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SUPREME COURT OF THE STATE OF WASHINGTON

QUALCOMM INCORPORATED,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

RESPONDENT'S ANSWER TO PETITION FOR REVIEW

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ORIGINAL

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I. INTRODUCTION

Qualcomm's petition for review should be denied because it does not meet the criteria for review in RAP 13.4(b). The Court of Appeals' decision does not conflict with any Supreme Court case, nor does the petition for review raise an issue of substantial public interest that should be determined by this Court.¹

Qualcomm sells the OmniTRACS Mobile Communications System which allows trucking companies to send and receive text messages between drivers and dispatch centers and to receive position information and sensor data from their trucks. The system contains three parts that are sold separately: (1) the hardware installed on the truck, (2) the software installed at the dispatch center, and (3) the OmniTRACS service that provides a satellite communications link between the software and the hardware. Qualcomm collected retail sales tax on its sales of the hardware and software, but not on its sale of the service.

The Department determined that the OmniTRACS service was primarily used to provide data transmission and, therefore, was subject to retail sales tax as a "network telephone service."² The Superior Court and the Court of Appeals agreed with the Department that the primary purpose

¹Qualcomm's petition for review cites only RAP 13.4(b)(4) as a grounds for review. Petition at 8. Because Qualcomm also alleges a conflict with *Community Telecable of Seattle, Inc. v. City of Seattle*, 164 Wn.2d 35, 186 P.3d 1032 (2008), this answer also addresses RAP 13.4(b)(1).

² Former RCW 82.04.065 imposed the tax on "network telephone service." In 2008, the Legislature changed the name of this defined term to "telecommunications service." Both parties agree that the 2008 amendment did not alter the scope of the definition. Petition at 2.

of the OmniTRACS service was to provide a medium of communication that was subject to retail sales tax.

Qualcomm argues in its petition for review that the Court of Appeals should have looked at the functions of the OmniTRACS hardware and software that were sold separately to determine the taxability of the OmniTRACS service. However, the Court of Appeals correctly analyzed the sales of the service at issue.

Qualcomm also argues that the Court of Appeals' decision conflicts with this Court's decision in *Community Telecable of Seattle, Inc. v. City of Seattle*, 164 Wn.2d 35, 186 P.3d 1032 (2008), and will vastly and unfairly expand the Department's authority to impose telecommunications taxes. However, Qualcomm is incorrect. The Court of Appeals' analysis is consistent with *Community Telecable*. Both decisions focused on the nature of service the company was selling. In *Community Telecable* it was cable Internet service, here it is a data communication service that allows the OmniTRACS software and hardware to communicate. *Community Telecable* did not hold that hardware and software sold separately impacts the taxability of a data communications service.

Moreover, Qualcomm did not sell two services bundled together. It sold hardware and software along with a related data communications service. The Court of Appeals appropriately looked at the system as a whole and determined that Qualcomm sold the OmniTRACS service primarily to provide communication between the hardware and the

software. Accordingly, the Court of Appeals' decision is consistent with the *Community Telecable* decision.

Qualcomm's claim that the Court of Appeals decision would greatly and unfairly expand the imposition of telecommunications taxes is likewise unfounded. Under the Court of Appeals' decision, if a service includes both data processing and telecommunications components it will be taxed according to the primary purpose of the service. However, the retail sales tax is imposed on each sale. Therefore, if components are sold separately, there are two different sales, and the nature of the services must be determined by the primary purpose of the service being sold in each transaction. Because the Department has used this analysis for many years, the Court of Appeals' decision does not expand the imposition of telecommunications taxes.

II. RESTATEMENT OF THE ISSUE

Did the Court of Appeals correctly determine that Qualcomm's sales of the OmniTRACS Mobile Communications Service were subject to retail sales tax by looking at the primary function of the service sold in the transactions at issue?

III. RESTATEMENT OF CASE

Qualcomm sells the OmniTRACS Mobile Communications System primarily to trucking companies. CP 29 (¶ 2). This system allows trucking companies to send and receive text messages between their drivers and their dispatch centers and to receive position information and sensor data from the trucks. CP 241. The OmniTRACS Mobile

Communications System contains hardware and software purchased by the customers as well as satellite communications and position data processing provided by Qualcomm. CP 241-42.

There are two main aspects of the OmniTRACS Mobile Communications System: (1) real-time data communication; and (2) automatic position reporting. CP 86. To acquire these capabilities, each customer purchases three different products: (1) the Mobile Communications Terminal (MCT) located on the truck; (2) the OmniTRACS software (QTRACS) installed at the customer's dispatch center; and (3) the OmniTRACS service, the monthly satellite communications service that transmits the text and position messages from the terminals on the trucks to the software at the dispatch center, and in some cases processes the raw position information coming from the trucks. CP 184-85, 241-42.

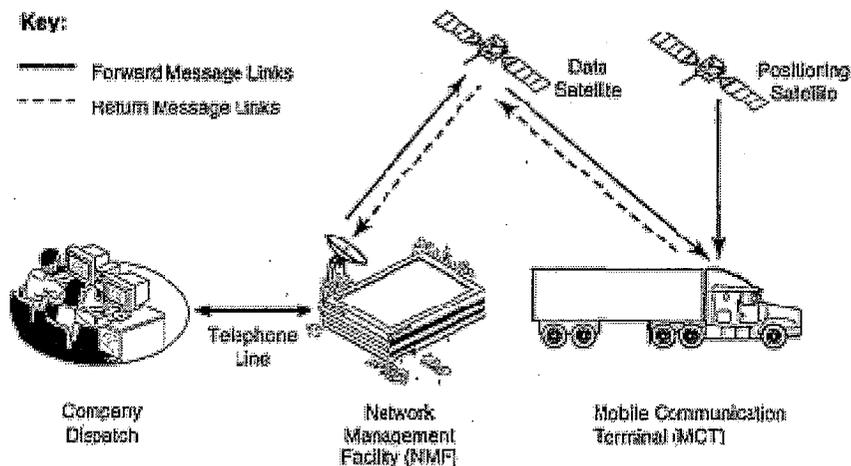
The mobile communications terminal costs \$2,950 - \$4,000 per unit and is installed on the customer's trucks. CP 193, 242. The terminal allows drivers to exchange messages with the customer's dispatch center. CP 242. It also transmits information about a truck's location via satellite to Qualcomm's network management facility, where it is forwarded to the customer's dispatch center. CP 242, 244. Qualcomm collects retail sales tax on its sales of the mobile communication terminals. CP 117.

The QTRACS software costs \$15,000 per license and allows the customer's dispatcher to exchange messages with a mobile communications terminal on the truck, to request location information

from the terminal, and to view the truck's location. CP 84, 110, 184, 241.

Qualcomm collects retail sales tax on its sales of the software. CP117.

The OmniTRACS service provides the satellite communications service needed to transmit signals from the terminal on the truck to the Qualcomm network management facility.³ For customers using Qualcomm's proprietary location service, the OmniTRACS service also converts the positioning information transmitted by the terminal into latitude and longitude coordinates.⁴ The following diagram, from Qualcomm's Mobile Communications Terminal Installation Guide, illustrates the data transmission paths:



CP 243.

³ Typically, the customer purchases connection between the customer's dispatch center and the network management facility separately. CP 188 ¶ 3.9.

⁴ In this answer, the Department will use the term "positioning information" to refer to the raw position information and the term "location information" to refer to the "positioning information" that has been converted into latitude and longitude coordinates.

A customer can purchase either one of two different OmniTRACS service plans. The Basic Plan costs \$35 per truck per month and includes one automatic position poll per hour. CP 185. An automatic position poll transmits a truck's location from the mobile communications terminal to the network management facility and from there to the customer's dispatch center. CP 88, 185, 242. The Enhanced Plan costs \$50 per month and includes the Basic Plan plus 180 regular messages and 18,000 characters per month. CP 185. If a Basic Plan customer sends a regular message, the customer is charged \$0.05 per message plus \$0.002 per character.⁵ CP 205, Appendix A. If an Enhanced Plan customer exceeds the monthly message allowance, incremental message charges are incurred at the same rate as Basic Plan customers. CP 185.⁶

A. Automatic Position Reporting

A mobile communications terminal generates and transmits information about a truck's location using one of two methods - either Qualcomm's proprietary system called the Qualcomm Automatic Satellite Position Reporting (QASPR) system or the public Global Positioning System (GPS). CP 243. Customers purchase the same OmniTRACS service, regardless of whether they use the proprietary or the GPS positioning systems. CP 246.

⁵ Customers can also send emergency, priority, and group messages, which are priced differently. CP 185.

⁶ At the administrative level, Qualcomm represented to the Department that approximately 17% of its total charges were for incremental messaging. CP 119.

In Qualcomm's proprietary system, the mobile communications terminal measures the signals it receives from two Qualcomm satellites⁷ and performs calculations on the signal measurements to generate the raw position data. CP 30 ¶ 3, 242. The terminal transmits this positioning information over Qualcomm's satellite communications system to the Qualcomm network management facility, where it is converted into latitude and longitude coordinates. CP 30 ¶ 3, 112, 242. The latitude and longitude coordinates are then forwarded to the customer's dispatch center for use in the QTRACS software. CP 88.

For the customers using the public GPS system, a GPS receiver and the terminal on the truck generates the latitude and longitude coordinates. These customers use the OmniTRACS service only to transmit the coordinates to the dispatch center. CP 246.

B. Mobile Messaging

There are three main types of messages transmitted via the OmniTRACS service: freeform, macro, and SensorTRACS. CP 30 ¶ 5. Freeform and macro messages allow drivers and dispatch centers to communicate with each other by sending messages such as pick-up and delivery confirmations. *Id.* Macro messages are typically fill-in-the blank messages that the dispatchers create with the QTRACS software and send to the mobile communications terminals for their drivers to use. CP 30 ¶

⁷ Technically, Qualcomm leases transponder space on these satellites. CP 30 ¶ 3.

6. Freeform messages allow drivers or dispatchers to send text messages without pre-defined data fields or inputs. CP 30 ¶ 6-8.

Qualcomm also offers an optional SensorTRACS system that collects information from various sensors on the vehicle and transmits it to SensorTRACS software located at the customer's dispatch center. CP 198. The SensorTRACS hardware and software are sold separately. CP 184, 197. SensorTRACS gathers speed, engine RPM, and other vehicle data through vehicle sensors and sends it to the terminal. CP 197. The terminal then transmits this information to the SensorTRACS software located at the customer's dispatch center using the OmniTRACS system. CP 198. When a customer transmits the SensorTRACS information, it is treated and billed as a regular message. CP 196.

C. Procedural History

In 2002, the Department audited Qualcomm for the period 1998 to 2001. CP 117. As a result of the audit, the Department assessed Qualcomm for uncollected retail sales tax on its sales of the OmniTRACS service. CP 10. Because Qualcomm collected and remitted retail sales tax on its separate sales of the software and hardware, those sales are not at issue. CP 117. Qualcomm paid the assessment and filed a de novo refund action under RCW 82.32.180. CP 5.

On cross-motions for summary judgment, the Superior Court granted the Department's motion and denied Qualcomm's motion, concluding there were no genuine issues of material fact and that the

Department was entitled to judgment as a matter of law. CP 304.

Qualcomm appealed the Superior Court's order. CP 306.

The Court of Appeals affirmed the Superior Court's order, holding that the primary purpose of the OmniTRACS service was to transmit customers' information, not to provide the customers with new information. *Qualcomm Inc. v. Dep't of Revenue*, 151 Wn. App. 892, 906-07, 213 P.3d 948 (2009).

Qualcomm then filed a petition for review, arguing that the Court of Appeals failed to consider the capabilities of separately purchased hardware and software when analyzing the primary purpose of Qualcomm's sale of the OmniTRACS service. Petition at 4.

IV. REASONS WHY THE COURT SHOULD DENY REVIEW

Qualcomm's petition for review does not satisfy the requirements of RAP 13.4(b)(1) or (4), and the Court should therefore deny review. The Court of Appeals' decision does not conflict with the Supreme Court's decision in *Community Telecable*. Moreover, the petition raises no issue of substantial public interest that should be determined by this Court.

Both Qualcomm and the Department agree on the legal standard in this case. Petition at 2. When a service primarily provides a medium of transmission or communication, it was taxable during the audit period as a "network telephone service" and is now taxable as a "telecommunications service." *Western Telepage v. City of Tacoma*, 140 Wn.2d 599, 610, 998 P.2d 884 (2000); Former RCW 82.04.065(2) (2002); RCW

82.04.065(27). When a service is purchased primarily to acquire new or processed information, it is taxable as an information service. DOR Determination No. 90-128, 9 WTD 280-1 at 4 (1990), Appendix B; RCW 82.04.065(27)(a).

The real dispute in this case is whether Qualcomm's customers purchased the OmniTRACS service primarily as a way to transmit data or primarily to obtain new or processed data. This is a fact-specific analysis, the determination of which has little or no application beyond the unique service at issue.

In its petition for review, Qualcomm attempts to recast the issue, alleging the Court of Appeals erred in limiting its analysis of the OmniTRACS service to the features of the service and not incorporating the capabilities of the hardware and software that were sold separately. However, as explained below, the Court of Appeals correctly analyzed the sales of the OmniTRACS service at issue. The Court of Appeals' analysis is consistent with this Court's decision in *Community Telecable* and is well supported by the relevant statutes, case law and administrative decisions. Accordingly, Qualcomm's petition for review should be denied because it does not satisfy any of the grounds for review in RAP 13.4(b).

A. The Court Of Appeals' Decision Is Consistent With This Court's Decision In *Community Telecable* Because Both Decisions Properly Analyzed The Nature Of The Services At Issue As A Whole

The Court of Appeals' decision is consistent with the *Community Telecable* decision. Unlike the City of Seattle in *Community Telecable*,

the Department and the Court of Appeals did not split the sales of the OmniTRACS service into two different components and analyze them separately. Rather, the Department and the Court of Appeals both viewed the sale of the service as a whole, the same as this Court did in *Community Telecable*. Qualcomm's primary allegation is that the Court of Appeals did not look at the capabilities of the hardware and the software. Petition at 4. However, the hardware and software were sold separately and were not components of the OmniTRACS service. CP 184-85.

The Court in *Community Telecable* did not hold that the taxation of a service changes based on separate sales of other services or products. Indeed, the Court cited with approval the Department's Excise Tax Advisory, which states that sales of telephone service to an Internet service provider are taxable as "network telephone service" even if the provider used the telephone service to provide Internet service. *Community Telecable*, 164 Wn.2d at 45 n.2; ETA 2029.04.245, Appendix C. In *Community Telecable*, the parties did not dispute that Comcast was selling Internet service to its customers, which was excluded from the definition of "telephone business."⁸ *Id.* at 41-42. The city merely argued that Comcast's agreement with the At Home Corporation, under which Comcast split the proceeds of its cable Internet service sales with At Home in exchange for backbone Internet connectivity, meant that Comcast was

⁸ "The dispositive issue in this appeal is whether the City may tax Comcast as a telephone business with regard to its cable Internet service." *Community Telecable*, 164 Wn.2d at 41.

also providing “transmission to and from the site of an internet provider via a ...cable.” *Id.* at 39-40, 43-44.

In response to the city’s argument, the Court held that the city could not break up Comcast’s sales of cable Internet service into different components and tax the components separately. *Community Telecable*, 164 Wn.2d at 45 (“the transmission component of cable Internet service cannot be taxed separately from those very services.”). As noted above, the Court distinguished the situation in which a telephone company sells telephone service to an Internet service provider that in turn uses the telephone service to provide Internet service. *Id.* at 44 n.2. These sales remain taxable as a telecommunications service because the telephone company is still selling telephone service to the Internet service provider, regardless of how the provider chooses to use the service.

Accordingly, *Community Telecable* did not hold that services sold separately must be analyzed together when determining their taxability. Therefore, the Court of Appeals’ decision to analyze the primary purpose of the sales at issue and not the capabilities of products sold separately does not conflict with the Court’s decision in *Community Telecable*. Because no conflict exists, review should not be granted under RAP 13.4(b)(1).

B. The Petition For Review Raises No Issue Of Substantial Public Interest That Should Be Determined By This Court Because A Fair Reading Of The Statutes And The Case Law Shows That The Court Of Appeals Decision Will Have No Significant Or Wide Ranging Impacts

Qualcomm's petition also fails to raise an issue of substantial public interest that should be determined by this Court. Qualcomm's arguments regarding the importance of this case rest on flawed logic and misreadings of the relevant statutes and cases. A reasonable reading of the statutes and cases shows that Qualcomm's claims regarding the importance of this case are incorrect. Further, there have been several changes in the law since the time period at issue, minimizing the impact of this case on the taxation of future sales of services. Thus, the Court of Appeals' decision will not broadly affect the taxation of telecommunication or information services.

1. The Court of Appeals' decision applied a straightforward legal analysis that determines the taxability based on the primary purpose of the service sold in the transactions at issue.

The retail sales tax is imposed on each sale of a good or service. RCW 82.08.020 ("There is levied ... a tax on each retail sale.") (emphasis added). *See also Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 40, 156 P.3d 185 (2007) (a sales tax taxes a specific sale of a good or service). Therefore, the taxability of each sale must be analyzed on its own to determine what is being sold in the transaction at issue.

Here, the Court of Appeals properly analyzed the taxability of sales at issue based on the primary purpose of the service that Qualcomm's customer purchased. *See* RCW 82.04.065(27)

(“‘Telecommunications service’ does not include: (a) Data processing and information services...where such purchaser's primary purpose for the underlying transaction is the processed data or information.”) (emphasis added).⁹ Since Qualcomm’s customers purchased the hardware and software separately, it would have been inappropriate to consider the capabilities of the hardware and software. The ability for the software and hardware to create and process data is irrelevant for analyzing the service at issue, just as the capabilities of a cell phone is irrelevant when determining the taxability of a wireless telephone service. The relevant question is what Qualcomm’s customers are seeking when they buy this service. The Court of Appeals correctly answered that question, determining that customers primarily purchased the service to transmit data between the hardware and software they had purchased separately. *Qualcomm*, 151 Wn. App. at 907.

Qualcomm maintains the Court of Appeals’ decision would turn every information service that transmits information electronically into a telecommunications service. Petition at 17. This argument ignores the fact that when a data processing service and a telecommunications service are sold separately there are two different sales that must be analyzed independently, since the retail sales tax is imposed on “each retail sale.” RCW 82.08.020. On the other hand, if a company sells a service that

⁹ Both parties agree that the current definition of “telecommunications service” has substantially the same meaning as the definition of “network telephone service” that was in effect during the audit period at issue. Petition at 2 n.1.

contains both information and transmission; such as Westlaw or payroll processing services did before the advent of the Internet, the resulting sale would be analyzed as a whole to determine the primary purpose of the transaction. In these examples the obvious answer is that the customer's primary purpose for purchasing the service is to obtain new or processed information. Accordingly, the service would be taxed as an information service and not as a telecommunications service. Thus, the Court of Appeals' decision does not create any shift in the taxation of information or telecommunications services. Instead it merely reflects a proper application of the existing law to the specific facts of this case.

2. The Court of Appeals' analysis does not impact Washington's compliance with the Streamlined Sales Tax Agreement.

Qualcomm raises for the first time in its petition the argument that taxing the OmniTRACS service as a "telecommunications service" violates Washington's obligations under the Streamlined Sales Tax Agreement. Petition at 13. A cursory review of the relevant authority shows this argument is groundless.

Qualcomm's first allegation is that the Court of Appeals conflicts with an unpublished Tennessee court decision. However, Tennessee is not a full member of the Streamlined Sales Tax Project and has not adopted the uniform laws or rules.¹⁰ Further, the Tennessee decision relies on an erroneous factual stipulation that the OmniTRACS service was principally

¹⁰ <http://www.streamlinedsalestax.org/index.php?page=state-info> (Last visited Nov. 20, 2009), Appendix D.

purchased to provide information to the customers. *Qualcomm Inc. v. Chumley*, 2007 WL 2827513 at *2 (Tenn. Ct. App. 2007). Therefore, the issue before the court in *Chumley* was different because there the parties agreed that customers were purchasing the OmniTRACS service to acquire information. Moreover, Qualcomm has cited no authority and presented no argument as to how the different result jeopardizes

Washington's compliance with the Agreement.

Qualcomm's new arguments regarding bundled transactions under RCW 82.08.190 and RCW 82.04.195 (both enacted in 2007) are likewise unfounded. Petition at 14. The OmniTRACS Mobile Communications System is not sold for a single non-itemized price and therefore the provisions of RCW 82.08.190 and .195 do not apply. Moreover, Qualcomm has not explained how selling three products that are all subject to retail sales tax individually would not be subject to retail sales tax when sold together. Accordingly, the Court of Appeals' decision does not impact Washington's compliance with the Streamline Sales Tax Agreement.

3. Further review of this case has limited impacts because the issues Qualcomm raises are unique to its particular business model.

The OmniTRACS Mobile Communications System contains related hardware, software, and transmission services. The manner in which Qualcomm sells this system is similar to most wireless telephone services where specific equipment is sold along with the service and neither component works without the other as the carriers lock the phones

into their network.¹¹ However, there is no confusion regarding the taxation of wireless telephone service, nor does Qualcomm allege wireless telephone services have been improperly classified as “telecommunication services.” Even though Qualcomm has alleged that the Court of Appeals’ decision will have wide ranging impacts, it has failed to identify any information services or products that have similar functions and are sold on a similar basis. The services Qualcomm identifies are commonly sold on a different basis than the OmniTRACS Mobile Communications System and Qualcomm has failed to show how these services will be impacted under the Court of Appeals’ decision. Therefore, the issues Qualcomm raises in its petition will have little or no impact on the taxation of other services.

Furthermore, the Legislature recently passed an act imposing retail sales tax on sales of digital goods, such as electronically delivered books, music, and movies, and digital automated services, such as online games and searchable databases. RCW 82.04.050(8)(a); Final H.B. Rep. on Engrossed Substitute H.B. 2075, at 2, 61st Leg., Reg. Sess. (Wash. 2009), Appendix F. These sales of digital goods and services include many sales transactions that would have been considered sales of information services during the audit period at issue. Since telecommunications services, digital goods, and digital automated services now are all subject to retail sales tax, further review would have little impact in future tax litigation

¹¹ John Haubenreich, *The iPhone And The DMCA: Locking The Hands Of Consumers*, 61 Vand. L. Rev. 1507, 1508 (2008), Appendix E.

and would not provide meaningful guidance to the Department on how to administer the retail sales tax.

Given the unique nature of the facts, the straightforward nature of the legal analysis and the recent changes in the statutes, Qualcomm's petition for review does not present an issue of substantial public interest that this Court should address. Consequently, the petition for review should be denied.

V. CONCLUSION

Qualcomm's petition for review does not satisfy the standards of review under RAP 13.4(b). The Court of Appeals' decision does not conflict with this Court's opinion in *Community Telecable*. Nor does Qualcomm's petition for review present an issue of substantial public interest that this Court should address. Furthermore, additional review would have little impact in future tax litigation and would provide no meaningful guidance to the Department. Therefore, the Court should deny Qualcomm's petition for review.

RESPECTFULLY SUBMITTED this 20th day of November, 2009.

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5775 MOREHOUSE DRIVE
 SAN DIEGO, CA 92121-1714
 (858) 651-5000 Fax (858)587-8276

Customer No. 6288
 Invoice No. 93267628
 Invoice Date 06-SEP-2001
 Period Ending 31-AUG-2001
 Date Due 30-SEP-2001

OmniTRACS BILLING SUMMARY

Base Charge Summary

<u>Billable Equipment</u>	<u>Rate</u>	<u>Total Charges</u>
48	\$35.00	\$1,680.00

OmniTRACS Activity Summary

	<u>Messaging Activity</u>		<u>Rate per Message</u>	<u>Rate per Character</u>	
	<u>Total Messages</u>	<u>Total Characters</u>			
Regular Forward Message	1,150	109,015	\$0.050	\$0.002	\$275.50
Regular Return Message	1,586	91,451	\$0.050	\$0.002	\$262.69
SensorTRACS Return Message	194	46,829	\$0.050	\$0.002	\$103.38
TOTAL ACTIVITY	2,940	247,295			\$641.57

Other Messages Summary

	<u>Messaging Activity</u>		<u>Rate per Message</u>	<u>Rate per Character</u>	
	<u>Total Messages</u>	<u>Total Characters</u>			
Group Message 26 - 50 MCTs	6	1,555			Sec Detail Breakout \$44.10
Special Requested Position Poll	1	0	\$0.050	\$0.000	\$0.05
TOTAL ACTIVITY	7	1,555			\$44.15

OmniTRACS Billing Summary
 MESSAGING COST (BASE CHARGES + INCREMENTAL CHARGES + OTHER MESSAGES CHARGES) **\$2,365.72**

In order for the furnishing of telephone lines to be taxable under the retailing classification of the business and occupations tax, the taxpayer must be making retail sales. RCW 82.04.250. A sale at retail means every sale of tangible personal property to consumers and includes "the providing of telephone service, as defined in RCW 82.04.065. . . ." RCW 82.04.050(5).

RCW 82.04.065 defines telephone service as either "competitive telephone service" or "network telephone service." The taxpayer claims that the furnishing of dedicated lines to its customers is network telephone service. According to RCW 82.04.065, network telephone service includes:

the providing by any person of access to a local telephone network, local telephone network switching service, toll service, or coin telephone services, or the providing of telephonic, video, data, or similar communication or transmission for hire, via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system.

WAC 458-20-245 includes a similar definition. The taxpayer is apparently relying upon the reference to "the providing of . . . data, or similar communication or transmission for hire" to support its position.

[1] In carving out an exception for telephone service from the definition of information services, the Department has drawn a distinction between those persons who are engaged in the business of furnishing a particular medium over which data is transmitted and those furnishing the data or information services being transmitted. Those engaged in the business of providing the means by which data is communicated are treated as making a sale, while those furnishing the data or processing it are providing a personal service.

As in the present case, the line is not always clear as to whether a transaction is a sale or a service. The examination must focus upon the real object of the transaction sought by the taxpayer's customers and not just its component parts. Rule 155 addresses this issue by providing in part:



Excise Tax Advisory

Excise Tax Advisories (ETAs) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

Number: 2029.04.245

Issue Date: February 24, 2006

Taxation of network telephone service used to provide Internet access services

On December 3, 2004, President Bush signed the Internet Tax Nondiscrimination Act of 2004, P.L. 108-435. This legislation reinstated and extended the moratorium on taxes on Internet access by amending the Internet Tax Freedom Act (ITFA). The legislation expanded the definition of tax-exempt Internet access by including telecommunications services that are purchased, used, or sold by an Internet service provider (ISP) to provide Internet access to its customers. This expanded definition of Internet access is thought by some taxpayers to include the type of services provided by network telephone service businesses to ISPs and their customers. This includes services used to connect an ISP to the Internet backbone or to ISP customer locations, such as the provision of transmission capacity over dial-up connections, coaxial cables, fiber optic cables, T-1 lines, frame relay service, digital subscriber lines (DSL), wireless technologies, or other means.

Washington has traditionally taxed the sale of these network telephone services to a consumer under the retailing classification of the business and occupation (B&O) tax and required the seller to collect retail sales tax. In 1997, RCW 82.04.065 was amended to explicitly include "the provision of transmission to and from the site of an internet provider via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system" as taxable network telephone service. To the extent that these services are included within the federal definition of "Internet access" (see below), ITFA appears to preempt the State's authority to apply B&O and retail sales taxes to the purchase of network telephone service used to provide Internet access, as well as the ISP's provision of traditional Internet access itself.

However, P.L. 108-435 also included two relevant grandfather clauses in section 3 of the Act. The first clause (subsection (a)(1)) grandfathers a state's right to continue assessing taxes on Internet access that were imposed and actually enforced as of October 1, 1998 if the tax was authorized by statute and the State had issued a public proclamation that such taxes were being imposed **or** the state generally collected tax on Internet access. This right continues through November 1, 2007, the date the moratorium is scheduled to end. P.L. 108-435 also included a second grandfather clause (subsection (b)) that applies to taxes imposed and enforced as of November 1, 2003. It grandfathers a state's right to continue imposing such taxes if the state had issued a public proclamation that taxes on Internet access were being imposed **and** the state generally collected such taxes. The right to continue imposing taxes under the second grandfather clause expires November 1, 2005. The language in the two grandfather clauses is substantively identical except for the different time periods (the first applies to pre-October 1998 taxes and the second applies to pre-November 2003 taxes) and the fact that the two provisos are written in the disjunctive for the first clause and in the conjunctive in the second clause.

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Some taxpayers believe that the second grandfather clause applies – to the exclusion of the first grandfather clause – to all taxes imposed on network telephone service used to provide Internet access services. These taxpayers point to statements made in the Congressional record that suggest that members of Congress thought that all state taxation of DSL services used to provide Internet access would cease as of November 1, 2005. Therefore, these taxpayers believe that they no longer need to collect and remit retail sales tax on sales of network telephone service used for Internet access after November 1, 2005.

The actual statutory language of ITFA does not, however, support this interpretation of the law. The first grandfather clause, effective until November 1, 2007, applies to any "tax on Internet access that was generally imposed and actually enforced prior to October 1, 1998." The term "Internet access service" is defined to include "telecommunications services . . . purchased, used, or sold by a provider of Internet access to provide Internet access." To the extent this modified definition includes purchased telecommunications used to provide Internet access, the first grandfather clause clearly applies to allow Washington State's taxation of these telecommunications services used to provide Internet access, because these taxes were imposed and enforced before October 1998. There is no indication in the statutory language that Congress intended the separate clauses to apply to different types of services, as opposed to covering taxes imposed in different time periods -- the language describing the applicable service is identical in both clauses. The applicable rule of statutory interpretation is that if the statutory language is unambiguous, a court will not consider the legislative history of the statute to reach a contrary conclusion. *Whitfield v. U.S.*, 543 U.S. 209, 215 (2005). Even if a court were to look to the legislative history of the act, however, the record is far from definitive and contains statements that could be seen to support either reading of the statute.

Finally, Washington meets the technical requirements of the first grandfather clause. In Washington, B&O and retail sales taxes on the sale of network telephone service used to provide Internet access were generally imposed and actually enforced prior to October 1, 1998. Taxpayers also had a reasonable opportunity to know of this practice due to the fact that RCW 82.04.065 explicitly stated that "the provision of transmission to and from the site of an internet provider via a local telephone network . . . or similar communication or transmission system" was taxable as network telephone service. Finally, the State generally collected B&O and retail sales taxes on the purchase of such network telephone service.

For these reasons, Washington's taxation of network telephone service used to provide Internet access qualifies under the first grandfather clause of ITFA and will continue as described above until at least November 1, 2007. This conclusion makes it unnecessary for the department to adopt a position with respect to the interpretation of the term "Internet access" advanced in the January 2006 Government Accountability Office report "Internet Access Tax Moratorium: Revenue Impacts Will Vary by State." The department may, before the expiration of the grandfather period, consider whether the amended definition allows the continued taxation of telecommunications services used to provide Internet access services, but does not do so at this time.

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State Info

Streamline Sales Tax State Members

Full Members - A full member state is a state that is in compliance with the Streamlined Sales and Use Tax Agreement through its laws, rules, regulations, and policies

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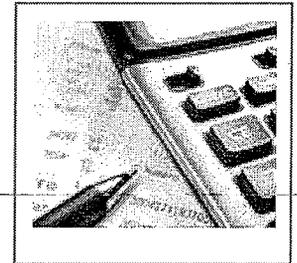
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Associate Members - An associate member state is a state that is in compliance with the Streamlined Sales and Use Tax Agreement except that its laws, rules regulations and policies to bring the state into compliance are not in effect but are scheduled to take effect no later than 12 months after becoming an associate member.

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It's high noon, Apple and AT&T--we really hate to break it to you, but the jig is up.

- Engadget.com [FN1]

***1508 I. Introduction**

On August 24, 2007, less than two months after its initial release for sale, the Apple iPhone was unlocked, untethering the phones from the AT&T cellular network. [FN2] Because AT&T has exclusive rights to provide coverage for the iPhone until the year 2010, hackers and computer enthusiasts worked feverishly to be the first to use the iPhone on a network other than AT&T. [FN3] Although the practice of cell phone unlocking has been occurring for years, [FN4] the tremendous public interest surrounding the launch of the iPhone focused attention on the issue like never before.

Wireless carriers can use software locks, hardware locks, or both to disable a handset from being used on any network except the one for which it was purchased. [FN5] Most handset makers, such as Motorola and Nokia, manufacture almost identical versions of their phones for different networks, making, for example, a new T-Mobile customer purchase a different version of the same phone he used on the AT&T network. As a result, most customers choose phones based on the network they plan to use. [FN6] The practice of linking a specific cell phone handset to a particular network did not, of course, originate with Apple and AT&T. T-Mobile, Verizon, and Sprint also lock handsets to prevent them from working on competitors' networks. [FN7] A network provider may sometimes unlock a customer's handset so that the customer can take the phone overseas to use on a foreign network, [FN8] but generally, providers operate according to a business *1509 model that subsidizes expensive handsets and locks customers into multi-year contractual commitments. [FN9] The iPhone, for instance, will not appear on networks other than AT&T, nor will AT&T unlock it for use overseas. If consumers want iPhones, they must use the AT&T network and be willing to use locked phones, with all their inherent limitations. [FN10]

In contrast, an unlocked cell phone offers considerably more freedom than a locked phone: it is available for use on any cellular network with which the customer has an account. [FN11] If a consumer has an unlocked iPhone, he can use the iPhone on an account with T-Mobile, O₂ (a British carrier), Vodaphone (a European carrier), or any other carrier using GSM technology. [FN12] Generally, phone owners replace the SIM cards (which carry users' phone numbers and other personal information) in their phones whenever they switch networks. [FN13] With multiple SIM cards and multiple accounts, an owner can use the same handset on multiple networks. Alternatively, a user could close his account with one network, purchase a new SIM card, and switch to another network. [FN14] The desire to achieve this level of portability and freedom prompted interested groups and individuals to enter the race to unlock the iPhone, a race that was won less than two months after the phone's release.

*1510 Once people began publishing their methods of unlocking the iPhone, AT&T sent many of them cease-and-desist letters, [FN15] grounded in section 1201(a)(2) of the Digital Millennium Copyright Act of 1998 ("DMCA" or "the Act"). [FN16] Congress passed the DMCA to curtail the copyright piracy made possible by the new technologies of the 1990s. [FN17] Section 1201(a)(2) of the DMCA protects an owner's copyright by making it illegal to "circumvent a technological measure" installed by the owner. [FN18] Essentially, the Act makes it illegal, as a separate offense, merely to circumvent protective measures that copyright holders place on copyrighted works; it does not require actual copying. [FN19]

For cell phones, the "copyrighted work" at issue is the software that runs the phone, known as "firmware." The "technological measure" that the act makes illegal to circumvent is the locking software or hardware that the manufacturer or wireless provider installs. Wireless service providers such as TracFone, the United States' largest pre-paid service provider, argue that the steps they have taken to lock the phones they sell simply are protective measures against copyright infringement. [FN20] On the other hand, consumer groups argue that cell phone locks hamper consumers' rights to choose which network to use with their handsets. [FN21]

Subsections 1201(a)(1)(C) and (D) of the DMCA offer an intriguing possibility for those who are concerned that copyright law overly restricts consumer choice. [FN22] These subsections allow the Librarian of Congress to accept comments from

FINAL BILL REPORT

ESHB 2075

C 535 L 09
Synopsis as Enacted

Brief Description: Concerning the excise taxation of certain products and services provided or furnished electronically.

Sponsors: House Committee on Finance (originally sponsored by Representative Hunter).

House Committee on Finance
Senate Committee on Ways & Means

Background:

Retail sales and use taxes are imposed by the state, most cities, and all counties. Retail sales taxes are imposed on retail sales of most articles of tangible personal property (TPP) and some services. If retail sales taxes were not collected when the property or services were acquired by the user, then use taxes are applied to the value of most TPP and some services when used in this state. Use tax rates are the same as retail sales tax rates. Downloaded prewritten computer software is included within the definition of TPP and is therefore subject to sales or use tax, but downloaded products such as digital music, movies, and books are not specifically included within the definition of TPP. The Department of Revenue (DOR) treats downloaded music, videos, and books as TPP, subjecting these products to retail sales and use taxes. However, if these same products are streamed to the customer, then sales and use taxes do not apply because the customer is not considered to have taken possession of the product.

In 2007 legislation directed the DOR to "conduct a study of the taxation of electronically delivered products" and to prepare a final report for the Legislature by September 1, 2008. The legislation required the DOR to conduct the study in consultation with a committee consisting of four legislative members, as well as additional members representing the industry and government. The committee consisted of 16 members in total. In December 2008 the DOR completed its study. The final report included a discussion of a number of issues related to the taxation of digital products, including compliance with the streamlined sales and use tax agreement (SSUTA), sourcing, bundled digital products, and methods of obtaining digital products. The report's conclusion stated that legislation implementing tax policy on digital products is necessary in 2009 to: (1) protect the sales and use tax base; (2) establish certainty in the tax code; (3) maintain conformity with the SSUTA; and (4) encourage economic development. Because of the differing views on certain fundamental

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

issues surrounding the taxation of digital products, the committee was not able to reach consensus on a specific tax policy proposal. However, the committee agreed that legislation adopting a broad, general imposition approach for digital products would be possible only if the legislation: (1) contains meaningful and easily administered broad-based exemptions for business inputs; (2) provided sales and use tax amnesty to taxpayers who failed to collect tax on digital products for prior periods; (3) maintained conformity with the SSUTA; and (4) protected and promoted the location of server farms and data centers in Washington.

On September 20, 2007, the SSUTA was amended to define three specified digital goods (digital audio-visual, digital audio, and digital books) as not being TPP. To remain compliant with the SSUTA, Washington has to enact a separate provision by January 1, 2010, to continue imposing sales and use tax on these three products. As of January 1, 2012, a separate tax imposition provision will be required to impose sales and use tax on all other electronically delivered products.

"Substantial nexus" is the connection required to exist between a state and a potential taxpayer, such that the state has the constitutional right to impose tax obligations on the taxpayer.

Summary:

Definitions.

Digital Good: A digital good is a product that includes sounds, images, data, or facts, which is transferred electronically. Digital good includes electronically delivered music, books, and movies.

Digital Automated Service (DAS): A DAS is an electronically delivered service that uses one or more software applications. Examples of a DAS include credit reports, online games, and searchable databases. A DAS does not include: the loaning or transferring of money or financial instruments, dispensing cash or other physical items from a machine, payment processing services, telecommunications services, providing Internet access, providing access to prewritten computer software, providing online educational programs including those by private accredited schools, online travel agent services, online auctions, and online classified advertising services.

Digital Code: A digital code is an enabling or activation code that gives a purchaser access to a digital good or a DAS. As an example, a soft drink company, as part of a promotion, may purchase digital codes from a music distributor. The soft drink company then gives away the codes to customers who purchase its soft drink products. Those customers use the code to download songs from the music distributor's website.

Digital Product: A digital product is a digital good or a DAS.

End User: An end user is a person who acquires a digital product or digital code without the right to broadcast, rebroadcast, license, or otherwise distribute the product or code.

Imposition of Sales and Use Taxes.

Sales and use taxes are separately imposed on the sale of digital goods to end users.

Sales and use taxes are imposed on the sale of DAS to end users.

Sales and use taxes are imposed on the sale of digital codes to end users. A digital code is taxed the same way as the underlying digital good or DAS to which the code gives the purchaser access.

Sales and use taxes are extended to prewritten computer software accessed remotely.

No distinction is made for sales and use tax purposes between digital codes, goods, or automated services that are downloaded, streamed, or accessed remotely.

Exemptions.

Digital products purchased for resale, and digital products incorporated as an ingredient or component of another product for resale, are exempt from sales and use tax.

Digital products provided free of charge are also exempt.

Sales of radio and television broadcast programming by a radio or television broadcaster are exempted from sales and use tax. This exemption includes broadcasts on a pay-per-program basis if the sale of the programming is subject to a franchise fee.

An exemption is provided for standard digital information purchased solely for business purposes. "Standard digital information" means a digital good consisting primarily of data, facts, or information that is not generated for a specific client or customer.

A partial exemption is provided for businesses that use digital products or prewritten computer software concurrently within and outside Washington. Tax is apportioned based on the number of users within Washington as a percentage of all users of the digital product or software.

A sales and use tax exemption is provided for newspapers transferred electronically as long as the electronic newspaper shares content and the same name as the printed newspaper.

Business and Occupation Taxes.

The standard business and occupation tax rates for wholesale and retail sales (0.484 percent and 0.471 percent) are explicitly imposed on wholesale and retail sales of digital goods, digital automated services, digital codes, and electronically delivered software.

Server Farms and Substantial Nexus.

The DOR is prohibited from considering a business's ownership or rights in digital goods or codes residing on a server located in Washington in determining whether the business has substantial nexus with the state.

Amnesty.

A person may not be held liable for the failure to collect or pay state and local sales and use taxes accrued before the effective date of this act on the sale or use of digital goods.

Technical Changes.

A number of conforming and technical amendments are made.

Votes on Final Passage:

House	52	46
Senate	28	20

Effective: July 26, 2009

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NO. 83673-6

**SUPREME COURT
STATE OF WASHINGTON**

CLERK

QUALCOMM INCORPORATED,

Petitioner,

v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,

Respondent.

CERTIFICATE OF
SERVICE

I certify that I served a copy of Respondent's Answer to Petition for Review and this Certificate of Service, by U.S. Mail, postage prepaid, through Consolidated Mail Services and electronically via email, on the following:

Michele G. Radosevich
Davis Wright Tremaine LLP
1201 Third Avenue, Suite 2200
Seattle, WA 98101-3045
MicheleRadosevich@dwt.com

I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 20th day of November, 2009, at Olympia, WA.


CANDY ZILINSKAS, Legal Assistant