not self-executing. *See Algona*, 101 Wn.2d at 791. Accordingly, municipalities must have express authority, either

constitutional or legislative, to levy taxes. *See id.* The Washington State Constitution also grants cities a general police power, but that power is limited to matters of a local nature within the cities' territorial boundaries. *See Hillis Homes, Inc. v. Snohomish County*, 97 Wn.2d 804, 808 (1982) (“Municipal police power is as extensive as that of the legislature, so long as the subject matter is local and the regulation does not conflict with general laws... .”); Const. art. VII, § 9; art. IX, § 11.

It is undisputed that, as a matter of law, the City is prohibited by Washington statute from taxing revenues derived from the provision of “access to, or charges for, interstate services.” *See* RCW 35A.82.060. Section 35A.82.060 of the RCW grants code cities such as Bellevue the authority to impose a license fee or tax on “one hundred percent of the total gross revenue derived from intrastate toll telephone services subject to the fee or tax.” RCW 35A.82.060(1). This provision represents an expansion of Bellevue’s ability to tax telephone services to a certain class of services which extend beyond its boundaries, namely intrastate toll services.² However, what is critical in this case is the second part of RCW 35A.82.060(1), which provides express limitations on the taxing powers of

² This statutory grant of jurisdiction extends to “intrastate toll telephone services” and not to any other non-local telephone services. *See* Appendix, Ex. 1 (*In re Southern Pacific Communications Co.*, TSB-D-91(41)S (New York Tax Appeals Trib. (May 14, 1991) (discussing differences between private line services and switched services)).

municipalities with respect to telecommunications. The second portion states:

... the city shall not impose the fee or tax on that portion of network telephone service which represents charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll telephone services, *or for access to, or charges for, interstate services*, or charges for network telephone service that is purchased for the purpose of resale, or charges for mobile telecommunications services provided to customers whose place of primary use is not within the city.

RCW 35A.82.060(1)(emphasis added).

RCW 35A.82.060 plainly prohibits not only the taxation of “interstate” telecommunications services, but also taxation of charges for *access* to interstate services. RCW 35A.82.060(1).

The statutory prohibition on taxation of charges for access to interstate services is clear on the face of the statute and is undisputed. However, the Court may also look to “legislative history, principles of statutory construction, and relevant case law in order to ascertain the meaning of the statute.” *See Berrocal v. Fernandez*, 155 Wn.2d 585, 599, 121 P.3d 82 (2005). The legislative history of RCW 35A.82.060 further confirms that access charges are not subject to municipal tax, showing that the legislature intended to follow the FCC’s rules for distinguishing between charges and services contained in an LEC’s interstate tariff and

those contained in a state tariff filed with the WUTC. *See* Appendix, Ex. 2 (legislative history of RCW 35A.82.060).

(1) 2002 Amendments

RCW 35A.82.060 has existed in its current form since 2002, when it was amended to clarify the taxing jurisdiction of cities where mobile telephone users are concerned, and the phrase “or charges for mobile telecommunications services provided to customers whose place of primary use is not within the city” was added to the end of subsection (1). *See Laws of 2002*, ch. 67, § 10. Subsections (2) and (3) were also added to the statute in 2002.³

(2) 1989 Amendments

In 1989, the statute was amended to include a prohibition on taxing revenues from services purchased for the purpose of resale under this provision. *See Law of 1989*, ch. 103, § 3. The phrase “or charges for network telephone service that is purchased for the purpose of resale” was added to the end of the statute.

³ Neither of these additions affect this analysis. Subsection (2) provides that any city charging a license tax or fee has the authority, rights and obligations of a taxing jurisdiction. Subsection (3) provides that the definitions in RCW 82.04.065 are applicable, but this is not a substantive change from the prior version of the statute, which included this reference in subsection (1).

(3) 1986 Amendments

In 1986, the statute was amended to exclude from its purview “charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll telephone services, or for...” *See Laws of 1986*, ch. 70, § 4. Prior to this amendment, the statute read:

...the city shall not impose the fee or tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents access to, or charges for, interstate services...

Id.

Thus, prior to 1986, the prohibition on taxing revenues for “access to, or charges for, interstate services” was an independent stand-alone limitation on cities’ rights to tax telephone services. Only after 1986 did the legislature insert *additional* limitations on cities’ taxing authority, which were directed at the right to tax revenues from charges made to other telephone companies. This history of the statutory language makes absolutely clear that the legislature intended RCW 35A.82.060 to prohibit cities from taxing revenues from access to interstate services.⁴

⁴ Additionally, even if the Washington statute did not expressly prohibit taxation of charges for access to interstate service, the FCC’s regulation of the access charges indicates that they are “interstate” in nature. *See South Cent. Bell Telephone*, 735 S.W.2d at 231 (“Since the charges are ordered by the FCC as a means of making all customers share in the costs of interstate service, we conclude that the income is generated from interstate commerce.”); *Qwest Corporation v. State of Wyoming*, 130

2. Washington Statute Prohibits Bellevue From Taxing Federally Tariffed Charges

Another change to the statute in 1986 provides further indication of the legislature's intention to follow the FCC and WUTC's jurisdictional divide with respect to taxation authority.

Prior to 1986, the phrase "for which rates are contained in tariffs filed with the federal communications commission" was included at the end of the statute. Here, in its form prior to 1986 the statute read:

...the city shall not impose the fee or tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents access to, or charges for, interstate services *for which rates are contained in tariffs filed with the federal communications commission.* (emphasis added).

The intent of the legislature could not have been more clear: municipalities were permitted to tax revenues from intrastate telephone services, but not income earned from providing access to interstate services, which rates are contained in the FCC tariffs. This is consistent with a grant of authority to tax based on licensing for revenue. Services regulated by the FCC were beyond the authority of the State of Washington (and thus the authority of its municipal political subdivisions) to regulate or license. It is, of course, undisputed that Qwest's CALC

P.3d 507 (Wyo. 2006) (holding "that the [CALC] charge is incidental to *interstate* telephone service" (emphasis in original)).

charges, as well as access charges for private line, ATM and frame relay services, are contained in the FCC tariffs.

The amendments to RCW 35A.82.060 after 1986 provide absolutely no indication that the legislature intended to diminish the statute's prohibitions on municipal tax authority with respect to charges for interstate access services. In regard to removing the tariff language, the amendment serves to *broaden* rather than to restrict the scope of the prohibition.⁵ Before 1986, there was an argument that municipalities were prohibited from taxing *only* revenues from interstate services or access thereto with rates included in FCC tariffs. By removing the last phrase, the legislature intended to prohibit taxation of interstate services and interstate access charges whether they were included in the FCC tariffs or instead had been "detariffed," *i.e.*, were subject to FCC regulatory authority but were not required to be formally tariffed. Similarly, all of the later additions of language to the statute are independent limitations that further restrict municipal tax authority. None of them can reasonably be read as a shift in legislative intent from the 1986 version of the statute.

⁵ The City cites to *Russello v. United States*, 464 U.S. 16, (1983) in an attempt to argue that the contrary conclusion is warranted. The *Rusello* Court ruled that where an earlier limitation is deleted, it may be presumed that the limitation was not intended. This is precisely Qwest's point. After 1986, the legislature no longer intended to limit the prohibition on municipal taxation to only those interstate access charges found in federal tariffs, but to include *in addition* access charges not in federal tariffs.

Bellevue's authority to classify categories of telephone service for tax purposes is expressly limited by the Washington legislature. Cities may not define their taxation categories as they see fit where they are "restrained by a constitutional provision or legislative enactment." See *City of Tacoma v. Seattle-First Nat'l Bank*, 105 Wn.2d 663, 667, 717 P.2d 760 (1986). To allow Bellevue to create its own tax categories despite contrary legislative intent would render the distinction between "interstate" and "intrastate" drawn by the FCC and the Washington legislature meaningless. The plain meaning of the term "access to interstate service" is a charge to a customer for a service supporting access to an interstate network. The CALCs and other access line charges at issue here are established and regulated by the FCC solely because they represented charges for a service providing for such access to interstate service. The WUTC and the Washington legislature in RCW 35A.82.060 adopt the same plain language. The authority is clear that as a matter of law the CALCs, private line and other access charges are for services to provide access to interstate service. Hence, the Court should affirm the declaration that as a matter of law that the City is not allowed to assess UOT on revenues from federally tariffed interstate access charges.

3. Federally Tariffed Charges Related to CALCs, Private Line, ATM and Frame Relay Services Are Interstate Access Charges

Bellevue admits this is the correct meaning of RCW 35A.82.060. *See e.g.* App.Br. at 9, 23. However, Bellevue persists in describing the access charges at issue here in terms of *services*. *See* App.Br. at 23 (defining “interstate” as “Literally, between states (crossing a state line). Services, traffic or facilities that originate in one state, crossing over and terminating in another.”). The City’s object is to obscure the express statutory exclusion in RCW 35A.82.060(1) of interstate *access* services from its taxing jurisdiction.

Washington’s unique statutory structure, which excludes from Bellevue’s taxing jurisdiction not only interstate services, but charges for access to interstate services, requires a different analysis than most other state statutes that distinguish only between interstate and intrastate services, and hence do not specifically allow or bar taxation of interstate access charges. Nonetheless, to better understand the purpose and origin of the CALC, it is helpful to briefly consider how other states have treated this charge.

It is well-established that states can tax interstate service charges. *See Goldberg v. Sweet*, 488 U.S. 252, 263 (1989). The issue arises where a state taxation statute distinguishes only between interstate and intrastate

services and prohibits taxation of interstate services. Under these circumstances a state can interpret the scope of interstate services to either include or not include access charges, without running afoul of federal law. Again, where, as here, a state expressly prohibits taxation of certain charges, it is irrelevant that federal law would permit such a tax.⁶

But where it does not, the prevailing rule in other states in which the issue has been litigated is that CALCs are considered an interstate service charge. In addition to Tennessee, New Mexico has ruled that CALCs represent an interstate service charge (*see GTE Southwest Inc. v. Taxation and Rev. Dep't*, 113 N.M. 610, 830 P.2d 162 (1992), as have Wyoming (*see Qwest Corp. v. State of Wyoming*, 130 P.3d 507 (2006) and California (*see Notice to Local Exchange Carriers, Appendix, Ex. 3*).⁷

The City represents that Michigan would treat these charges as intrastate services, citing *MCI Telecomms. Corp. v. Dep't of Treasury*, 136 Mich. App. 28 (Mich. Ct. App. 1984) (dealing with carriers' carrier charges under 47 C.F.R. § 69.106). App.Br. at 27. However, in *GTE*

⁶ This is best illustrated by *South Central Bell Tel. Co. v. Comm'r of Revenue*, 735 S.W.2d 228 (Tenn. 1987). In that case, the Tennessee Supreme Court held that, because the state sales tax extended to transactions constitutionally within the taxing authority of the state, the sales tax did apply to CALCs. However, because the state gross receipts tax excluded transactions in interstate commerce, the CALC was not subject to the state's gross receipts tax.

⁷ California does not impose sales tax on telephone services, but does levy an Emergency 911 fee on "intrastate telephone communication service." *See* California Revenue and Taxation Code § 41000 et seq. Section 41010 adopts the same physical point of service test advocated by the City. Even under this test, CALCs are considered interstate.

Sprint Communications Corp. v. Dep't of Treasury, 445 NW2d 476, 477 (Mich.Ct.App. 1989), decided some five years later, the Michigan Court of Appeals took the opposite position as to the taxation of various access charges. It is not clear that *MCI* represents current Michigan law. Similarly, the City relies on an advisory ruling by the New York State Department of Taxation and Finance, *Advisory Opinion* TSB-A-93(26)S (April 12, 1993), as to the treatment of private line services. App.Br. at 26-27. However, this administrative statement was rendered moot by the decision of the New York State Tax Appeals Tribunal in *Concentric Network Corporation*, DTA No. 819533 (March 16, 2006), holding that private line services entirely within New York state, but providing access to an interstate network were in fact interstate. *See* Addendum, Ex. 5.

More importantly, however, the CALCs and other access service charges at issue here fall squarely within Washington's statutory prohibition, so decisions from other states are ultimately unpersuasive here. The very name of the CALC – customer *access* line charge – shows the purpose of this charge. The word “access” is defined as “[t]he ability or right to approach, enter, exit, communicate with, or make use of.” American Heritage Dictionary, 4th ed., 2000. The CALC at issue here is just this – a charge imposed in exchange for the “ability or right” to “make use of” the interstate telephone network.

The FCC expressly established the CALC and other Part 69 charges as fees for access to interstate telecommunications. *See* 47 C.F.R. § 69.2(b) (defining access service to include “services and facilities provided for the origination or termination of any interstate or foreign telecommunication.”). In addition, the FCC has expressly classified the CALC as an “access charg[e] for interstate or foreign access services provided by [local] telephone companies.” 47 C.F.R. § 69.1. The City concedes this point in its brief. *See* App.Br. at 25, note 5 (stating that end user charges “would appear to be charges for ‘access to’ interstate service.”). Moreover, Assistant City Attorney Patrice Cole acknowledged in a letter sent to Qwest during the audit that “the FCC provides the ability for local exchange carriers to charge CALC charges for the purpose of funding the interstate functions of their local network [...]” CP 284-287. According to Bellevue’s own description of the CALC, it is a charge established by the FCC to compensate local exchange carriers for allowing access to interstate networks, which under RCW 35A.82.060(1) cannot be taxed. There can be and, in fact, is no genuine dispute that CALCs fall within the meaning of interstate access charges under RCW 35A.82.060.

The same is true of the other federally tariffed charges at issue here, which are all charges for forms of access to interstate service. The private line transport, ATM and frame relay charges are purchased from

Qwest's interstate *access* services tariff and are provided by Qwest under its obligation to provide services to support interconnection with other carriers, including the establishment of "through routes and charges applicable thereto." *See* 47 U.S.C. §201(a); *In the matter of Coastal Auto Parts, Inc.*, 20 FCC 2d 316 (1969); CP 358. For example, the private line transport service is defined in Qwest's FCC tariff as providing a transmission path to connect a customer to a Company hub from which the customer can access several other functions. CP 359. The charges for frame relay and ATM are for optional high speed transmission protocols over private line circuits. These are in all instances supported by a connecting circuit. CP 381-382; 387-388. The issue here is not the exclusion of private line services and advanced network function such as ATM and frame relay services from the City's jurisdiction to tax, but rather the exclusion of FCC tariffed private line services and advanced network functions such as ATM and frame relay services.

The City's description of the ATM and frame relay services as "services" rather than access charges glosses over the point that the charges at issue here are FCC tariffed services. These specific services are included within the FCC tariff as they represent services connected with and supporting "interstate and foreign communication within Section 2(a) of the Communications Act of 1934. *See* 47 U.S.C. § 152(a). Section

2(b) of the Act also expressly prohibits the FCC from asserting jurisdiction with respect to “charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communication service... .” 47 U.S.C. § 152(b). The City’s argument is merely an insinuation that Qwest’s tariff filings with the FCC and the WUTC are wrong. The jurisdictional boundaries forming the foundation of the regulation of the telecommunication industry put in place by Congress cannot be ignored or overruled by the City.

4. The City’s Attempt To Challenge The Purpose Of The CALCs Is Irrelevant

As noted above, Bellevue effectively concedes the dispositive point that CALCs are charges for access to interstate service. *See* App.Br. at 25, note 5. Instead, Bellevue’s challenge to Qwest’s treatment of the CALCs appears to relate to Qwest’s identification of revenues as CALC charges, and not the taxability of the charges under Washington statute. This issue is legally irrelevant and factually a red-herring and should not distract the Court from the legal issue before it.

The City argues that it has “no way of knowing whether Qwest’s charges are indeed being imposed for access to interstate services or are instead surcharges being imposed on all customers simply to increase Qwest’s profits.” App.Br. at 28-29. Again, the City challenges the

accuracy of the tariffs filed by Qwest with the FCC and the WUTC, respectively. The CALCs are authorized and charged for providing access to interstate telephone service. CP 341-357. If Qwest were to charge a “surcharge” that was not authorized by the FCC, that charge would not be a CALC. The fact that collection of the CALC increases Qwest’s profits does not change its purpose or origin, and most certainly does not change it from an interstate access charge to something else. Nor does it convert it into an intrastate toll telephone service, the only service Bellevue is permitted to tax.

The City also argues that because the total amount of CALC revenues Qwest received during the audit test month is not divisible by \$5.85 (the current monthly CALC authorized for Qwest by the FCC), the CALC revenues are not actually revenues for CALCs. Here, the City appears to challenge the integrity of Qwest’s billing and accounting systems, which is immaterial to the issue on appeal. The Superior Court’s ruling concerned the scope of RCW 35A.82.060 and state and federal regulatory authority as they relate to the taxability of CALCs and the other federal access charges at issue. Whether or not the City believes Qwest has miscalculated its CALC revenues has no bearing on the legal issues about which Qwest seeks declaratory relief. Incidentally, there are numerous explanations for why Qwest’s CALC revenues are not divisible

by \$5.85, including issues as to whether Qwest pro-rates the CALC for customers who commence service mid-month, the effect of when a customer does not pay a bill in full, and whether the CALC rate in effect during the audit period was different.

All of the charges at issue in this case are imposed pursuant to FCC regulations to compensate Qwest for providing access to the national interstate telephone network. The revenues generated by these charges cannot be taxed, regardless of whether the customers who pay for the access use the interstate network. The argument that the CALC should not be imposed on local subscribers who do not make or receive interstate calls was considered and rejected by the FCC. *See N.A.R.U.C.*, 737 F.2d at 1115. The FCC would not have jurisdiction to fix and authorize imposition of these charges if they were not for access to interstate telecommunications services. *See* 47 U.S.C. § 152(b). The City's attacks on the legitimacy of the CALC charge are irrelevant to the legal issue before the Court. For all of these reasons, the Superior Court's ruling should be affirmed.

5. Bellevue Lacks Jurisdiction to Impose a License for Revenue on Federally Regulated Charges

In addition to the above, the Superior Court's ruling should be affirmed because Bellevue lacks jurisdiction to tax the charges. The

Bellevue UOT provides that it is enacted pursuant to the City's power to "license for revenue" under RCW 35A.11.020 See BCC § 4.10.010.

RCW 35A.82.020 provides as follows:

A code city may exercise the authority authorized by general law for any class of city to license and revoke the same for cause, to regulate, make inspections and to impose excises for regulation or revenue in regard to all places and kinds of business, production, commerce, entertainment, exhibition, and upon all occupations, trades and professions and any other lawful activity: PROVIDED, That no license or permit to engage in any such activity or place shall be granted to any who shall not first comply with the general laws of the state.

No such license shall be granted to continue for longer than a period of one year from the date thereof and no license or excise shall be required where the same shall have been preempted by the state, nor where exempted by the state, including, but not limited to, the provisions or RCW 36.71.090 and chapter 73.04 RCW relating to veterans.

RCW 35A.82.020 (emphasis added).

The City's levy of the UOT on Qwest is thus based on the exercise of its authority to license specific business activities. RCW 35A.82.020 authorizes code cities to impose license fees for regulation or revenue. The BCC specifically provides that the UOT is levied pursuant to Bellevue's authority to "license for revenue." See BCC § 4.10.010.

Bellevue has no regulatory or licensure authority over interstate access charges. Since Bellevue may not license those services, it lacks regulatory jurisdiction to impose its UOT on the services.

Indeed, the WUTC's jurisdiction – and hence the limit of any municipal jurisdiction – over the CALC and other federally tariffed access or service charges is limited to investigating and filing a complaint with the FCC if it objects to a charge in any way. *See* RCW 80.36.250. The CALC and other FCC tariffed charges are within the exclusive regulatory jurisdiction of the FCC. As the CALC and other interstate access and service charges are beyond the potential regulatory authority of the WUTC, the State of Washington has no authority over licensing such charges that could be delegated to Bellevue, and Bellevue thus lacks jurisdiction to impose a license for revenue on these charges. The fact that this licensure authority can be used to raise revenue does not necessarily strip the license of its regulatory basis.

The source of the City's grant of authority and the limitations therein determine that Bellevue can have no greater authority to license than the State of Washington. Accordingly, the City's jurisdiction to license a given business activity cannot encroach any more than the State's authority to license can impinge on the FCC's exclusive jurisdiction to license and regulate a given activity. RCW 35A.11.020 is a specific grant of authority to code cities to license and regulate local business activities. RCW 35A.82.060 expands that power somewhat as to telephone services by allowing municipalities to tax intrastate toll

telephone services. But as noted above, the section also puts a number of express limitations on the City's ability to tax telephone services, including express prohibitions on the taxation of interstate telephone services, revenues representing access to interstate telephone service, and various charges to other telecommunications providers.

It is undisputed that Bellevue cannot tax revenues from interstate telephone services. It is undisputed that the FCC, acting pursuant to its regulatory jurisdiction, classifies the CALCs and other access charges at issue as interstate. And it is undisputed that the City does not have authority to regulate where the FCC has exercised its jurisdiction. The intersection of these three statements of the law determines that if Bellevue imposes the UOT pursuant to its regulatory authority, Bellevue cannot impose the UOT on the CALCs and other interstate access charges because it is bound by the regulatory classifications made by the federal government through statute and regulation. The City does not have regulatory authority to override the FCC by reclassifying a charge for access to interstate telephone service as an *intrastate* service charge. Simply put, what Bellevue cannot license, Bellevue cannot license for revenue.

The Superior Court correctly decided that Bellevue lacks the regulatory and taxation authority required to assess its UOT on CALCs

and other federal access charges. For this reason, the Court should affirm the Superior Court's decision to grant Qwest's motion for summary judgment.

C. The Superior Court Did Not Abuse Its Discretion In Denying The City's Motion For A Rule 56(F) Continuance

The Superior Court's discretion to deny a motion for continuance is not abused if (1) the requesting party does not offer a good reason for the delay in obtaining the desired evidence; (2) the requesting party does not state what evidence would be established through the additional discovery; or (3) the desired evidence will not raise a genuine issue of material fact. *See Turner v. Kohler*, 54 Wn.App. 688, 693, 775 P.2d 474 (1989). If the moving party does not show that the requested discovery would raise a question of fact, it is not an abuse of discretion to deny a Rule 56(f) motion. *See Van Dinter v. The City of Kennewick*, 64 Wn.App. 930, 937 (1992). In addition, Washington courts follow federal case law in applying Rule 56(f). *See Turner v. Kohler*, 54 Wn.App. 688, 694 (1989) (citing *Rinke v. Johns-Mancille Corp.*, 47 Wn.App. 222, 225 (1987)). Under federal case law, "the party seeking a continuance bears the burden to show what specific facts it hopes to discover that will raise a material issue of fact." *Cont'l Mar. of San Francisco v. Pac. Coast Metal Trades Dist. Council*, 817 F.2d 1391, 1395 (9th Cir. 1987).

Here, the Superior Court did not abuse its discretion by denying the City's Rule 56(f) motion because, as discussed above, the issue of whether Bellevue can levy UOT on CALCs and other federally-regulated access service charges is a legal question that would not have been affected by factual discovery. In its Rule 56(f) motion, the City sought "evidence as to whether the CALC has been applied to Qwest's provision of interstate or intrastate service [...]" and "evidence [to establish] the intrastate or interstate nature of the service for which Qwest has collected CALCs and certain other charges." CP 162. The City maintains that it determines the interstate or intrastate nature of a service by its point of origin and termination. CP 159.

Qwest's summary judgment motion did not depend on whether the services upon which CALCs and other federal access charges are imposed occur between Washington and some other state. Qwest argued, and the Superior Court agreed, that access charges imposed pursuant to federal tariffs are by law charges imposed on access to interstate service. The physical location of the telephone services that correspond to the federally tariffed access charges is irrelevant to Qwest's arguments, which raise pure questions of law that only require review of federal case law, the Code of Federal Regulations, Qwest's FCC and WUTC tariffs and Washington State statutes and case law.

The access charges at issue in this case are imposed pursuant to Qwest's *federal* interstate tariff, and they are classified by the FCC as charges for access to interstate services. Under both federal and state law, the City does not have the authority to impinge on the FCC's jurisdiction as to the classification of what services are interstate versus intrastate, nor to regulate where the FCC has classified a charge as compensation for interstate service.

The City's proposed factual discovery would have altered the Superior Court's decision only if it had decided that Qwest's legal arguments were wrong, in which case summary judgment would have been unwarranted for that reason. In light of this, the Superior Court correctly concluded that Qwest should not be forced to incur the cost and delay of unnecessary discovery. The City did not meet its burden of demonstrating how evidence obtained through discovery would alter the legal analysis of whether RCW 35A.82.060 prohibits imposition of UOT on these federally tariffed charges. The Superior Court did not abuse its discretion by denying the City's Rule 56(f) motion.

D. The Superior Court Did Not Abuse Its Discretion In Denying The City's Motion To Dismiss

The Superior Court did not abuse its discretion in denying the City's motion to dismiss. The Court can find an abuse of discretion

occurred only where the trial court exercised discretion on untenable grounds or for untenable reasons. *See Lindgren v. Lindgren*, 58 Wn.App. 588, 595, 794 P.2d 526 (1990); CR 60. Here, it was squarely within the Superior Court's discretion to exercise jurisdiction over the case because Qwest's declaratory judgment complaint invoked the Superior Court's original jurisdiction, and because the case involved issues of important public policy and resolution of the case by a state court would promote efficiency.

1. The Superior Court Properly Exercised Its Discretion To Hear This Case Under The Doctrine Of Primary Jurisdiction

In its motion to dismiss, the City argued that Qwest was required to exhaust its administrative remedies by asking the Bellevue hearing examiner to interpret the scope of RCW 35A.82.060. CP 77-84. However, this argument was based on a misunderstanding of the nature of Qwest's complaint and the procedural stance of the case. Qwest did not invoke the Superior Court's appellate jurisdiction over a decision by the Bellevue hearing examiner or Department of Finance. In fact, when it filed its complaint, it would have been impossible for Qwest to seek this type of review, because at the time the complaint was filed, there was no assessment to appeal. CP 3-7; CP 40-41.

As set forth in its complaint, Qwest invoked the Superior Court's *original* jurisdiction, pursuant to the Uniform Declaratory Judgments Act, RCW 7.24.010, and the Washington Constitution, Article IV, Section 6 and RCW 2.08.010, which vest the Superior Court with original jurisdiction over all cases involving the "legality of any tax, impost, assessment, toll or municipal fine." CP 4 (§ 4). Where a court has original jurisdiction over a dispute, the requirement that an agency action be exhausted through administrative appeal does not apply. *See Chaney v. Fetterly*, 200 Wn.App. 140, 145, 995 P.2d 1284 (2000). An appeal from an administrative tribunal invokes the appellate jurisdiction of a superior court. *See id.* (citing *Union Bay Preservation Coalition v. Cosmos Dec. & Admin Corp.*, 127 Wn.2d 614, 617, 902 P.2d 1247 (1995)).

Where both an administrative body and a court could hear a dispute, the relationship between the bodies is governed by the doctrine of primary jurisdiction. *See Chaney*, 100 Wn.App. at 148 ("when *both a court and an agency have jurisdiction* over a matter, the doctrine of primary jurisdiction determines whether the court or the agency should make the initial decision." (emphasis in original)). Under the doctrine of primary jurisdiction, a court should decline jurisdiction in favor of an administrative body where: "(1) the administrative agency has the authority to resolve the issues [...] (2) the agency has special competence

over all or some part of the controversy which renders the agency better able than the court to resolve the issues [...] and (3) the claim before the court involves issues that fall within the scope of a pervasive regulatory scheme so that a danger exists that judicial action would conflict with the regulatory scheme.” *In re Real Estate Brokerage Antitrust Litig.*, 95 Wn.2d 297, 302-03, 622 P.2d 1185 (1980).

Courts have consistently held that questions of statutory interpretation need not be referred to the administrative agency. *See State ex re. Graham v. Northshore Sch. Dist.* 417, 99 Wn.2d 232, 242, 662 P.2d 38 (1983) (court asked to interpret provisions of labor relations statute); *American Legion Post #32 v. City of Walla Walla*, 116 Wn.2d 1, 802 P.2d 784 (1991) (court asked to consider legality of gambling tax); *Dioxin/Organochlorine Center v. Dep’t of Ecology*, 199 Wn.2d 761, 837 P.2d 1007 (1992) (court asked to interpret requirements of environmental statute). Interpretation of a statute is a question of law and within the conventional competence of a court. *See Northshore*, 99 Wn.2d at 242. “Where the only question is the interpretation of a statute, resort to the administrative agency is unnecessary since it has no special competence over the controversy.” *American Legion*, 116 Wn.2d at 5. This conclusion reflects a well-recognized exception to the doctrine of primary

jurisdiction. *See id.* at 6 (citing *Great N. Ry. v. Merchant Elevator Co.*, 259 U.S. 285 (1922)).

As demonstrated in Qwest's cross-motion for summary judgment, the question before the Superior Court below, and this Court upon review, is a pure question of state statutory and constitutional interpretation as to the scope of powers conferred upon municipalities by the State. This is a legal question that rests squarely within the expertise of the courts. *See Northshore*, 99 Wn.2d at 242. This legal question is beyond the expertise of the municipal hearing officer. The parties do not dispute that Qwest has collected the CALCs and other FCC regulated charges for access services from its customers, that Bellevue seeks to levy the UOT on these charges, and that the Washington Constitution and the RCW control Bellevue's ability to levy a tax or fee on Qwest's revenues. Qwest did not ask the Superior Court to decide the amount of tax owed to Bellevue by Qwest. Nor does the complaint challenge Bellevue's methods for calculating Qwest's taxes. Because the Superior Court's review was limited to the interpretation of relevant constitutional and RCW provisions, the doctrine of primary jurisdiction did not prevent the Superior Court from retaining its original jurisdiction over this case.

2. Qwest Was Not Required To Exhaust Administrative Remedies Because It Did Not Invoke The Superior Court's Appellate Jurisdiction

a) Exhaustion Was Not Required

Despite the fact that Qwest invoked the Superior Court's original jurisdiction, the City continues to analyze the case under the exhaustion of remedies doctrine, which is simply inapplicable here. The error of the City's argument is apparent from the first prong of the exhaustion of remedies test it cites in its brief: "that exhaustion is required "when a claim is cognizable in the first instance by the agency alone." App.Br. at 37 (citing *South Hollywood Hills Cits. v. King County*, 101 Wn.2d 68, 73, 677 P.2d 114 (1984)). Qwest's declaratory judgment claim is *not* cognizable by the City alone. As discussed above, under the Washington Constitution and Washington statutes, the Superior Court has jurisdiction to hear any claim involving the legality of a tax. *See* Wash. Const., Art. IV, § 6; RCW 2.08.010. The doctrine of exhaustion governs an appellate relationship between the administrative body and a court. Where a claim is originally cognizable in a superior court, the doctrine of exhaustion does not apply. The Superior Court correctly determined that Qwest was not required to exhaust its administrative remedies in this case.

b) Even If Exhaustion Were Required, It Was Within The Superior Court's Discretion To Retain Jurisdiction

Even if the Superior Court had found the doctrine of exhaustion applicable here, it would not have abused its discretion to retain jurisdiction over the case in the interest of public policy and efficiency. Contrary to the City's assertions, the exhaustion of administrative remedies doctrine is not absolute. *See Prisk v. City of Poulsbo*, 46 Wn.App. 793, 797, 732 P.2d 1013 (1987) (excusing exhaustion requirement where no factual dispute was present and "fairness and practicality" justified the excusal). Reviewing courts have significant discretion when deciding whether to require exhaustion. *See id.* at 798. Courts will excuse a party's failure to exhaust administrative remedies where a "continuing question of great public importance" is involved. *Ackerly Communications, Inc. v. City of Seattle*, 92 Wn.2d 905, 602 P.2d 1177 (1979); *Smith v. Bates Technical College*, 139 Wn.2d 793, 991 P.2d 1135 (2000).

Here, the issue of whether municipalities can impose assessments on CALC and other FCC regulated access charges is of important interest far beyond the narrow issue of Bellevue's assessment. It was essential to obtain definitive resolution of the issues presented in Qwest's complaint as early as possible to protect consumers of telephone services from increases

to their telephone bills from unauthorized taxes and to avoid inconsistent application of Washington statutory law by individual municipalities, resulting in unnecessary piecemeal administrative proceedings and civil litigation.

The burden at issue in this case extends beyond Qwest's bottom line. Based on Bellevue's assessment, Qwest is authorized to directly pass on utility and other municipal taxes to its customers via an itemized bill charge. *See Allgaier Decl.*, ¶ 6. If Qwest had passed the levies at issue here onto its customers, and if it was determined that Bellevue could not lawfully impose its UOT on CALCs and other federal access charges only after a lengthy administrative hearing and subsequent judicial review, Qwest would face significant difficulties in refunding these amounts to customers. CP 294 (¶ 4). It would be quite burdensome and expensive to determine which Qwest customers paid the tax and were entitled to a refund. A refund would require that Qwest identify each customer who has a right to a refund individually. This task is burdensome enough for existing customers. However, Qwest would also be required to identify and locate customers who have moved or discontinued service.

Moreover, the problems associated with a refund would increase proportionately in the event other cities followed Bellevue's lead and attempted to impose taxes on the federally tariffed charges. RCW

35.21.714 and 35A.82.060 grant identical authority and provide identical limitations on all classes of cities in the state of Washington. Bellevue is currently the only city in Washington that has attempted to levy a tax on Qwest's interstate access revenues. CP 294 (§ 5). However, Seattle is currently conducting an audit of Qwest and has employed the same contract auditor who conducted the Bellevue audit. CP 294 (§ 5). Seattle may demand the same payments. CP 294 (§ 5). Other cities may well follow the example of these two major municipalities. Both Qwest and Bellevue, but moreover other municipalities and customers, required guidance of the courts with respect to whether cities are authorized to impose a tax on federally tariffed interstate access charges, as Bellevue has attempted to do. The speedy determination of Qwest's declaratory judgment action has likely helped, and will continue to help, avoid the piecemeal administrative appeals and civil litigation.

The City argues that the rationale behind the exhaustion doctrine supports dismissal of this case. However, the City's own characterization of this rationale clearly supports the Superior Court's decision to retain jurisdiction. The City argued that the doctrine of exhaustion serves several important purposes:

- (1) it insures against premature interruption of the administrative process;

- (2) it allows the agency to develop the necessary factual background on which to base a decision;
- (3) it allows exercise of agency expertise in its area;
- (4) it provides a more efficient process;
- (5) it protects the administrative agency's autonomy by allowing it to correct its own errors and insuring that individuals were not encouraged to ignore its procedures by resorting to the courts.

App.Br. at 38 (citing *South Hollywood Hills*, 101 Wn.2d at 73-74).

First, Qwest's declaratory judgment action did not "interrupt" the administrative process. To the contrary, it helped clarify issues before the hearing examiner by deciding statutory and constitutional issues that the Superior Court was better equipped to decide. Indeed, the Superior Court's ruling has allowed the hearing examiner to dispose of the legal issues surrounding the CALCs and other interstate access service charges. Thus, the administrative appeal is now narrowed and focused on the several remaining factual issues that are part of the Qwest's administrative appeal. *See* App.Br., Ex. 6.

Second, the development of a "factual background" was not necessary for the Superior Court to decide Qwest's motion for summary judgment. As discussed above, the question of statutory interpretation before the Court is a legal issue. There are no disputed facts relevant to the determination of whether a tax on the CALCs and other FCC regulated access services is beyond Bellevue's constitutional authority to levy.

Third, the Bellevue hearing examiner has no expertise in the area of statutory interpretation. The hearing examiner may have expertise in the calculation and assessment of taxes, but Qwest's declaratory judgment action did not require this. Instead, Qwest asked the Superior Court to interpret constitutional and statutory provisions, something that lies well within the expertise of the courts and beyond the expertise of the hearing examiner. *See Northshore*, 99 Wn.2d at 242 (finding that statutory interpretation is within traditional competence of the courts).

Fourth, it clearly would not have been more efficient for the hearing examiner to have decided the statutory issue raised in Qwest's complaint. The legal issue before the Superior Court had broader implications than just this case. A definitive judicial decision on the scope of RCW 35A.82.060 helped provide guidance not only to the hearing examiner in this case, but to auditor's and cities around Washington. If the Superior Court had declined jurisdiction, Qwest would have appealed the issue through the City's administrative and appellate process, and depending on the result, either Qwest or the City likely would have appealed the issue to a superior court at that time. As discussed above, the quick resolution of the issue by the Superior Court avoided potential piecemeal litigation and duplicative administrative appeals throughout the State.

Finally, through its audit, Bellevue had ample opportunity to correct its error and has consistently demonstrated its unwillingness to do so. Qwest did not “ignore” the administrative procedure (which in fact it is utilizing in its appeal of issues more appropriate to that forum), but instead sought to obtain a judicial ruling on an important constitutional and statutory question. The Court should affirm the Superior Court’s denial of Bellevue’s motion to dismiss because the Superior Court’s exercise of jurisdiction over the case was not an abuse of discretion.

VI. CONCLUSION

For the foregoing reasons, the Court should affirm the Superior Court’s decision to grant Qwest’s motion for summary judgment because the Superior Court correctly determined that Bellevue is not permitted to levy the UOT on CALCs and other federally tariffed access charges. The Court should also find that the Superior Court did not abuse its discretion in denying the City’s motion to dismiss because the Superior Court’s exercise of original jurisdiction was proper. Finally, the Court should find that the Superior Court did not abuse its discretion in denying the City’s motion for a Rule 56(f) continuance because the question of statutory interpretation presented to the Superior Court was a pure legal issue that did not require factual discovery.

VII. APPENDIX

- Exhibit 1. *In re Southern Pacific Communications Co.*, TSB-D-91(41)S, New York Tax Appeals Trib. (May 14, 1991)
- Exhibit 2. Legislative History of RCW 35A.82.060
- Exhibit 3. California State Board of Equalization Notice to All Local Exchange Carriers (July 1994)
- Exhibit 4. *Advisory Opinion*, New York State Department of Taxation and Finance, TSB-A-88(1)S (December 9, 1987)
- Exhibit 5. *Concentric Network Corporation*, DTA No. 819533, New York State Tax Appeals Tribunal in (March 16, 2006)

DATED this 16th day of August, 2006.



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CERTIFICATE OF SERVICE

I hereby certify that on this date a true and correct copy of Qwest Corporation's **Response Brief** was served on the below-listed counsel of record, in the manner indicated:

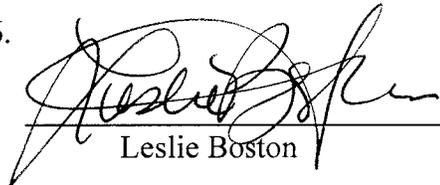
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Dated August 16, 2006.



Leslie Boston

EXHIBIT 1

In the Matter of the Petition of **SOUTHERN PACIFIC COMMUNICATIONS COMPANY** for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period September 1, 1970 through February 28, 1981.

TSB-D-91(41)S; Sales Tax

STATE OF NEW YORK-TAX APPEALS TRIBUNAL

1991 N.Y. Tax LEXIS 273

May 14, 1991

PANEL:

[*1]

John P. Dugan, President; Francis R. Koenig, Commissioner; Maria T. Jones, Commissioner

OPINION:

DECISION

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on March 22, 1990 with respect to the petition of **Southern Pacific Communications Company**, One Stamford Forum, Stamford, Connecticut 06904 for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1970 through February 28, 1981 (File No. 800275). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel). Petitioner appeared by Richard N. Wiley, Esq. and Scott B. Clark, Esq.

The Division of Taxation submitted a memorandum of law in support of its exception. Petitioner submitted a brief in opposition. Oral argument was heard at the request of the Division of Taxation on November 14, 1990.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

Issue

Whether long distance telephone services rendered by petitioner are subject to sales taxes.

Findings of Fact

We find the facts as determined by the Administrative [*2] Law Judge. These facts are set forth below.

Pursuant to 20 NYCRR 3000.7, the Division of Tax Appeals and petitioner entered into a stipulation of facts. At the request of the Administrative Law Judge, this initial stipulation was supplemented with additional facts. The stipulated facts and additional facts are as follows.

During the period in issue, petitioner, **Southern Pacific Communications Company**, was a specialized common carrier of communications subject to the jurisdiction of the Federal Communications Commission ("FCC"). As a specialized common carrier, it did not provide the services commonly associated with local telephone companies. It offered a limited microwave system for the transmitting of electrical impulses. This system provided inter-city communications services to the public, offering private line, restricted switched service and data services to both business and residential customers. In short, petitioner was what is commonly called a long-distance telephone company.

On June 20, 1982, the Division of Taxation issued to petitioner, GTE Sprint Communications Corporation, then known as **Southern Pacific Communications Company**, and hereinafter referred to [*3] as "GTE Sprint", two notices of determination and demands for payment of sales and use taxes due, asserting additional sales and use taxes plus interest. Notice number S820611019A, dated June 20, 1982, notified GTE Sprint that sales and use taxes in the amount of \$ 584,737.84 plus interest of \$ 350,510.82, for a total of \$ 935,248.66, had been determined to be due for the period

September 1, 1970 through August 31, 1977. Notice number S820611020A, also dated June 20, 1982, notified GTE Sprint that sales and use taxes in the amount of \$ 1,450,733.12 plus interest of \$ 377,751.45, for a total of \$ 1,828,484.57, had been determined to be due for the period September 1, 1977 through February 28, 1981.

The first sales tax return filed by GTE Sprint was for the quarter beginning December 1, 1975. Consents to extend the three-year limitation period were periodically executed only for quarters beginning after March 1, 1976. Therefore, the three-year limitation period for the quarter ending February 29, 1976 expired before the issuance of the statutory notice. The notices, as they relate to all other periods assessed, were timely issued.

The \$ 2,035,470.96 total sales and use taxes assessed [*4] consisted of sales tax of \$ 634,819.00 and use tax of \$ 1,399,234.97. On September 17, 1987, the Division of Taxation issued a Statement of Proposed Audit Adjustment, following further review of the use tax portion of the assessment. The statement specifically stated that it reflected the results of the use tax audit only. Revised use tax of \$ 984,999.96 plus interest of \$ 1,169,887.57 was proposed for the period September 1, 1970 through February 28, 1981. On September 17, 1987, GTE Sprint's authorized representative submitted to the Division, a Consent to Fixing of the (Use) Tax as proposed. On October 8, 1987, GTE Sprint remitted the use tax of \$ 984,999.96 plus interest of \$ 1,169,887.57 to the Department of Taxation and Finance. As a result of these actions, the only taxes remaining in contention in the instant proceedings are sales taxes totaling \$ 634,819.00, assessed for the period September 1, 1970 through February 28, 1981.

In the stipulations: the word "State" means the State of New York; the phrase "GTE Sprint's physical network" means the tangible communications facilities owned or leased by GTE Sprint and over which it exercised exclusive rights of management [*5] and control - the term specifically excludes services or facilities provided by other carriers pursuant to tariff; and the word "period" refers to September 1, 1970 through February 28, 1981.

The Assessed Transactions

The individual items offered by GTE Sprint to its customers in transactions for which sales tax was assessed are set out below, along with the corresponding amounts of sales tax assessed. n1

n1 The services listed here as Items 2 through 19 and 23 through 43 are described in Appendix II.

ITEM

Private Line Services:

1. Monthly mileage service charge	\$ 55,944.94
2. Local distribution facilities	60,445.29
3. 4 kilohertz termination charges	43,273.50
4. Modems	•529.44
5. Termination at CCSA	6,229.83
6. Outside move charges	794.16
7. LDF end of foreign exchange	1,058.87
8. Special billing	1,094.18
9. Busy lamp	35.32
10. C-2 conditioning	158.82
11. Multi-point service drops	653.01
12. Short-haul termination charges	1,023.20
13. Multi-point channel	1,411.85
14. Signaling equipment	847.13
15. Service charge	141.18
16. Loop	617.67
17. Voice and data arrangement	158.82
18. Traffic analysis - 12 months	1,835.40
19. DTMF to Rotary	229.83

Private Line Services Total \$ 176,482.44

Switched Services:

ITEM	
20. Sprint 5 access	\$ 155,780.36
21. Sprint 5 usage	210,125.86
22. Sprint 5 minimum	33,530.66
23. Datadial	6,196.22
24. Sprint 1 speedline	2,411.32
25. Sprint 1 business port	2,251.87
26. Sprint 1 speedline minimum	3,016.29
27. Sprint 1 security code	5.33
28. Sprint 1 WBT line	405.75
29. Sprint 1 Greenwich dial	352.65
30. Sprint 1 NY site preparation	85.98
31. Sprint 1 NY SP/power	105.16
32. Sprint 2 & 4 general access port	1,910.08
33. Sprint NYC usage	81.10
Switched Services Total	\$ 416,258.63
"Other"	
34. Modem	\$ 7,615.97
35. Traffic analysis - 12 months	1,304.40
36. Installtion	1,472.57
37. Voice and data arrangement	1,178.26
38. Multi-point service drop	2,229.76
39. C-2 conditioning	1,220.23
40. Baud data term	.420.76
41. DTMF to rotary	1,051.81
42. Service charge	25,498.18
43. D-1 conditioning	84.22
"Other" Total	\$ 42,076.16
TOTAL	\$ 634,817.23
Effects of rounding	1.77
ROUNDED TOTAL = Sales tax assessed	\$ 634,819.00
[*6]	

Each of the 43 separate items upon which sales tax was assessed was separately identified on GTE Sprint's customers' bills, and each was assigned a separate charge. When totaled the separate charges reflected the amount due from the customer for the month.

GTE Sprint did not charge or collect any sales tax from its customers for any of the above-described transactions.

The parties stipulate that Items 2 through 19 and 24 through 43 above are for services, and not equipment. Further, these services do not, by themselves, comprise telephone services, but are, instead, component parts of the telephone services provided by GTE Sprint to its customers.

As an additional fact, it is found that on audit, items 24 (Sprint 1 Speedline), 25 (Sprint 1 business port), 26 (Speedline minimum) and 32 (Sprint 2 and 4 general access port) were deemed to be the lease of equipment in New York State and as such were held to be taxable charges.

GTE Sprint was authorized by the FCC to provide only long distance interstate service and GTE Sprint offered only such service during the period at issue. GTE Sprint's customers had the capability of making and did in fact make long distance phone calls [*7] between points within the State via GTE Sprint's switched services.

Private Line Services

The term "private line service" generally refers to the provision by a carrier of specific circuits, or lines, dedicated to the sole use of a particular customer. Private lines are sometimes referred to as "tie-lines". GTE Sprint offered telephone-to-telephone ("end-to-end") private line services which were regulated by the Federal Communications Commission (FCC) and offered pursuant to FCC-approved tariffs. Those tariffs described the specific services and enhancements offered, and specified the terms and conditions by which they were provided. Specifically, the items listed above for "private line service" (Items 1 through 19) and "other" (Items 34 through 43) were offered for sale in GTE Sprint's private line tariffs filed with the FCC.

The monthly mileage service charge (Item 1) refers to the charge for private line service which varied according to the length of the line, increasing as the length of the line increased. During the period, all GTE Sprint private lines between points in the State passed physically through the State of New Jersey, although the charge was calculated [*8] based upon the airline mileage distance between the in-State points. A customer's private line circuits between points in the State could be, and were, connected to other private line circuits ending out-of-State. Thus, a customer's Albany/New York City circuit could connect to the same customer's New York City/Miami, or Albany/Chicago circuits.

GTE Sprint's physical network comprised only an intermediate part of the private line communication pathways. In order to complete the communication pathways, additional physical facilities were needed to link the customer's telephones at either end to GTE Sprint's intermediate physical network. In addition, certain enhancements of that line could only be performed at one or both ends. As an intermediate carrier, GTE Sprint could not, by itself, provide those enhancements.

The facilities that provided the final "links" in, and enhancements of, the communication pathways were purchased by GTE Sprint from the local exchange telephone companies ("LECs"), and consisted of the items listed above at items 2 through 19 and 34 through 43. GTE Sprint purchased those items from the LECs and then charged its customers for those very same items. [*9] The LECs' provision of these items was regulated by the FCC, and was subject to the terms and conditions of the LECs' tariffs filed with that agency. Those tariffs were entitled "Local Distribution Circuits For Patrons of the Other Common Carriers". No customer could make communications solely through the employment of those items. Rather, the addition of the GTE Sprint physical network and LEC-provided facilities at the distant end was necessary to establish the end-to-end communication pathway, and to place into effect the enhancements.

Under the LECs' tariffs, neither GTE Sprint nor its customers could designate, specify, design, own, control, test, repair, maintain, move, change, or in any other way assert dominion or control over the physical facilities (i.e., cable, structures, protective features, poles, plug-in units, etc.) used by the LEC to complete and enhance the communication pathway to and from the GTE Sprint physical network. The design and assignment or routing of specific facilities and equipment items to meet the service requirement as requested by GTE Sprint was performed exclusively by the LEC. Although GTE Sprint was responsible for the end-to-end service, [*10] it was required to notify the LEC of problems with the LEC portion of the pathway, and the LEC would perform any necessary repairs at no charge to GTE Sprint.

The private line monthly mileage service charges were calculated on the basis of connecting two points, such that a separate charge would be made for a Buffalo/Albany circuit and for a New York City/Miami circuit. The charges for each circuit would be calculated pursuant to GTE Sprint's FCC tariffs.

GTE Sprint provided private line services on a telephone-to-telephone basis. The charges for those services were determined by the circuit mileage, the access arrangements, or "links", employed, and by the circuit enhancements ordered. All of the access arrangements and circuit enhancements necessary to service a customer's needs were purchased by GTE Sprint from the LECs and were then sold to the end users by GTE Sprint. These access arrangements and enhancements, provided in connection with private line services, are listed at items 2-19 and 34-43 above.

Switched Services

The term "switched services" generally refers to the provision by a carrier of services over any available line selected by the carrier's switch. [*11] If all of the lines are "busy", the call cannot go through. Unlike the dedicated private line networks, all customers "share" the switched networks. Most residential and business customers use the switched networks. GTE Sprint's end-to-end switched services were regulated by the FCC, and were offered pursuant to FCC-approved tariffs. Those tariffs described the basic switched services and features offered, and specified the applicable terms and conditions. Specifically, the items listed above for "switched services" (Items 20 through 33) were offered for sale in those switched service tariffs.

The Sprint 5 usage charge (Item 21) and Datadial charge (Item 23) refer to the charges for switched services which varied according to the distance, duration, and time of day of the telephone communication, increasing as the distance and duration increased. During the period, all GTE Sprint switched service communications that might have been between points in the State passed physically through the State of New Jersey, although the charge was calculated based upon the airline mileage distance between the GTE Sprint physical network entry point and the location where the communication [*12] was received.

As was the case for private line services, GTE Sprint's physical network comprised only an intermediate part of the switched communications' pathways. In order to complete the communications pathways, additional physical facilities were needed to link the telephones at either end to GTE Sprint's intermediate physical network. The facilities that provided the final "links" in the communication pathway were purchased by GTE Sprint from the LECs. The LECs' provision of these links was regulated by the FCC, and was subject to the terms and conditions of the LECs' tariffs filed with that agency. Those tariffs were entitled "Exchange Network Facilities For Interstate Access" ("ENFIA").

These ENFIA services provided by the LECs did not provide GTE Sprint with information identifying the telephone number, and thus the location (state), from which calls originated. This information, known as automatic number identification ("ANI") was made available by the LECs only to themselves for traffic billed by them. Therefore, while the LECs were able to determine the location of the origin of calls billed by them, no such information was available to GTE Sprint during the period. [*13] This information is now available to companies like Sprint as a result of the provision by the LECs of "equal access", which was mandated by the court decree divesting AT&T of its LECs.

The Sprint 5 access charge (Item 20) was \$ 10.00 per customer per month. For this charge, the customer was given "access" to the GTE Sprint network. That is, the customer was given a list of the telephone numbers to dial in order to access the GTE Sprint network, along with a personal identification number which, when dialed, would identify the caller to the GTE Sprint switch as a valid GTE Sprint customer. However, the charge was imposed whether or not telephone calls were made, so long as the personal identification number was maintained in the system. Separate and additional charges were imposed for any telephone calls actually made by the customers, without credit for the \$ 10.00 access charge. The access charge allowed GTE Sprint to charge less for telephone calls than it would have had to charge were no access charge imposed.

The Sprint 5 minimum usage charge (Item 22) was \$ 25.00 per customer per month. If the customer used more than \$ 25.00 in telephone service, no minimum usage charge [*14] would apply. However, if the customer used less than \$ 25.00 in telephone service, he or she would be subject to all or part of the minimum usage charge. For example, if the actual usage was \$ 20.00, the customer would be subject to a minimum usage charge in the amount of \$ 5.00, and \$ 5.00 would be treated by the Division of Taxation as subject to the sales tax. Minimum usage charges were imposed to recover administrative expenses associated with maintaining records for nonperforming customers, and to assure that inactive customers would take steps to cancel their accounts.

Sprint 1 speedline (Item 24) and business port (Item 25) allowed customers who called the same number often the ability to be automatically connected to that number upon accessing the GTE Sprint network. The Sprint 1 speedline minimum usage charge (Item 26) was similar to the Sprint 5 minimum usage charge, above. Other charges (Items 27 through 31 and Item 33) were for special services provided to particular customers. The Sprint 1 & 4 general access port services provided customers with dedicated "links", over facilities provided by the LECs, into the GTE Sprint network access number and personal identification [*15] number.

The switched service charges included in items 20 through 26 and item 32 were all imposed for services offered by GTE Sprint pursuant to the terms and conditions specified in its FCC tariffs.

Origination of Calls

Calls could be made from out-of-State locations which would enter GTE Sprint's physical network in New York State. In some cases GTE Sprint charged for the in-State and out-of-State portions of these interstate calls, while in other cases another company might charge for the out-of-State portion.

The cross-border local exchange situation was one case where GTE Sprint would render the entire charge for an out-of-State call entering its network in-State. Thus, when a caller was across the State border, but within an exchange partly located in New York, he or she utilized cross-border exchange access services to enter the GTE Sprint network in New York. In this case, FCC rules placed the responsibility for the entire telephone-to-telephone transmission upon GTE Sprint, and GTE Sprint was required to pay the local telephone company for the cross-border access portion. GTE Sprint priced its telephone-to-telephone service to recover the cross-border access costs [*16] (which, overall, comprise

roughly 25% to 50% of the company's nationwide operating expenses), and billed the customer accordingly. In sum, a single charge was applied by GTE Sprint to the whole of a call across state lines.

The split-billing scenario, on the other hand, is illustrated by an example where New York offers the closest Sprint network entry point for an out-of-State Sprint customer (as was often the case during the audit period). Here, an LEC (in partnership with AT&T's Long Lines Department) would impose a separate interstate toll charge for the portion of the call from the out-of-State telephone to the GTE Sprint switching computer in New York, the remainder of the interstate call being billed by GTE Sprint. In this case, then, two separate charges were applied to the whole interstate call, one by the LEC and the other by GTE Sprint.

Audit Method

The Division of Taxation treated the private line monthly service charge (Item 1) as subject to sales tax when made for private line circuits between two points in the State. This was so, regardless of whether the customer was billed to an out-of-State address or whether the in-State circuit was connected to a [*17] circuit ending out-of-State. Tax was not assessed for circuits between a point in the State and a point in another state.

Sprint 5 usage charges (Item 21) and Datadial usage charges (Item 23) were treated by the Division as subject to sales tax when made for switched service communications entering GTE Sprint's physical network in the State and also received in the State. This was so, regardless of whether the customer's billing address was in or out of State. Tax was not assessed on communications entering GTE Sprint's physical network in another state and received in-State. Likewise, tax was not assessed on communications entering GTE Sprint's network in-State, but received in another State.

Sprint 5 access charges (Item 20) and Sprint 5 minimum charges (Item 22) were treated by the Division as taxable if the customer's billing address was located in the State, without regard to whether that customer made any communications, whether the communications made entered GTE Sprint's network in the State or elsewhere, or whether the communications made were received in-State or elsewhere. These charges were also deemed subject to sales tax even if the customer's address was out [*18] of state and the customer was billed to an address located out of State, if the customer's bill indicated that more than 50 percent of its calls entered GTE Sprint's physical network in-State. The Sprint 5 access charges and minimum charges represent fees for the privilege of having the capability of making long distance telephone calls over GTE Sprint's telecommunications systems. The fees were due regardless of whether the customer ever used GTE Sprint's telecommunications systems.

All other charges (Items 2 through 19 and 24 through 43) were treated by the Division as subject to sales tax if the charge was made for activity occurring within the State. This was so, regardless of whether the customer's billing address was located in the State or elsewhere. The Division deemed the providing of these items to be a transaction subject to sales tax.

The Division used two methods to determine the taxability of charges billed by GTE Sprint for items 2 through 19 and 24 through 43. The first was to identify GTE Sprint billing invoices which had a New York billing address. The Division assessed sales tax on all charges on these invoices, excepting those charges made for calls entering [*19] GTE Sprint's physical network in states or countries that were different from the calls' destination state or country, and excepting those charges made for calls entering GTE Sprint's physical network in the same state as the calls' destination state if that state was not New York.

The second method focused on GTE Sprint billing invoices which had non-New York billing addresses. The examiners identified the invoices with non-New York billing addresses which contained charges for calls entering GTE Sprint's physical network in New York. Sales tax was assessed on the charges made for all of the calls billed out of State which entered GTE Sprint's physical network in New York when the calls also had New York destinations. In addition, sales tax was assessed on the minimum, access and other charges if more than 50 percent of all of the calls on an invoice entered GTE Sprint's physical network in New York, (calculated without regard to whether those calls had New York or out-of-State destinations).

The parties stipulate to the authenticity of the diagram included as Appendix I, describing the communication pathways for a communication between New York City and San Francisco.

Opinion [*20]

In the determination below, the Administrative Law Judge determined that petitioner's provision of interstate telephone services was not subject to the imposition of sales tax under Tax Law § 1105(b). The Administrative Law Judge

specifically found that the telephone service sold by petitioner was interstate in nature and that the audit's attempt to isolate the purely intrastate components of the service was arbitrary. Accordingly, the Administrative Law Judge cancelled the assessment against petitioner in the amount of \$ 634,819.00 for the period at issue, September 1, 1970 through February 28, 1981.

On exception, the Division of Taxation (hereinafter the "Division") asserts that the Administrative Law Judge erred in excepting petitioner's telephone service from sales tax. First, the Division contends that the Administrative Law Judge erred in concluding that there was a single meaning of interstate commerce. Specifically, the Division contends that the meaning of interstate depends on its context and for purposes of Tax Law § 1105(b), the term "interstate" means a communication with one terminus outside New York. The Division further maintains that petitioner's charges for [*21] private line service between points within the State are subject to sales tax, notwithstanding that these charges may have been supplemented by charges for interstate phone services. The Division also asserts that the portion of petitioner's receipts attributable to access charges are subject to sales tax because they represent the consideration for the right to make intrastate long distance phone calls. It is irrelevant, suggests the Division, that the charges may also represent the consideration for the right to make interstate phone calls. Lastly, the Division posits that the fact that petitioner's customers may have made infrequent intrastate calls does not change the taxable status of the components at issue.

In response, petitioner argues in the first instance that the Tax Appeals Tribunal lacks jurisdiction to review the determination of the Administrative Law Judge. In addition, petitioner asserts that the Division failed to carry its burden to show petitioner's service was subject to sales tax. Petitioner also argues that the proper approach to discern whether the transaction is subject to tax is to look at the overall activity rather than examining the service on a [*22] "component by component" approach as advocated by the Division. In that regard, petitioner notes that the relevant case law supports an inquiry based on the overall nature of the service. Petitioner also emphasizes that the stipulation of facts indicate that the charges at issue are components of the overall interstate service and, therefore, are not subject to tax.

We affirm the determination of the Administrative Law Judge for the reasons set forth below.

Preliminarily, petitioner asserts that Tax Law § 2006(7) prohibits the Tribunal from reviewing the determination of the Administrative Law Judge. Tax Law § 2006(7) provides, inter alia, that a determination by an Administrative Law Judge denying a motion for summary determination is not reviewable by the Tax Appeals Tribunal. The determination at issue here does not involve the denial of a motion for summary determination. A review of the procedural posture of this matter establishes that neither party to this proceeding ever made a motion for summary determination pursuant to Tax Law § 2006(6). Accordingly, the provision in Tax Law § 2006(7) limiting the review of the Tax Appeals Tribunal is inapplicable here.

We [*23] now turn to the merits of the matter before us. Tax Law § 1105(b) imposes a tax on "[t]he receipts from every sale . . . of telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international . . . service" (Tax Law § 1105[b] emphasis added). As relevant here, the term "receipt" is further defined as "the charge for any service taxable under [Article 28]" (Tax Law § 1101[b][3]). The term "telephony and telegraphy" includes the "use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals" (20 NYCRR 527.2[d][2]).

It is undisputed that petitioner provides telephone service within the meaning of Tax Law § 1105(b) n2 and 20 NYCRR 527.2(d)(2). Contrary to the Division's assertion, it is also undisputed that the telephone service provided by petitioner in this matter is interstate in nature. The stipulation of facts entered into between the Division and petitioner in this matter specifically provides that petitioner is authorized by the FCC to provide only long distance interstate service and that during the period at issue, petitioner in fact offered only long distance interstate [*24] service. Accordingly the issue is not, as the Division argues, whether petitioner's service is interstate in nature. The interstate nature of petitioner's service has been established by the stipulation of facts agreed to by the Division and petitioner (see, 20 NYCRR 3000.7[e]). Rather, the issue presented on exception is whether certain components of petitioner's interstate service which have intrastate attributes may be segregated out and separately taxed under section 1105(b) of the Tax Law. We conclude that such an imposition of tax is not supportable.

n2 The Administrative Law Judge did not, as argued by the Division (brief on exception, p. 3), find that certain of the charges at issue were for the lease of tangible personal property. Instead, the Administrative Law Judge found that the Division's audit report characterized the charges in this manner.

Our conclusion rests on the Court of Appeals decision in *Matter of Moran Towing and Transp. Co. v. New York State Tax Commn.* (72 NY2d 166, 531 NYS2d 885) which interpreted the meaning of interstate commerce for sales tax purposes in the context of another sales tax exemption, section 1115(a)(8) of the Tax Law. [*25] This case establishes two important points to guide our analysis. First, that it is appropriate, absent any contrary indication in the statute or legislative history, to give the phrase interstate commerce its "precise and well settled legal meaning in the jurisprudence of the state" (*Matter of Moran Towing and Transp. Co. v. New York State Tax Commn.*, *supra*, 531 NYS2d 885, 889, citing McKinney's Cons Laws of NY, Book 1, Statutes § 238). Since this was the standard utilized by the Administrative Law Judge, this holding rebuts the Division's challenge to this aspect of the Administrative Law Judge's determination.

The second important aspect of Moran Towing is that it establishes that in determining whether a taxpayer's activities are in interstate commerce, it is improper to isolate and individually examine separate components of the overall activity being engaged in by the taxpayer. In Moran Towing, tugboats operating only in New York State waters provided towing services to vessels traveling in interstate commerce. The former State Tax Commission held that the tugboat operations were not within the interstate commerce exemption, stating "while the tugboats are [*26] related to the conduct of interstate or foreign commerce, their activities are in general a local event, separate and distinct from interstate commerce" (*Matter of Moran Towing and Transp. Co. v. New York State Tax Commn.*, *supra*, 531 NYS2d 885, 887). The Court of Appeals rejected this analysis stating "[t]hat the taxpayer's activities were conducted entirely within the waters of the State of New York does not affect the interstate character of those activities. The focus is on what the actor does, not where he does it" (*Matter of Moran Towing and Transp. Co. v. New York State Tax Commn.*, *supra*, 531 NYS2d 885, 887, citations omitted). The Court concluded that the tugboats were engaged in interstate commerce because the boats they directed were in interstate commerce.

We conclude that the Court's decision in Moran Towing dictates that the Division's attempt to segregate and tax components of petitioner's interstate service must be rejected. If the activities of a taxpayer operating exclusively in New York State cannot be examined for sales tax purposes apart from their interstate context, it follows that the activities of a taxpayer in interstate commerce cannot be segmented [*27] into State components and isolated from their interstate commerce context (see, *Matter of M & G Convoy v. State Tax Commn.*, 55 AD2d 204, 389 NYS2d 656, *affd* 42 NY2d 1017, 398 NYS2d 657 [where the isolation of a New York component of an interstate trip was rejected for franchise tax purposes]).

Our conclusion, that the overall nature of the telephone service determines whether it is in interstate commerce and excepted from tax, is consistent with the Division's opinion that a charge by a local telephone service provider to its customers for the ability to access long distance services is subject to sales tax as a component of the basic local telephone service (New York Tel. Co., Advisory Opn., Commr. of Taxation & Fin., January 5, 1988 [TSB-A-88(8)S]; Rochester Tel. Corp., Advisory Opn., Commr. of Taxation & Fin., December 9, 1987 [TSB-A-88(1)S]).ⁿ³ Clearly, these advisory opinions rest on the rationale that the local telephone service was intrastate in nature and the inclusion of an incidental component that may have had an interstate character did not alter the overall intrastate nature of the service. A similar analysis was also the basis for the Appellate Division's [*28] decision in *Matter of Callanan Mar. Corp. v. State Tax Commn.* (98 AD2d 555, 471 NYS2d 906, *lv denied* 62 NY2d 606, 479 NYS2d 1026), where the Court concluded that the incidental passage of a boat through interstate waters in what was clearly an intrastate journey did not affect the intrastate nature of the tripⁿ⁴ (see also, *Matter of Western Union Tel. Co.*, State Tax Commn., March 14, 1983 [where it was concluded that messages passing between points in New York State did not lose their intrastate character simply because they reached their New York destination via New Jersey]). If, as these opinions hold, an intrastate service retains a single intrastate identity in spite of an incidental interstate aspect, we can see no reason for a different rule which would segment an interstate service into components.

ⁿ³ This advisory opinion regarding Rochester Telephone Corporation was cited with approval by the Supreme Court, Albany County in *Davidson v. Rochester Tel. Corp.* (Sup Ct, Albany County, April 10, 1989, Prior, J) and was said to represent "an accurate interpretation of the law." On appeal to the Third Department, the decision of the Supreme Court was affirmed but on a different legal basis (*Davidson v. Rochester Tel. Corp.*, AD2d, 558 NYS2d 1009, *lv denied* 76 NY2d 714, 564 NYS2d 717). As noted by the Administrative Law Judge, the advisory opinion cited in *Davidson* does not lend support to the Division's position. In fact, that advisory opinion advocates an approach opposite to the one argued by the Division on exception; that is, that the overall nature of the telephone service is the point of inquiry, not the adjunct components of the service (see, TSB-A-88[1]S, *supra*).

n4 The Division relies on *Matter of Callanan Mar. Corp. v. State Tax Commn.* (98 AD2d 555, 471 NYS2d 906) for its position that the New York components of petitioner's service can be taxed. The Court of Appeals in *Moran Towing* concluded that Callanan did not establish such a rule, but instead merely established the rule that an incidental interstate aspect did not change the nature of "indisputably intrastate voyages" (*Matter of Moran Towing & Transp. Co. v. New York State Tax Commn.*, *supra*, 531 NYS2d 885, 888). The *Moran Towing* decision also disposes of another case relied on by the Division, *Matter of Niagara Junc. Ry. Co. v. Creagh* (2 AD2d 299, 154 NYS2d 229). The Court of Appeals indicated that Niagara Junction Railway has little bearing where, as here, the statutory meaning of interstate commerce is in issue (*Matter of Moran Towing & Transp. Co. v. New York State Tax Commn.*, *supra*, 531 NYS2d 885, 888).

[*29]

Applying the *Moran Towing* analysis to the stipulated facts in this matter results in the conclusion that petitioner has demonstrated its entitlement to the exclusion at issue here. The stipulation of facts specifically provides that the character of the service provided by petitioner is exclusively interstate service. The stipulated facts further state that the charges at issue "do not, by themselves, comprise telephone services, but are, instead, component parts of the telephone services provided by [petitioner] to its customers" (emphasis added). While it is true that portions of the components at issue included long distance service between points within the State, these components are clearly part of the overall interstate service provided by petitioner. Accordingly, the portions of petitioner's interstate service which the Division is seeking to tax must be treated as a component part or adjunct to the overall interstate service provided by petitioner. Therefore, we find that the charges at issue here are excluded from the imposition of sales tax pursuant to section 1105(b) of the Tax Law.

Lastly, the Division argues that if taxable and nontaxable services are [*30] covered by a single charge, the entire charge is subject to sales tax. The Division appears to be arguing thereby that the stipulated fact that petitioner's service is interstate in nature is irrelevant (Division's brief, pp. 11-13) and that the entire service should be rendered taxable. That position, however, must be rejected because it would result in imposition of tax on an interstate service in clear violation of the exemption provided in Tax Law § 1105(b) for interstate telephone service.

Nothing in this decision is intended to address the application of the sales tax to an audit that identified and taxed only those services that took place entirely in New York State and which were not an intrastate strand of an interstate service. Examples of such services might include switched services for calls originating in New York State and going to New York State locations and private line circuits between points in New York State which were not connected to a circuit going to another state.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The [*31] petition of **Southern Pacific Communications** Company is granted to the extent indicated in conclusions of law "E" and "F" of the Administrative Law Judge's determination; and
4. The notices of determination and demand for payment of sales and use taxes due dated June 20, 1982 are cancelled.

APPENDIX I

New York City-San Francisco Private Line Circuit

[SEE ILLUSTRATION IN ORIGINAL]

End-to-End Switched Services Connection

[SEE ILLUSTRATION IN ORIGINAL]

APPENDIX II

Description of Items 2 through 19 and 23 through 43

2. Local distribution facilities - the basic charge made by GTE Sprint to recover the costs of the LEC - provided access "link" portion of the private line circuits, that is, the portion of the circuit that connects the Sprint network entry-

exit points to the subscriber's telephones. The charge is partly fixed and partly sensitive to the distance from the customer's premises to the GTE Sprint facility.

3. 4 Kiloherertz termination charge - the charge made by GTE Sprint to recover the costs of LEC-provided multiplexing services. Multiplexing is the process of breaking a single radio channel into several circuits so that numerous conversations may simultaneously be [*32] carried over that single channel.

4. Modems - charges are for LEC-supplied conversions of signals from analog (wave) form to digital form, such as when a digital computer signal is converted to an analog signal for transmission over GTE Sprint's (then) analog network.

5. Termination at CCSA - charges imposed for GTE Sprint circuits terminating onto LEC-supplied "common control switching arrangement" facilities, which are used by the LECs to provide their very large customers (such as Ford) with virtually private networks, while utilizing the resources of the public switched network.

6. Outside move - charges for LEC's movements of facilities located "outside" their central office facilities, such as when the LEC moves a customer circuit from one location to another.

7. LDF end of foreign exchange - Foreign exchange services permit a company to maintain a local telephone number in a city far away from the company's office. For example, an airline may subscribe to foreign exchange services which permit its reservation agents in Minneapolis to pick up calls to a local New York City telephone number. The Minneapolis LEC's access services linking GTE Sprint's Minneapolis facilities [*33] to the customer's Minneapolis facilities is called the LDF end of the foreign exchange.

9. Busy Lamp - tells a customer whether his/her private line is already in use. As with the other items, the lamp is supplied by the LEC to GTE Sprint under tariff and GTE Sprint supplies it to the end user, also under tariff.

10. C-2 conditioning - a type of circuit conditioning (e.g., frequency response, attenuation, distortion, delay characteristics) necessary in order for a circuit to carry certain types of data transmissions. The LEC provides the conditioned circuits.

11. Multi-point service drops - this is where a subscriber would have, for example, a private line terminating in NYC and also might have offices located in midtown. The subscriber requires that one circuit connect both locations (i.e., a private line between multiple locations). To provide this service GTE Sprint would order facilities or access from the local exchange provider.

12. Short haul termination charges - this describes the rate schedule which exists for short haul service versus long haul service, which has a different rate structure.

13. Multi-point channel - similar to multi-point service drops. Involves [*34] a private line service that serves multiple points. A subscriber may have one point of service in NYC, another in Philadelphia and a third and fourth in Baltimore and Washington, DC. All four of these points are connected to the same private line channel.

16. Loop-transmitting loop - like a local distribution facility, but it is used to connect one of GTE Sprint's locations to one of its other locations or one customer location to another customer location in the same area.

17. Voice and data arrangement - type of conditioning. Service leased by GTE Sprint from a local exchange provider for resale to its subscriber.

18. Traffic analysis - 12 months- traffic analysis usage recording and analysis service on GTE Sprint's private line facilities.

19. DTMF to Rotary - refers to a rotary converter used to convert touch tone signaling to rotary signaling.

23. Datadial - similar to GTE Sprint access, usage and minimum charges but for data rather than voice transmittal.

24. Sprint 1 Speedline - an arrangement whereby GTE Sprint provides customers with the ability to be connected to a pre-selected location without dialing any digits after accessing the network.

25. Sprint 1 [*35] business port - denotes a switch port designed to enable a subscriber to enter or exit the GTE Sprint network to or from an off network location via a local telephone company provided business line.

26. Sprint 1 speedline minimum - a minimum charge billed to the customer for speedline service whether or not the customer uses the service.

27. Sprint 1 Security code - this is a service requested by a customer to prevent unauthorized usage of a service.
32. Sprint 2 & 4 general access port - denotes entrance or exit device on a switching machine which provides a means of connection between that switching machine and a termination point of the service.
34. Modem - see item #4.
35. Traffic analysis - 12 months- provided where there was a private line.
37. Voice and data arrangement - equipment to provide a voice alternate data service.
38. Multi-point service drop - a piece of equipment (i.e., a bridge) required to provide a multi-point configuration.
39. C-2 conditioning - see item #10.
40. Baud data term - equipment associated with a modem.
41. DTMF to rotary - converts touch tone signaling to rotary dial pulse type signaling required for private line service.
43. [*36] D-1 conditioning - type of conditioning similar to C-2 conditioning.

EXHIBIT 2

(8) Vessels with no propulsion machinery of any type for which the primary mode of propulsion is human power;

(9) Vessels which are temporarily in this state undergoing repair or alteration;

(10) Vessels primarily engaged in commerce which have or are required to have a valid marine document as a vessel of the United States;

(11) Vessels primarily engaged in commerce which are owned by a resident of a country other than the United States.

Passed the Senate April 10, 1989.

Passed the House April 6, 1989.

Approved by the Governor April 20, 1989.

Filed in Office of Secretary of State April 20, 1989.

CHAPTER 103

(Senate Bill No. 5990)

TELEPHONE TAX—RESALE OF NETWORK TELEPHONE SERVICES—EXEMPTION FROM MUNICIPAL TAX

AN ACT Relating to limiting the authority of cities to impose license fees or taxes on the sale of network telephone services; and amending RCW 35.21.714, 35.21.715, 35A.82.060, 35A.82.065.

enacted by the Legislature of the State of Washington:

Sec. 1. Section 10, chapter 144, Laws of 1981 as last amended by section 1, chapter 70, Laws of 1986 and RCW 35.21.714 are each amended to read as follows:

Any city which imposes a license fee or tax upon the business activity of engaging in the telephone business, as defined in RCW 82.04.065, which is based on gross receipts or gross income may impose the fee or tax, if the fee or tax is not more than one hundred percent of the total gross revenue derived from the sale of network telephone services subject to the fee or tax: PROVIDED, that the city shall not impose the fee or tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges for other telecommunications company, as defined in RCW 80.04.010, for switching fees, switching charges, or carrier access charges relating to interstate toll telephone services, or for access to, or charges for, interstate toll telephone services, or for charges for network telephone service that is purchased for the purpose of resale.

Sec. 2. Section 2, chapter 70, Laws of 1986 and RCW 35.21.715 are each amended to read as follows:

Notwithstanding RCW 35.21.714 or 35A.82.060, any city or town may impose a tax upon business activities measured by gross receipts or income from sales, may impose such tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges

to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to interstate toll services, or charges for network telephone service that is purchased for the purpose of resale. Such tax shall be levied at the same rate as is applicable to other competitive telephone service as defined in RCW 82.04.065.

Sec. 3. Section 11, chapter 144, Laws of 1981 as last amended by section 4, chapter 70, Laws of 1986 and RCW 35A.82.060 are each amended to read as follows:

Any code city which imposes a license fee or tax upon the business activity of engaging in the telephone business, as defined in RCW 82.04.065, which is measured by gross receipts or gross income may impose the fee or tax, if it desires, on one hundred percent of the total gross revenue derived from intrastate toll telephone services subject to the fee or tax: PROVIDED, That the city shall not impose the fee or tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges for other telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll telephone services, or for access to, or charges for, interstate toll telephone services, or charges for network telephone service that is purchased for the purpose of resale.

Sec. 4. Section 5, chapter 70, Laws of 1986 and RCW 35A.82.065 are each amended to read as follows:

Notwithstanding RCW 35.21.714 or 35A.82.060, any city or town which imposes a tax upon business activities measured by gross receipts or gross income from sales, may impose such tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges for other telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll services, or charges for network telephone service that is purchased for the purpose of resale. Such tax shall be levied at the same rate as is applicable to other competitive telephone service as defined in RCW 82.04.065.

NEW SECTION. Sec. 5. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

Passed the Senate March 13, 1989.

Passed the House April 11, 1989.

Approved by the Governor April 20, 1989.

Filed in Office of Secretary of State April 20, 1989.

(8) The meaning ascribed to words and phrases in chapters 82.04, 82.08 and 82.12 RCW, as now or hereafter amended, insofar as applicable, shall have full force and effect with respect to taxes imposed under authority of this chapter.

(9) "Taxable event" shall mean any retail sale, or any use of an article of tangible personal property, upon which a state tax is imposed pursuant to chapter 82.08 or 82.12 RCW, as they now exist or may hereafter be amended: PROVIDED, HOWEVER, That the term shall not include a retail sale taxable pursuant to RCW 82.08.150, as now or hereafter amended;

(10) "Treasurer or other legal depository" shall mean the treasurer or legal depository of a county or city.

Sec. 8. RCW 82.14B.030 and 1998 c 304 s 3 are each amended to read as follows:

(1) The legislative authority of a county may impose a county enhanced 911 excise tax on the use of switched access lines in an amount not exceeding fifty cents per month for each switched access line. The amount of tax shall be uniform for each switched access line. Each county shall provide notice of such tax to all local exchange companies serving in the county at least sixty days in advance of the date on which the first payment is due.

(2) The legislative authority of a county may also impose a county 911 excise tax on the use of radio access lines located within the county in an amount not exceeding twenty-five cents per month for each radio access line. The amount of tax shall be uniform for each radio access line. The location of a radio access line is the customer's place of primary use as defined in RCW 82.04.065. The county shall provide notice of such tax to all radio communications service companies serving in the county at least sixty days in advance of the date on which the first payment is due. Any county imposing this tax shall include in its ordinance a refund mechanism whereby the amount of any tax ordered to be refunded by the judgment of a court of record, or as a result of the resolution of any appeal therefrom, shall be refunded to the radio communications service company or local exchange company that collected the tax, and those companies shall reimburse the subscribers who paid the tax. The ordinance shall further provide that to the extent the subscribers who paid the tax cannot be identified or located, the tax paid by those subscribers shall be returned to the county.

(3) A state enhanced 911 excise tax is imposed on all switched access lines in the state. The amount of tax shall not exceed twenty cents per month for each switched access line. The tax shall be uniform for each switched access line. The tax imposed under this subsection shall be remitted to the department of revenue by local exchange companies on a tax return provided by the department. Tax proceeds shall be deposited by the treasurer in the enhanced 911 account created in RCW 38.52.540.

(4) By August 31st of each year the state enhanced 911 coordinator shall recommend the level for the next year of the state enhanced 911 excise tax, based on a systematic cost and revenue analysis, to the utilities and transportation

commission. The commission shall by the following October 31st determine the level of the state enhanced 911 excise tax for the following year.

Sec. 9. RCW 35.21.714 and 1989 c 103 s 1 are each amended to read as follows:

(1) Any city which imposes a license fee or tax upon the business activity of engaging in the telephone business(~~as defined in RCW 82.04.065~~) which is measured by gross receipts or gross income may impose the fee or tax, if it desires, on one hundred percent of the total gross revenue derived from intrastate toll telephone services subject to the fee or tax: PROVIDED, That the city shall not impose the fee or tax on that portion of network telephone service(~~as defined in RCW 82.04.065~~) which represents charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll telephone services, or for access to, or charges for, interstate services, or charges for network telephone service that is purchased for the purpose of resale, or charges for mobile telecommunications services provided to customers whose place of primary use is not within the city.

(2) Any city that imposes a license tax or fee under subsection (1) of this section has the authority, rights, and obligations of a taxing jurisdiction as provided in sections 11 through 15 of this act.

(3) The definitions in RCW 82.04.065 apply to this section.

Sec. 10. RCW 35A.82.060 and 1989 c 103 s 3 are each amended to read as follows:
(1) Any code city which imposes a license fee or tax upon the business activity of engaging in the telephone business(~~as defined in RCW 82.04.065~~) which is measured by gross receipts or gross income may impose the fee or tax, if it desires, on one hundred percent of the total gross revenue derived from intrastate toll telephone services subject to the fee or tax: PROVIDED, That the city shall not impose the fee or tax on that portion of network telephone service(~~as defined in RCW 82.04.065~~) which represents charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll telephone services, or for access to, or charges for, interstate services, or charges for network telephone service that is purchased for the purpose of resale, or charges for mobile telecommunications services provided to customers whose place of primary use is not within the city.

(2) Any city that imposes a license tax or fee under subsection (1) of this section has the authority, rights, and obligations of a taxing jurisdiction as provided in sections 11 through 15 of this act.

(3) The definitions in RCW 82.04.065 apply to this section.

NEW SECTION. Sec. 11. A new section is added to chapter 82.32 RCW to read as follows:
(1)(a) The department may provide an electronic data base as described in this section to a mobile telecommunications service provider, or if the department does not provide an electronic data base to mobile telecommunications service

Be it enacted by the Legislature of the State of Washington:

Sec. 1. Section 10, chapter 144, Laws of 1981 as amended by section 37, chapter 3, Laws of 1983 2nd ex. sess. and RCW 35.21.714 are each amended to read as follows:

Any city which imposes a license fee or tax upon the business activity of engaging in the telephone business, as defined in RCW 82.04.065, which is measured by gross receipts or gross income may impose the fee or tax, if it desires, on one hundred percent of the total gross revenue derived from intrastate toll telephone services subject to the fee or tax: PROVIDED, That the city shall not impose the fee or tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll telephone services, or for access to, or charges for, interstate services ((for which rates are contained in tariffs filed with the federal communications commission)).

NEW SECTION. Sec. 2. A new section is added to chapter 35.21 RCW to read as follows:

Notwithstanding RCW 35.21.714 or 35A.82.060, any city or town which imposes a tax upon business activities measured by gross receipts or gross income from sales, may impose such tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll services. Such tax shall be levied at the same rate as is applicable to other competitive telephone service as defined in RCW 82.04.065.

NEW SECTION. Sec. 3. A new section is added to chapter 35.21 RCW to read as follows:

A city or town required by RCW 35.21.870(2) to reduce its rate of taxation on telephone business may defer for one year the required reduction in rates for the year 1987. If the delay in rate reductions authorized by the preceding sentence is inadequate for a city or town to offset the impact of revenue reductions arising from the removal of revenues from connecting fees, switching charges, or carrier access charges under the provisions of RCW 35.21.714, then the legislative body of such city or town may reimpose for 1987 the rates that such city or town had in effect upon telephone business during 1985. In each succeeding year, the city or town shall reduce the rate by one-tenth of the difference between the tax rate on April 20, 1982, and six percent.

Sec. 4. Section 11, chapter 144, Laws of 1981 as amended by section 38, chapter 3, Laws of 1983 2nd ex. sess. and RCW 35A.82.060 are each amended to read as follows:

Any code city which imposes a license fee or tax upon the business activity of engaging in the telephone business, as defined in RCW 82.04.065, which is measured by gross receipts or gross income may impose the fee or tax, if it desires, on one hundred percent of the total gross revenue derived from intrastate toll telephone services subject to the fee or tax: PROVIDED, That the city shall not impose the fee or tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll telephone services, or for access to, or charges for, interstate services ((for which rates are contained in tariffs filed with the federal communications commission)).

NEW SECTION. Sec. 5. A new section is added to chapter 35A.82 RCW to read as follows:

Notwithstanding RCW 35.21.714 or 35A.82.060, any city or town which imposes a tax upon business activities measured by gross receipts or gross income from sales, may impose such tax on that portion of network telephone service, as defined in RCW 82.04.065, which represents charges to another telecommunications company, as defined in RCW 80.04.010, for connecting fees, switching charges, or carrier access charges relating to intrastate toll services. Such tax shall be levied at the same rate as is applicable to other competitive telephone service as defined in RCW 82.04.065.

NEW SECTION. Sec. 6. A new section is added to chapter 35A.82 RCW to read as follows:

A city or town required by RCW 35.21.870(2) to reduce its rate of taxation on telephone business may defer for one year the required reduction in rates for the year 1987. If the delay in rate reductions authorized by the preceding sentence is inadequate for a code city to offset the impact of revenue reductions arising from the removal of revenues from connecting fees, switching charges, or carrier access charges under the provisions of RCW 35A.82.060, then the legislative body of such code city may reimpose for 1987 the rates that such code city had in effect upon telephone business during 1985. In each succeeding year, the city or town shall reduce the rate by one-tenth of the difference between the tax rate on April 20, 1982, and six percent.

NEW SECTION. Sec. 7. The joint select committee on telecommunications shall study the degree to which cities and towns are able to uniformly assess their telephone business utility taxes upon all similarly taxable events within the individual jurisdiction. Such study shall assess how local utility taxes may be implemented to apply equally to similarly located customers served by competing intrastate toll service providers. The study shall determine if state agencies may be of assistance to cities and towns in identifying the providers of telephone services which are subject to locally levied

EXHIBIT 3



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001
TELEPHONE: (916) 322-9651

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First District
BRAD SHERMAN
Second District, Los Angeles
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Third District, San Diego
MATTHEW K. FONG
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BURTON W. OLIVER
Executive Director

NOTICE TO ALL LOCAL EXCHANGE CARRIERS UNDER THE CALIFORNIA EMERGENCY TELEPHONE USER'S SURCHARGE LAW

In a recent Board of Equalization hearing, the Board ruled that the Federal Communications Commission (FCC) access line charges are interstate in nature and therefore not subject to Emergency Telephone Users Surcharge (9-1-1 tax). Effective immediately, you should discontinue charging the 9-1-1 tax on the FCC access line charges.

The amount of any 9-1-1 surcharge billed and collected from service users must either be remitted to the Board or refunded to the service user. Any 9-1-1 tax previously billed on monthly FCC access line charges and remitted to the Board must either remain with the Board or be refunded by the service supplier to the service user in accordance with Section 41023 of the Emergency Telephone Users Surcharge Law which reads as follows:

Surcharge collections are debts. The surcharge required to be collected by the service supplier, and any amount unreturned to the service user which is not a surcharge but was collected from the service user as representing a surcharge, constitutes debts owned by the service supplier to the state.

A service supplier that has collected any amount of surcharge in excess of the amount of surcharge imposed by this part and actually due from a service user, may refund such amount to the service user, even though such surcharge amount has already been paid over to the Board and no corresponding credit or refund has yet been secured. Any service supplier making a refund of any charge to a service user upon which surcharge is collected under this part from the service user may repay therewith the amount of the surcharge paid. The service supplier may claim credit for such overpayment against the amount of surcharge imposed by this part which is due upon any other quarterly return, providing such credit is claimed in a return dated no later than three years from the date of overpayment.

Any amount of 9-1-1 tax refunded to service users resulting in credit taken on any tax return will be subject to audit verification. If any refund and subsequent credit is claimed, the service supplier shall maintain all records related to the refund and any claimed credit. To avoid any possible conflicts, we recommend contacting the Board prior to making any refunds or credits to assure the proper records are maintained.

If you have any questions regarding this matter, please contact the Excise Taxes Division at (916) 322-9651.

BOARD OF EQUALIZATION

Excise Taxes Division

EXHIBIT 4

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-88(1)S
Sales Tax
December 9, 1987

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S860911A

On September 11, 1986, a Petition for Advisory Opinion was received from Rochester Telephone Corporation, 100 Midtown Plaza, Rochester, New York 14646.

The issue raised is whether the flat rate End-User Common Line charges ("EUCL") Rochester Telephone Corporation assesses its customers in partial recovery of its costs of providing telephone service in New York are subject to the sales tax imposed by section 1105(b) of the Tax Law.

Petitioner is a local exchange company which provides telecommunication services to all or parts of six counties in Western Central New York State. Petitioner furnishes each of its subscribers with an access line, directly connecting each subscriber's premises with Petitioner's central office. Through this access line, passes all of a subscriber's local and intrastate and interstate toll messages. Petitioner provides local exchange telephone service and limited toll service within its franchised service territory.

As part of the basic telephone service, Petitioner provides to all of its subscribers a dial tone which gives such subscribers the ability to originate and receive local telephone calls and toll calls across the state and across the nation. When, for instance, a subscriber makes a long-distance intrastate call, the transmission passes over the subscriber's access line, through Petitioner's central office facilities, to the point of interconnection in New York with an interexchange carrier. The interexchange carrier would transmit the call to the appropriate local exchange telephone company, whereupon such local exchange company would route the call over its facilities to the access line of the called party. In the case of a long distance interstate call, the transmission is accomplished in the same manner except that a different interexchange or local carrier is involved in completing the call.

Like a subscriber's individual access line, Petitioner's central office facilities are used in the provision of local and intrastate and interstate toll calling. Interstate investment devoted to interstate calling is determined through an accounting procedure termed "Separations". 47 C.F.R. 67. Separations is "The process by which telephone property, costs, revenues, expenses, taxes and other revenues are apportioned among operations." 47 C.F.R. 67.701.

Petitioner stated that the FCC has fashioned a system of "Access Charges" to compensate local exchange companies for their participation in the origination and termination of interstate toll calling. The FCC has mandated that local exchange companies, such as Petitioner, recover some of its costs in providing interstate access service through charges levied on both its end-user subscribers, as well as on interexchange carriers which use Petitioner's facilities for the origination and/or termination of interstate calls made by the customers of such interexchange carriers.

RODERICK G. W. CHU, COMMISSIONER

GABRIEL B. DICERBO, DEPUTY COMMISSIONER

FRANK J. PUCCIA, DIRECTOR

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Pursuant to the FCC's Access Charge plan, local exchange telephone companies have submitted tariffs for filing with the FCC designed to recover from their subscribers some of the accounting separated costs of providing service with respect to interstate calling. A portion of Petitioner's separated costs are assessed on a per minute of use basis against interexchange carriers which incorporate these charges into their tariffed rates for interstate service. The balance of Petitioner's separated costs are recovered by assessing all of their subscribers a flat fee, the EUCL charge. Thus, this accounting separated cost is born by the local subscriber and paid as part of the monthly charges for basic telephone service.

An example of the accounting nature of cost separation is shown by the following federal regulation with respect to a purely local activity.

(a) If end user common line charges for intrastate toll access are assessed in a particular state, one-half of the end user common line access charge billing expense shall be apportioned to the interstate operations. If no end user common line charge is assessed for intrastate toll access, all of the end user common line access charge billing expense shall be assigned to interstate operations. (47 C.F.R. 67.385)

The EUCL charges are billed to each subscriber whether or not the subscriber makes or receives any long-distance interstate telephone calls and regardless of how many such calls may be made. Thus, the charge is not transactionally based. Furthermore, the service of providing its subscribers with the ability to access petitioner's central office in New York and there connect with an interstate carrier is local in that the Petitioner and the subscriber are both located in the Rochester area.

Section 1105(b) of the Tax Law imposes a tax on "the receipts from every sale . . . of telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service."

Section 1101(b)(3) defines receipt as "the amount of the sale price of any property and the charge for any service taxable under this article . . . without any deductions for expenses . . .".

The effect of §1101(b)(3) of the Tax Law is to treat as a single sale any sale in which any of the components cannot be singly purchased. Thus, even though the components of a particular sale can be separately stated, calculated or estimated, if they cannot be separately purchased, the combination of the items listed must be considered as one. Penfold v. State Tax Commission, 114 AD 2d 696 (1985). Because Petitioner's subscribers simply cannot purchase local service without also receiving the ability to access long-distance services, it must be concluded that EUCL charges are nothing more than an adjunct or component of the charges for local service. This access service is part and parcel of basic telephone service supplied by petitioner to its customers.

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Moreover, it is also clear that section 1101(b)(3) does not permit Petitioner to subtract out its costs of providing services when calculating taxable receipts from the provision of basic telephone service.

The EUCL charges are billed to each subscriber without regard to the actual long-distance interstate calls, if any, made by each subscriber. Although charged pursuant to an FCC tariff, the EUCL charges are nothing more than an accounting procedure used in an attempt to segregate and calculate from its basic charge, an item of expense incurred by Petitioner in providing each of its subscribers with access to an interstate long-distance carrier. The EUCL charges do not necessarily represent actual expenses incurred by Petitioner to provide interstate access to a particular subscriber nor is the activity represented by such charges any more interstate than any other component of the charges for basic telephone service.

Accordingly, it must be concluded that the access charge is a part of the basic service and thus subject to the sales tax imposed under §1105(b) of the Tax Law.

DATED: December 9, 1987

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.

EXHIBIT 5

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CONCENTRIC NETWORK CORPORATION	:	DETERMINATION
for Revision of a Determination or for Refund of Sales	:	DTA #819533
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Years 1999 and 2000.	:	

Petitioner, Concentric Network Corporation, c/o Michael O'Day, XO Communications, 11111 Sunset Hills Road, Reston, Virginia 20190, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the years 1999 and 2000.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on March 2, 2004 at 10:30 A.M., with all briefs to be submitted by July 26, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared by Anderson, Gulotta & Hicks, P.C. (Michael A. Warnagiris, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (James Della Porta and Lori P. Antolick, Esqs., of counsel).

ISSUES

I. Whether the Division of Taxation properly denied petitioner's claim for refund of sales and use taxes on its purchases of line access charges from MCI Worldcom, Frontier and Eagle Communications on the basis that such services were intrastate telephone services subject to tax pursuant to Tax Law § 1105(b)(1)(B).

II. Whether, if determined to be subject to tax as purchases of telephony or telegraphy, such services are nevertheless exempt from tax on the basis that they were used by petitioner to provide its customers with internet access which, by its very nature, is an interstate activity exempt from taxation.

FINDINGS OF FACT

In its brief filed on May 11, 2004, petitioner submitted 15 proposed findings of fact, each of which has been substantially incorporated into the following Findings of Fact:

1. On February 25, 2002, the Division of Taxation ("Division") received from Concentric Network Corporation ("Concentric") an Application for Credit or Refund of Sales and Use Tax which claimed a refund in the amount of \$438,960.26. The application stated that Concentric, a company wholly owned by XO Communications (Concentric was purchased by XO Communications, formerly Nextlink, Inc., in 2000), is located at various locations throughout the State of New York and is engaged in the business of providing internet service to customers located in New York. The refund claim involved sales tax paid by Concentric on tangible personal property, including equipment and dial-up access, in connection with its delivery of internet services.

The bases upon which Concentric claimed exemption from tax were: (a) that pursuant to Tax Law § 1115(a)(12) for the period prior to 2000 and pursuant to Tax Law § 1115(a)(12-a) thereafter (actually after September 1, 2000, the effective date of the enactment of paragraph 12-a), its purchase of equipment used directly to provide internet access service was exempt; and (b)

that pursuant to Tax Law § 1105(b)(1), sales for resale of telephone service are not subject to tax.¹

2. On September 30, 2002, the Division denied, in full, Concentric's claim for refund of sales tax stating as follows:

There are three issues involved in this refund denial:

1. Part of the refund is for periods beyond the time this company filed sales tax returns and paid sales tax. (The company's ownership and ID number changed in August 2000.)

2. ISP² equipment was not exempt from sales and use tax prior to September 2000.

3. Telephone charges are not exempt when an ISP pays them, even though they bill their customers an internet access charge.

3. Due to the fact that Concentric merged into XO Communications in August 2000, the claim for refund was revised from its original amount of \$438,960.26 to \$272,113.42 to reflect only those amounts of tax paid prior to the merger, i.e., all of the transactions at issue occurred during the years 1999 and 2000. Transactions occurring after 2000 were included in a separate claim for refund which is not at issue in this proceeding.

At the hearing, Concentric introduced into evidence a summary of all of the invoices upon which sales tax was paid by Concentric and for which the claim for refund was based. This summary listed: a reference number, the name of the vendor to whom tax was paid, the date of the invoice, a description of what was purchased (examples included: "private line," "dial access," "Colo Class III Pops," etc), invoice amount, amount paid, Federal tax, State sales tax,

¹ Concentric's assertion that its purchases were exempt because they were for resale was apparently withdrawn since at the hearing and in its brief and reply brief, it contended that its purchases were not subject to tax because such purchases were not properly classified by the Division as telephony or telegraphy.

² The abbreviation "ISP" refers to an Internet Service Provider.

local sales tax and refund requested (the amount of refund was the sum of State and local sales tax paid). The summary also contained a column entitled "Comments." Under this column were listed the locations of the line access purchased by Concentric which, in all cases, were New York locations. The locations listed included: "New York," "Buffalo, New York," "New York(Hudson)," "New York City, New York " and Syracuse, N.Y."

4. During the period from February 1999 until June 2000, Concentric purchased channelized T-1 lines and ATM lines from MCI Worldcom, Eagle Communications and Frontier. A T-1 or Trunk Level 1 is a digital transmission link with a total signaling speed of 1.544 Mbps (1,544,000 bits per second which may be divided into up to 24 separate voice-quality channels or which may be utilized as a single two-way high speed data stream). An ATM or Asynchronous Transfer Mode is a layered networking protocol which allows for a single physical line to be used to connect multiple destinations.

5. The internet is the worldwide interconnected system of packet-switched computer networks that connects computers and facilitates the exchange of data and information.

6. An ISP or Internet Service Provider is a vendor whose primary function is to provide its customers with access to the internet and world wide web along with other secondary functions such as providing electronic mail accounts.

7. The Internet Backbone is the high-speed network which spans the world from one metropolitan area to another.

8. National Access Points or NAPs are interconnection points where the lines that form the internet backbone are linked and where local ISPs must connect in order to carry their customer's data traffic to the internet backbone.

9. TCP/IP Protocol stands for Transmission Control Protocol/Internet Protocol. Internet Protocol defines how information is broken down into packets and routed. Transmission Control Protocol adds reliability to the IP packets which helps the packets reach their destination in the proper fashion.

10. T-3 or Trunk Level 3 is a digital transmission link with a total signaling speed of 44.736 Mbps with a capacity equivalent to 28 T-1 lines.

11. A packet switched network allows the same computer to send and receive data packets to and from multiple sources simultaneously. It is not necessary for a direct connection to be established in order for two computers to communicate with one another over the internet. This network differs from circuit switched networks or traditional phone networks which require a continuous connection.

12. A POP or Point of Presence is a facility where local internet traffic is aggregated. A Super POP is a combination point of all of the aggregated traffic for delivery to the internet backbone.

13. During 1999 and 2000, Concentric did not provide voice products or switch traditional voice traffic of any kind.

14. In all cases, internet traffic on Concentric's network, originating in New York and other states, was routed through Washington D.C. or Chicago, Illinois before reaching its destination.

15. Any ISP could insure that all of its traffic was routed both inside and outside a particular state by locating a router and related equipment in at least two states.

16. Michael Scott who is employed by Access Communications and was a director of access technology at Concentric until approximately 2002 appeared at the hearing and was

qualified as an expert witness in the area of internet access. He participated in the creation of the commercial entity known as the "internet." In 1993, Mr. Scott and two other individuals started Concentric, initially offering internet e-mail and then offering more interactive internet services where people could chat with each other, exchange files and use other computer systems. In 1994, they built their own internet network because it became too expensive to pay Sprint for dial-up service. In 1995, network upgrades were made to prepare for the worldwide web. After April 30, 1995, the internet was privatized; previously, the National Science Foundation operated the internet backbone and controlled access to the internet. In 1996, with the passage of the Telecommunications Act, competitive local exchange carriers were created and Mr. Scott and his associates began a company called MFS Communications which was eventually acquired by World Com. MFS Communications was a pioneer in the network architecture specifically for ISPs. In 1997, MFS Communications worked with SBC Communications to launch digital subscriber line service (DSL) which is a high-speed form of internet access which was competitively priced to compete with dial-up internet service. In 1998, Concentric purchased Internex Information Services, a national entity which had pairing arrangements with 35 or 40 different ISPs across the United States which allowed Concentric to become a Tier 1 ISP which is not dependent upon traffic with other internet service providers. In June 2000, Concentric merged with Nexlink Communications and later that year changed its name to XO Communications.

17. Mr. Scott explained that when one dials into or connects to the internet, there is an engine for every computer that is connected to the internet and that can "talk to" other computers. That process is done through creating packets which are collections of data. The

internet is made up of thousands of devices called routers which are responsible for taking bits of information and passing them through the communication links that make up the entire internet.

There are a collection of ISPs that make up the internet backbone. The internet categorizes ISPs as Tier 1, 2 or 3. A Tier 1 ISP is the largest and is an ISP that maintains a relationship with all of the other ISPs in the internet, i.e., it talks to everyone. After its purchase of Internex, Concentric was considered to be a Tier 1 ISP and had the network facilities to operate the internet network across the United States.

A Network Access Point is the facility at which all of the ISPs come together to exchange traffic with each other and to interconnect their networks. There were three original network access points: Pentsauken, New Jersey, Chicago, Illinois and San Francisco, California.

18. Mr. Scott indicated that a traditional telephone network is made up of a circuit switch technology which means that the network sets up a phone call in such a fashion that there is a reserved amount of space or bandwidth to cross that telecommunication network for the call to occupy. With packet switch networks which are utilized when computers are communicating across the internet, there is no fixed amount of band allocated for that session. The bandwidth is used as it is needed thereby making it more efficient. There is a telephone aspect of dial-up internet access which is that portion that connects one to the telephone where calls are received and routers answer those calls.

19. While all of the invoices at issue were introduced into evidence at the hearing, Concentric also introduced into evidence, as a separate exhibit, a packet of selected invoices which were referenced by Mr. Scott during his testimony. For example, the invoice labeled "1710A" is an invoice from MFS Worldcom, dated November 1, 1999, which describes the item purchased by Concentric, for the sum of \$756.00, as "COLO Class III Pops" which Mr. Scott

indicated was the cost associated with Concentric's co-location (putting the equipment into someone else's facility) of equipment into the City of Buffalo with World Com. It must also be noted that this invoice, under the heading "BAN DESCRIPTION" states "PRIVATE LINE BUFFALO."

The invoice labeled "1768A" is an invoice from MFS Worldcom which bills Concentric for the sum of \$55,354.53 for six different items. Mr. Scott indicated that the invoice was related to the ATM network connectivity that Concentric's super POP has in Hillburn, New York. Mr. Scott described the first of the six items, "BB ATM Access - MCI," as representing two circuits, one which goes to Washington, D.C. and the other to Chicago, Illinois. The next two items, "INTERNET MCI" and "INTERNET Other" could not be identified by Mr. Scott. The final three items on the invoice, "DAF installation," "DAF local loop" and "DAF infrastructure," were described by Mr. Scott as the infrastructure for the ATM network, the "port level" costs for the virtual circuits and virtual paths.

Invoice "1773E," an invoice from MFS Telecom, Inc., dated April 1, 1999, is part of a larger invoice for new charges totaling \$23,602.04 (including taxes and finance charges) which is labeled "1773B." The first two charges on invoice 1773E were described by Mr. Scott as charges associated with the DSL base internet access product, customer circuits. Invoice "1773G" and "1773H" list the customers of Concentric's internet services.

Invoice "2268C" contains charges (current charges are \$822.20) billed to Concentric by Frontier, dated August 28, 1999, for channelized T1 service in Rochester, New York. These charges include fees for "VP Flat Rate T1 Link" and "VP T1 Channel Termination." This invoice indicates that the charges are for monthly service for the period August 28, 1999 through

September 27, 1999. Mr. Scott indicated that these services represent channelized T1 or the telephone line portion of Concentric's internet network in Rochester, New York.

Invoice "2838A" is an invoice dated January 12, 2000 from MFS Dial Access NY (Hudson) for dial access in the amount of \$12,326.26. Mr. Scott indicated that the invoice was for a facility at 60 Hudson Street in New York City and represented the dial-up portion of the internet network.

SUMMARY OF THE PARTIES' POSITIONS

20. Concentric's position may be summarized as follows:

a. Concentric's purchases of channelized Trunk Level I (T-1) and Asynchronous Transfer Mode (ATM) lines are not subject to sales tax because such purchases are not properly classified as telephony or telegraphy. It maintains that while these line types can be used to switch voice traffic, it did not provide voice products or switch traditional voice traffic of any kind during the period at issue. While the telephony and telegraphy are defined as the "use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals" (20 NYCRR 527.2[d][2]), Concentric does not transmit signals. In the internet context, transmission and receipt of data traffic occurs at the central processing unit of an end user's computer;

b. Concentric states that the lines at issue are component parts of its interstate product known as interstate access. Through the evidence produced at the hearing, Concentric contends that it has established that in all cases, internet traffic on its network, originating in New York (and other states), was routed through Washington, D.C. or Chicago, Illinois before reaching its destination. Internet service, by its very nature, is an interstate activity which is not subject to tax by New York State; and

c. Since the Tax Law imposes the sales tax upon every sale except interstate and international telephony and telegraphy and telephone and telegraph service (Tax Law § 1105[b][1][B]), to be exempt from taxation, Concentric need not establish that it resold telephony, only that it purchased interstate telephony. In the matter at issue, 100 percent of Concentric's internet traffic travels outside New York.

21. In response, the Division maintains that Concentric purchased *intrastate* telephone service from MCI Worldcom, Frontier and Eagle Communications and used this intrastate telephone service which it purchased to allow its customers to dial into and connect to the internet. While petitioner did not use the telephone lines to transmit voice communications, as noted in 20 NYCRR 527.2(d)(2), telephony includes "use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals." The Division states that the regulations clearly contemplate a situation where a taxpayer would purchase telephone lines from a communications carrier and then use the lines to provide a packet switched network to provided internet access to its customers.

The Division further contends that the interstate nature of the internet is irrelevant. Concentric was not selling telephone service (interstate or otherwise) or any other taxable service and its purchases were, therefore, not for resale. Accordingly, Concentric's use of the telephone service is irrelevant and has no bearing on the taxable status of the charges incurred by Concentric therefor.

CONCLUSIONS OF LAW

A. Tax Law § 1105(b)(1)(B) imposes sales tax upon the receipts from every sale, other than sales for resale, of "telephony and telegraphy and telephone and telegraph service of

whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service”

20 NYCRR 527.2(a)(2) provides, in relevant, part that the words “of whatever nature” contained in Tax Law § 1105(b) “indicate that a broad construction is to be given the terms describing the items taxed.”

B. 20 NYCRR 527.2(d)(1) states that “[t]he provisions of section 1105(b) of the Tax Law with respect to telephony and telegraphy and telephone and telegraph service impose a tax on receipts from intrastate communication by means of devices *employing the principles of telephony and telegraphy.*” (Emphasis added.)

20 NYCRR 527.2(d)(2) provides as follows:

The term *telephony and telegraphy* includes use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals.”

* * *

Example 3: Message switching services, transmitted to a computer over lines leased from a communication carrier are telegraph services subject to the tax imposed under section 1105(b) of the Tax Law.

20 NYCRR 527.2(4) states:

A service is not considered telegraphy or telephony if either of these services is merely an incidental element of a different or other service purchased by the customer.

Example 6: A company offers its customers a protective service using a central station alarm system, which transmits signals telegraphically. The customer is purchasing a protective service.

C. Chapter 615 of the Laws of 1998 added a new section 179 of the Tax Law which provides as follows:

1. For purposes of this article, Internet access service shall not constitute a telecommunications service, nor shall the provision of Internet access service constitute the carrying on of a telephone, local telephone, telegraph, or transmission business.

2. The term 'Internet access service' shall have the meaning ascribed thereto in subdivision (v) of section eleven hundred fifteen of this chapter.

Chapter 615 of the Laws of 1998 also added a new subdivision (v) to section 1115 of the Tax Law (referred to in subdivision [2] of the new section 179 of the Tax Law hereinabove) which provides as follows:

(v) Receipts from the sale of Internet access service, including start-up charges, and the use of such service, shall be exempt from the taxes imposed under this article. For purposes of this subdivision, the term 'Internet access service' shall mean the service of providing connection to the Internet, but only where such service entails the routing of Internet traffic by means of accepted Internet protocols. The provision of communication or navigation software, an e-mail address, e-mail software, news headlines, space for a website and website services, or other such services, in conjunction with the provision of such connection to the Internet, where such services are merely incidental to the provision of such connection, shall be considered to be part of the provision of Internet access service.

D. Prior to September 1, 2000, Tax Law § 1115(a)(12), in relevant part, exempted from sales and use taxes:

telephone central office equipment or station apparatus or comparable telegraph equipment for use directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication or in receiving, amplifying, processing, transmitting and retransmitting telephone or telegraph signals

E. In 2000, chapter 63 of the Laws of 2000 (part S, section 7) added a new paragraph 12-a to Tax Law § 1115(a) which provided that, effective September 1, 2000, receipts from the following shall be exempt from sales and use taxes:

Tangible personal property for use or consumption directly and predominantly in the receiving, initiating, amplifying, processing, transmitting, retransmitting, switching or monitoring of switching of

telecommunications services for sale or internet access services for sale or any combination thereof. Such tangible personal property exempt under this subdivision shall include, but not be limited to, tangible personal property used or consumed to upgrade systems to allow for the receiving, initiating, amplifying, processing, transmitting, retransmitting, switching or monitoring of switching of telecommunications services for sale or internet access services for sale or any combination thereof. As used in this paragraph, the term 'telecommunications services' shall have the same meaning as defined in paragraph (g) of subdivision one of section one hundred eighty-six-e of this chapter.

The term "tangible personal property" means corporeal personal property of any nature having a material existence and perceptibility to the human senses (Tax Law § 1101[b][6]; 20 NYCRR 526.8[a]).

The definition of "telecommunication services" set forth in Tax Law § 186-e(1)(g)³ provides as follows:

'Telecommunication services' means telephony or telegraphy, or telephone or telegraph service, including, but not limited to, any transmission of voice, image, data, information and paging, through the use of wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar media or any combination thereof and shall include services that are ancillary to the provision of telephone service (such as, but not limited to, dial tone, basic service, directory information, call forwarding, caller-identification, call-waiting and the like) and also include any equipment and services provided therewith. Provided, the definition of telecommunication services shall not apply to separately stated charges for any service which alters the substantive content of the message received by the recipient from that sent.

At the same time, chapter 63 of the Laws of 2000 removed from Tax Law § 1115(a)(12), the language set forth in Conclusion of Law "D".

F. First, while it appears that Concentric has abandoned its argument that its purchases from MCI Worldcom, Eagle Communications and Frontier are exempt from tax as sales for

³ This definition was added to the Tax Law by chapter 2 of the Laws of 1995 and became effective on January 1, 1995.

resale, it is clear that Concentric did not make these purchases for resale. Concentric, admittedly, is an internet service provider and, as such, does not sell telephone or telegraph services to its customers. As noted by the Tax Appeals Tribunal in *Matter of Phone Programs, Inc.* (Tax Appeals Tribunal, April 6, 2000), “the resale exclusion for utility services demands that the services be resold as utility services, i.e., telephone services (20 NYCRR 526.6[c]; 527.2[e]).”

G. The next issue which must be considered is whether Concentric’s purchases from MCI Worldcom, Eagle Communications and Frontier, which are the subject of this refund claim, are telephony or telephone service. The primary obstacle in addressing this issue is the confusion over exactly what it was that Concentric purchased, i.e., did it, as the Division claims, purchase intrastate telephone service from these providers or did it, as Concentric asserts, purchase line access to provide its customers with internet access via a packet switched network which is distinguishable from sound reproduction networks. In essence, the Division contends that Concentric’s use of the telephone lines to provide internet access is irrelevant. Concentric, on the other hand, states that the Division improperly categorized these purchases as intrastate telephone services because the lines constitute access points to a packet switched network. While Concentric acknowledges (*see*, Petitioner’s Reply Brief, p. 5) that the T-1 and ATM lines which it purchased could be used for traditional telephone lines and that the lines begin and end in the State of New York, it maintains that it did not use the lines to transmit signals and, therefore, did not use the lines to provide telephone service.

As previously noted (*see*, Conclusion of Law “B”), Tax Law § 1105(b) imposes the tax “on receipts from intrastate communication by means of devices employing the principles of telephony and telegraphy.” While Concentric did not use the lines to transmit traditional

telephone signals, admittedly, the lines could have been used for that purpose. 20 NYCRR 512.2(a)(2) clearly states that the words “of whatever nature” contained in the statute which imposes the tax (Tax Law § 1105[b]) indicate that “a broad construction is to be given the terms describing the items taxed.”

It must be noted that the sales tax is a “transaction tax,” i.e., the liability for the tax occurs at the time of the transaction (*see*, 20 NYCRR 525.2[a][2]). At the time of its purchases, Concentric was a retail customer of MCI Worldcom, Frontier and Eagle Communications and what it purchased from these vendors was apparatus which could be used “for transmission of sound, sound reproduction or coded or other signals” (20 NYCRR 527.2[d][2]). The fact that Concentric, subsequent to its purchase of the lines, used such lines to provide its customers with internet access via a packet switched network and did not utilize them for sound reproduction does not render the purchases nontaxable. Moreover, the Division, in a memorandum of its Technical Services Bureau (TSB-M-97[1.1]C, TSB-M-97[1.1]S) dated November 15, 1999, stated, in relevant part, as follows:

Thus, the purchase of telephone service from telecommunications providers (such as local exchange companies or long-distance companies) to access the Internet does not fall within the scope of this exemption.⁴ For example, the charge for the telephone call to an ISP to initiate access to the Internet is still subject to both sales tax and the telecommunications excise tax, *as is the charge to an ISP for leasing telephone lines from a telecommunications provider* (emphasis added).

It is hereby determined, therefore, that Concentric’s purchases of line access from MCI Worldcom, Frontier and Eagle Communications were properly held by the Division to be purchases of telephony or telephone service.

⁴ The exemption referred to in the memorandum is that set forth in Tax Law § 1115(v) which exempted from sales tax the receipts from the sale of internet access service and the use of such service. This exemption was added by chapter 615 of the Laws of 1998 (*see*, Conclusion of Law “C”).

H. Concentric's alternative argument is that even if held to be purchases of telephony or telephone services, its purchases of line access are nevertheless exempt from tax because such lines are component parts of Concentric's interstate product known as internet access. As indicated in Conclusion of Law "A", the statute imposing the tax (Tax Law § 1105[b][1][B]) specifically excludes from tax interstate and international telephony and telegraphy and telephone and telegraph service. Concentric asserts that in all cases the internet traffic on its network, while originating in New York, was routed through Washington, D.C. or Chicago, Illinois before reaching its destination. In support of its position, Concentric cites to *Matter of Southern Pacific Communications Co.* (Tax Appeals Tribunal, May 14, 1991) wherein the Tribunal stated that in determining whether a taxpayer's activities are involved in interstate commerce, it is improper to isolate and individually examine the separate components of the overall activity being engaged in by such taxpayer. Concentric states that the T-1 and ATM lines which are the subject of this refund claim when integrated with other network components (such as servers, routers and modems) form an interstate internet network. Since the line access is just one component part of interstate internet access, Concentric contends that it cannot be subject to tax.

In response, the Division states that the line access services were delivered to and consumed by Concentric in its New York State locations. Unlike the petitioner in *Southern Pacific (supra)*, Concentric did not provide interstate telephone services to its customers. Instead, the line access services were used to provide a service which is not subject to tax, i.e., internet access service.

For each of the purchases of Concentric which are at issue herein, the line access service was delivered to and consumed by Concentric at various locations in New York State (*see*,

Finding of Fact "3"). Simply because the internet traffic on Concentric's network was routed out of state, i.e., through Washington, D.C. or Chicago, Illinois, does not, in and of itself, lead to the conclusion that what Concentric purchased was *interstate* telephony or telephone service.

Unlike the taxpayer in *Southern Pacific (supra)*, Concentric was not in the business of selling an interstate telephone service; in fact, it sold no telephone service at all. Concentric was the purchaser of the line access and it used the lines to provide an entirely separate service, internet access service, which, pursuant to Tax Law § 1115(v), was exempt from sales tax for the period at issue herein.

In Concentric's reply brief it states that if, as the Division argues, line access purchases constitute telephony, then line access must be considered an interstate variety of telephony. Based upon the record in this matter, Concentric's argument is without merit since the line access purchases at issue in this matter were all located within New York State. While the lines may well have been used to provide internet access service of an interstate nature to Concentric's customers, the taxes for which this petitioner seeks a refund were not imposed upon the internet service but upon the intrastate line access charges only.

Matter of Callanan Marine Corp. v. State Tax Commn. (98 AD2d 555, 471 NYS2d 906, *lv denied* 62 NY2d 606, 479 NYS2d 1026) is a case which involved sales tax imposed upon scows which delivered crushed stone to locations within New York State. The taxpayer transported the crushed stone from quarries located near Kingston, New York down the Hudson River to New York City. However, for a portion of the trip, the scows proceeded on the New Jersey side of the Hudson River for navigational reasons for approximately 20 miles. Petitioner argued that the scows were engaged in interstate commerce because they crossed state lines. The Court disagreed stating that the scows had a New York origin and a New York destination and

that passage through New Jersey waters was merely incidental to what was clearly an intrastate journey.

In *Matter of Western Union Telegraph Company* (State Tax Commission, February 4, 1983 [TSB-H-83(57)S]), the Commission held that telegraphic messages which originated and terminated in New York but which passed through a computer complex in New Jersey was intrastate telegraphy subject to sales tax under Tax Law § 1105(b).

Later in the reply brief, Concentric asserts that line access is only one component part of internet access which is an interstate network and, therefore, the line access component of internet access cannot be subject to sales tax. What Concentric appears to be conveniently overlooking is the fact that the tax is not being imposed on the internet access which is an interstate activity and which, pursuant to Tax Law § 1115(v), is exempt from tax. The purchase of the telephone line access by Concentric from its various vendors was the act that triggered the imposition of the tax and the fact that Concentric subsequently used the line access to provide a nontaxable interstate service to its customers does not affect the taxability of the preceding transactions, i.e., the purchase of the line access by Concentric from its vendors.

I. It must be noted that in its original claim for refund, Concentric alleged that the tax for which the refund was being sought was imposed and paid not only on line access charges, but on tangible personal property, including equipment, used in connection with its delivery of internet services. As previously noted (*see*, Finding of Fact “3”), the summary of the invoices upon which the refund claim was based indicates that what was actually purchased was some type of line access. In its brief and reply brief, Concentric concedes that the subject purchases were for line access. At the hearing, Concentric’s expert witness, Michael Scott, was unable to identify each of the items contained on various invoices.

This is noteworthy because if Concentric purchased tangible personal property such as equipment in conjunction with its purchases of line access, it is likely that some or all of that equipment could have been exempt from sales tax. For periods prior to September 1, 2000, Tax Law § 1115(a)(12) exempted certain telephone equipment and for periods after September 1, 2000, Tax Law § 1115(a)(12-a) exempted certain tangible personal property for use or consumption directly and predominantly in internet access services for sale.

However, as correctly noted by the Division, all sales of tangible personal property are presumed to be taxable unless the contrary is established and the burden of proving entitlement to an exemption from tax is upon petitioner (*Matter of Surface Line Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451). In the present matter, Concentric failed to produce sufficient evidence (other than invoices the contents of which even its expert witness had difficulty in clearly identifying) to sustain its burden of proving that what it purchased was exempt from tax under the aforesaid provisions of the Tax Law.

I. The petition of Concentric Network Corporation is hereby denied.

DATED: Troy, New York
January 20, 2005

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE