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I. INTRODUCTION

Plaintiff/Appellant Qualcomm Incorporated (“Qualcomm”) provides a service that allows commercial trucking companies to track and determine the status of individual vehicles and interact with drivers using satellite transmissions. Qualcomm paid business and occupation tax (“B&O”) to the State of Washington at the service rate on the revenue it obtained from Washington customers from 1998 to 2001, the period at issue here. The Department of Revenue (“Department”) then claimed that Qualcomm should have paid the lower rate for retail businesses, but also collected the retail sales tax from its customers because Qualcomm’s satellite tracking system is a “network telephone service” as that term was statutorily defined. Qualcomm paid the additional taxes assessed by the Department and filed this action for refund. Because the primary purpose of Qualcomm’s service is information about vehicle location and status rather than driver communications, Qualcomm’s service is *not* network telephone service and it is entitled to summary judgment.

II. ASSIGNMENTS OF ERROR

A. The trial court erroneously denied Qualcomm’s motion for summary judgment because it held that Qualcomm’s tracking service is “network telephone service” as that term was defined in RCW 82.04.065.

B. The trial court erroneously granted the Department's cross motion for summary judgment on the same basis.

III. ISSUES

A. Does the definition of "network telephone service" under the former RCW 82.04.065 encompass Qualcomm's tracking system, which transforms and manipulates the signal received from a truck and adds additional data to create information for the fleet operator?

B. When a service includes a transmission component as well as an information component and the two are not separable, does the "true object" test determine the nature of service?

IV. STATEMENT OF THE CASE

Statement of Facts

Qualcomm offers OmniTRACS service to Washington customers, typically trucking companies, who contract for this service to enable their fleet management centers or fleet dispatchers to track and manage their vehicles more efficiently. CP 29, ¶ 2. The OmniTRACS system involves hardware, software, data processing, and transmission. CP 241-42.

Qualcomm's website describes some of its uses:

The OmniTRACS system goes beyond merely promoting efficiency and provides the tools needed for a proactive approach to fleet and service/delivery vehicle management. Fleet data, for example, can help enable customers to identify routes that yield a greater revenue stream. . . . The

OmniTRACS system also helps increase the security and safety of vehicles and their operators. Tamper-alert systems, panic alarms, and satellite-tracking capabilities help minimize the risk of loss due to tampering and theft, and help facilitate quick recovery by providing timely location information for law-enforcement agencies. . . . It helps fleet managers identify drivers that make unplanned stops, accrue excessive idle time, or accumulate out-of-route mileage as well as providing detailed information on fuel consumption.

CP 104-05. The hardware and software necessary to perform these functions is separately priced and the sales tax on those items has been collected and paid. CP 94, 184. At issue is the tracking service, which, at the basic level, generates “messages” about the vehicle location, and which can also be used for text messaging and for reports from optional additional monitoring systems.

Basic OmniTRACS service allows customers to track the location of all vehicles in its fleet, and thereby, the location of all shipments carried by its fleet. CP 29, ¶ 2, CP 185. In addition, a customer fleet management center can use the vehicle location and status information to compute out-of-route miles and determine other time sensitive matters, both of which allow better utilization planning. CP 29, ¶ 2. The customer can also choose to make the information available to its shippers, allowing them track and estimate the time of deliveries. *Id.*

A mobile communications terminal (“mobile unit”) in each vehicle sends a signal via satellite to Qualcomm’s Network Management Center (“NMC”) where the vehicle position is calculated and reprocessed into a data packet that is available to the customer. CP 30, ¶ 3, CP 242-43. Qualcomm leases transponder space on two separate satellites, one of which is dedicated to sending and receiving data and one of which is used to triangulate the location of the vehicle. *Id.*, CP 30, ¶ 3. In addition to pinpointing a vehicle’s latitude and longitude, the OmniTRACS system generates a unique identification number for each vehicle and a date/time stamp. *Id.*

The OmniTRACS system is proprietary; it predates and differs from GPS.¹ CP 112, 242. In Qualcomm’s proprietary system, the truck transmits only its identity, not its position. CP 112. The position is calculated at the NMC. *Id.*, CP 30., ¶ 3. Moreover, it is not even directly transmitted to the customer, but resides on the NMC computers until it is accessed by the customer via internet or landline, neither of which is part of the OmniTRACS system. *Id.*, CP 112. This means that OmniTRACS does not provide real time communication of the truck’s position.

Basic OmniTRACS service includes hourly reports on the position of the truck. CP 30, ¶ 4, CP 185. These are generated as described above.

¹ OmniTRACS is capable of using GPS, but fewer than 10 percent of customers choose this option. CP 112.

CP 30, ¶ 4. This is the most frequently used component of OmniTRACS service. *Id.* These hourly reports are called “messages.” CP 185.

Customers may purchase extra services beyond the basic level. *Id.* Enhanced OmniTRACS service includes not only hourly tracking but macro messaging capability. CP 30, ¶ 5, CP 185. Two types of macro messages may be sent: a form in which the sender uses a predefined template (“Macro”) or freeform by the sender (“Freeform”). CP 30, ¶ 5.

“Macro” messages are the majority of all text messages sent. *Id.*, ¶ 6. They can be sent by either the dispatch center (forward messaging) or the driver (return messaging). *Id.* Typical Macros include messages such as pick-up and delivery confirmations. *Id.* Each Macro message is a form template defining file types, sizes, and placement of characters within the resulting message. Once defined by dispatch, the templates for both forward and return messaging are stored on both the dispatch center computer and the mobile unit and can be reused without being redefined. To send a forward message to a truck, dispatch enters variable data that is transmitted to the driver via the NMC; the variable data is combined with the Macro template to produce a readable message. Return macro messaging works in the same way: variable data is entered by the driver, to be sent to dispatch via the NMC and combined with the macro template stored on the dispatch computer to produce a readable message for the

dispatch center. This allows for messages to be created in a “fill in the blank” style. *Id.* The macro template acts as a local fixed form to be filled by variable data sent from a remote location. The software allows a driver to push a number of keys to signify common shipping terms. *Id.*

With Macros, the customers can integrate OmniTRACS data with their other business computer systems. CP 31, ¶ 7, CP 82-83. By

knowing exactly where specific key pieces of information are within a message, integration software can automate the handling of information – pulling key data elements out of the data transmission with the NMC and marrying these key elements with data from other information systems.

¶CP 31, ¶ 7. This can automate processes such as invoicing. *Id.*

Freeform messaging accounts for a small share of all macro messages. CP 31, ¶ 8. It involves a manual process whereby a person uses a computer to create and send a message typically using some type of dispatch software or where a driver uses the Mobile to create and send a message to dispatch. *Id.* It is not ordinary e-mail. *Id.* When a message is created, it is forwarded to the NMC, which assigns a tracking number, which can be used by the creator to check on the status of the Freeform message. *Id.*

Upon reading a message, the mobile unit or customer computer automatically sends back a confirmation to the NMC. CP 31, ¶ 9. If

confirmation is not received, the message is automatically resent. *Id.* The transmission to or from the Mobile includes information which allows the NMC to calculate the position of the mobile unit and provide information on the signal strength of the satellite communications link between the mobile unit and the satellite. *Id.*

Besides the messaging capability of Enhanced OmniTRACS, other monitoring products are available. *See, e.g.,* CP 198-99. OmniTRACS offers the capability to send binary coded data between a mobile unit and a customer's computer via the NMC. CP 31, ¶ 10. This data, which is typically not human readable, includes performance information gathered from various points on a truck (including the computerized engine bus). *Id.* This information is routed by the NMC to other Qualcomm applications, allowing customers to monitor things such as driver performance, engine diagnostics, and truck location. *Id.* Another service offered by Qualcomm tracks events that occur on the truck, such as rapid and sustained truck deceleration, which are captured and transmitted by the Mobile to the NMC. *Id.*

OmniTRACS collects the data generated on the truck—both the basic identity signals used to calculate position and, if the customer has bought other monitoring products, the data generated by those systems. For instance, SensorTRACS includes sensors to monitor such things as

fuel use and driver performance. CP 198, 298-99. OmniTRACS then processes the data to generate useful information which is conveyed to the customer via “messages” like the hourly position report messages. *See* CP 196 (“All OmniTRACS messages which occur in the use of the SensorTRACS System . . . constitute regular messages under the OmniTRACS Service and will be invoiced in accordance with the message services. . . .”). Thus, OmniTRACS offers customers a range of management tools that are integrated and work with one another. CP 82-83, 94-96. These tools, which may have different names, interface through OmniTRACS, which *collects and processes* the information.

Qualcomm’s service is not designed to be used for voice communications, and drivers normally use cell phones to communicate with their fleet management centers. CP 32, ¶11. Even the text messaging component of OmniTRACS cannot practically be used to carry on a two-way exchange between the driver and fleet management center because of the significant amount of processing and formatting of messages. *Id.* Messages are processed on a “store and forward” basis, whereby a message sent from a driver or fleet management center is first stored at the NMC, and is then forwarded to the recipient after the necessary processing and formatting is facilitated by Qualcomm. Therefore, these exchanges are not in real-time. *Id.*

Statement of Procedure

Qualcomm filed its refund action on July 27, 2007. CP 4-17.

Following discovery, the parties filed cross motions for summary judgment, which were heard on May 2, 2008. The court granted the Department's motion for summary judgment and denied Qualcomm's motion. CP 303-05. This appeal was filed on May 13, 2008. CP 306.

V. ARGUMENT

A. The Standard of Review is De Novo.

The dispositive issue in this appeal is whether the Department of Revenue may tax Qualcomm as a telephone business with regard to OmniTRACS, its truck tracking service. This issue was resolved below on cross-motions for summary judgment, and thus review is de novo. *See Qwest Corp. v. City of Bellevue*, 161 Wn.2d 353, 358, 166 P.3d 667 (2007).

B. OmniTRACS is Not Network Telephone Service.

The Department contends that Qualcomm's OmniTRACS is "network telephone service," as defined in RCW 82.04.065:

"Network telephone service" means 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. . . .

(emphasis added). But OmniTRACS does much more than transmit data. Its computerized system generates data about truck location and status and sends that data, not to the customer, but to its own central operations center, where it is further manipulated and stored. The end product is information in a format that is readable by the customer's computers and that can be downloaded to automate the customer's operations.

In contrast, a pure transmission service is "virtually transparent in terms of . . . interaction with customer supplied information." *In re Amendment of Section 64.702 of the Commissions Rules and Regulations*, Docket No. 20828, Final Decision, 77 FCC 2d 384, 420 (May 2, 1980).² In other words, it is a transmission pipeline in which data enters and exits in the same form. Therefore, one way of judging a service is to look at the data entering the pipeline. In this case, neither the truck nor its driver "knows" its position. The data enters OmniTRACS as simple transmission signals that contain little information and exits in the form of position reports or status reports that are created by Qualcomm using its leased satellite space and computer programming. The information is created by the processing that goes on at the NMC. The information is not generated at the truck and fed through a pipeline.

² These rules were adopted by the Federal Communications Commission to differentiate between "telephone service" subject to regulation and computer-processing services offered over phone lines, which was not subject to regulation.

“Network telephone service” has never been understood to include data processing or information services such as OmniTRACS. Neither the plain language of the definition, the case law, legislative history, nor consistent interpretation by the Department support the Department’s current effort to enlarge the definition to include data processing or information services. Moreover, if a service contains a transmission component and an information component, the Department’s precedents require the service to be classified by whether the “true object” of the service is the transmission or whether it is data processing/information. Under the Department’s own prior interpretations, OmniTRACS clearly is a data processing or information service.

1. The Plain Language of the Network Telephone Service Definition Does Not Include Data Processing or Information Services.

RCW 82.04.065 (2000) defined “network telephone service” during the period at issue in this case:

“Network telephone service” means 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. “Network telephone service” includes interstate service, including toll service, originating from or received on telecommunications equipment or apparatus in this state if the charge for the services is billed to a person in this

state. "Network telephone service" does not include the providing of competitive telephone service, the providing of cable television service nor the providing of broadcast services by radio or television stations.

This definition plainly includes voice telephone service and data transmission services carried over telephone networks. The language just as plainly does not mention the provision of data processing or information services. The definition focuses on pure transmission—transporting voice and data messages from one point to another—not on generating or processing the content of those messages.

The Department argued below that the definition of "network telephone service" unambiguously includes OmniTRACS, citing *Western Telepage v. City of Tacoma*, 140 Wn.2d 599, 611, 998 P.2d 884 (2000). The Department relied on the fact that the court said that the definition of "network telephone service" was unambiguous. But what the court actually said was that the definition of "network telephone service" ***unambiguously included one-way paging services.***

The primary issue addressed In *Western Telepage* was whether the RCW 82.04.065 definition of telephone business and network telephone service included pager services as they were defined in the Tacoma Municipal Code. Telepage provided pager service as it was defined by the City, but argued that pager service was not included in the definition of

network telephone service. Telepage conceded that its paging services involved the transmission of signals by microwave, but argued that “the Legislature did not intend to include paging services in the statute because the statutory definition, when properly construed, is limited to ‘two-way’ communications. . . .” 140 Wn.2d at 608. Telepage did not assert that it created new information or that its customers purchased the paging service for any purpose other than to obtain simple transmission of alphanumeric messages to their pagers, and the opinion does not mention any other purpose for purchasing the service. Thus, the court’s holding in *Western Telepage* was simply that the definition of network telephone service unambiguously included one-way as well as two way transmission services.

Unlike *Western Telepage*, Qualcomm does not provide pure transmission services. It generates information about a truck’s location from a signal transmitted from the truck, and it stores that information until it is accessed by the customer using the internet or a transmission service such as a leased line. The access line or internet service is not part of OmniTRACS service and is not at issue here. *Western Telepage* is not relevant to a situation, like this one, where both information and data transmission are involved in the service.

2. Recent Case Law Makes It Clear That “Network Telephone Service” is Pure Transmission.

If *Western Telepage* left any doubt, the Washington Supreme Court has recently made it clear that “network telephone service” refers to pure transmission services. *Community Telecable of Seattle v. City of Seattle*, slip op. (June 26, 2008) involved an effort by the City of Seattle to impose telephone utility tax on the transmission component of internet access on the basis that this portion of the service met the definition of “network telephone service.” Slip op. at 7. The Supreme Court disagreed, noting that more than pure transmission was involved:

Moreover, the record reflects that Comcast “transforms” and “manipulates” data as it passes through the Comcast network; this manipulation is an integral and necessary part of the provision of Internet services. Even where Comcast passes on data to another entity, such as At Home Corporation, *that passed data would not be useful unless Comcast had transformed the data along the way. Therefore, Comcast is not engaging in the mere “provision of transmission” under RCW 82.04.065(2).* Comcast’s cable Internet service is plainly excluded from the statutory definition of “network telephone service” under RCW 82.04.065(2).

Slip op. at 9 (citations omitted) (emphasis added).

If internet access services do not fit the definition of “network telephone service,” a truck tracking service clearly cannot. The Supreme Court held internet services were more than transmission even though the transformation of data consisted of changes in form—from digital to

electronic signal and back and conversion to IP packets that could be sent over the internet. Slip op. at 2-3. In contrast, OmniTRACS not only changes the form of the signal but also adds content and produces new information.

3. The Legislative History Indicates that the Definition Includes Only Pure Transmission Services.

The legislature did not intend the “network telephone service” embrace more than pure transmission. The definition of “network telephone service” is largely the product of the 1981 legislature and a response to the impending breakup of the Bell System.³ *See* Department of Revenue memorandum re SHB 61 (attached hereto as Exhibit A). In that year, Pacific Northwest Bell, the local “baby Bell” came to the legislature to request that it be taxed on the same basis as its new competitors and would-be competitors *Id.* At that time the regulated utilities—Pacific Northwest Bell and General Telephone—paid the utility tax rather than the B&O tax paid by non-regulated companies. *See id.* Non-regulated companies could not offer local telephone service at that time, but they had begun offering telephone equipment and were planning to move into long-distance service. *Id.* The intent of the legislation was to tax the new, non-regulated companies on the same basis as the traditional

³ The breakup was the result of an antitrust action filed by the Department of Justice in 1974, which ended in a settlement in January 1982.

telephone companies. *Id.* There is no indication that the legislature intended to tax data processing and information services as “telephone” services.

This reading of the statute was confirmed last year when the Legislature amended RCW 82.04.065 to replace the term “network telephone service” with “telecommunications service” Wash. Laws 2007,

Ch. 6 § 1004. The change clarified and did not purport to alter the existing classification scheme. The Final Bill Report states: “Several telecommunication definitions recently incorporated into the SSUTA [Streamlined Sales and Use Tax Act] are adopted. These are changes to terminology in current law, but *do not change current law regarding taxability* and exemptions.” Final Bill Report, SSB 5089, C 6 L 07, at. 3 (emphasis added). In the new law, “Telecommunications service” is defined as follows:

(8) “Telecommunications service” means the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points. “Telecommunications service” includes such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code, or protocol of the content for purposes of transmission, conveyance, or routing without regard to whether such service is referred to as voice over internet protocol services or is classified by the federal communications commission as enhanced or value added. “Telecommunications service” does not include:

(a) data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser where such purchaser's primary purpose for the underlying transaction is the processed data or information.

This express exception confirms that data processing and information services were never within the definition of network telephone service.

Qualcomm's OmniTRACS service falls squarely within the exception. Data regarding the location and conditions of a truck company's fleet is generated by devices onboard the truck, retrieved by Qualcomm, processed so that it can be read by the trucking company's internal computers, and then stored by Qualcomm so it can be retrieved by the trucking company. The trucking company is clearly paying Qualcomm for the processed data or information—if the company merely wanted to talk with its driver, a cell phone would be much more economical.

4. The Department Has Historically Recognized the Distinction Between Pure Transmission and Information or Data Processing Services.

The distinction between telecommunications and data processing/information services was not new in the 2007 legislation. In 1985, the Department adopted a rule governing “information and computer services” that defined “information services” as “every business

activity, process, or function by which a person *transfers, transmits, or conveys data*, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium.” WAC 458-20-155 (emphasis added). The Department thus recognized that transmission was a part of “information services,” but that the content—data, facts, knowledge, procedures—made it different than pure transmission services.

WAC 458-20-155 provides, in relevant part:

Liability for sales tax or use tax depends upon whether the subject of the sale is a product or a service. If information services, computer services or data processing services are performed, such that the only tangible personal property in the transaction is the paper or medium on which the information is printed or carried, the activity constitutes the rendering of professional services, similar to those rendered by a public accountant, architect, lawyer, etc., and the retail sales tax or use tax is not applicable to such charges. . . Persons who charge for providing information services or computer services (other than retailing or wholesaling as defined above) are subject to the service and other activities classification of business and occupation tax measured by the gross income of such business. This includes charges for custom program development, *charges for on-line information and data*, and charges in the nature of royalties for the reproduction, use, and reuse of patented systems and technological components of hardware or software, whether tangible or intangible.

The thrust of the rule is to differentiate services subject to service B&O from off-the-shelf software and hardware, which are subject to retail B&O and the retail sales tax. There is no suggestion that data processing or

information services could be considered network telephone service even if the service involved transmission.

C. Even if Transmission Were an Important Part of OmniTRACS, the “True Object” Test Would Require It Be Taxed as a Service.

In its arguments below, the Department placed heavy emphasis on the transmission component of OmniTRACS, conflating it with GPS and citing the fact that the product literature calls OmniTRACS a communication service. Even if transmission were more central to Qualcomm’s service, however, the Department’s prior determinations would require that OmniTRACS be taxed as a service.

When a business activity has both retailing and service elements, and the charges are not bifurcated between the two, the Department follows the true object test to determine the proper classification of the entire activity:

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

Det. No. 03-0170, 24 WTD 393 (2005). The Department has explained that the true object test focuses on the purchaser’s subjective goal:

The true object test, however, is a subjective test and is more a conclusion than a true test. The inquiry as to the true object of the transactions involved in this matter should focus on the issue of what the buyer is seeking in exchange for the amount paid to the seller.

Det. No. 89-009A, 12 WTD 1 (1993) (citations omitted) [App. B-2].

In applying the true object test, the Department has held that even separately itemized charges, imposed by a data processing service for dedicated data transmission lines, were imposed for information and computer services, as they are defined in WAC 458-20-155, rather than network telephone service. The Department stated:

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.

* * *

Here, it is clear that the furnishing of the telephone lines is not the object of the transaction, but merely incidental to the personal services being rendered. * * *

Det. No. 90-128, 9 WTD 280-1 (1990) (italics added) [App. B-1]. In another determination, the Department quoted Determination 90-128 and concluded that a reservation system's separately itemized charges for data communications were imposed for reservation services rather than network telephone service, because reservation service was the "true object" of the transaction. The Department stated:

In this case, we similarly believe that the *true object* of the...monthly communication charge is for the ability to access the information in System's reservation system and to make the reservation with the service providers on behalf of Taxpayer's client. * * * The telephone line charges are merely incidental to the information services being supplied by System and may not be bifurcated and separately taxed from the object of the transaction.

Det. No. 98-202, 19 WTD 771 (2000) (italics added) [App. B-3]. The fact

that the taxable item was called a communications charge and that the system was used for communications was not dispositive because the purpose of the communications was to obtain information about availability and to reserve space, not simply to transport data.

When the true object test is applied here, it is clear that the true object of OmniTRACS is *information* about trucks. Customers buy the service in order to get information about the location and status of their fleet, not to provide a communications channel between the driver and the company. The Court of Appeals of Tennessee recently came to the same conclusion:

Having thoroughly analyzed the facts as they were agreed upon by the parties before the trial court, we conclude that the true object or primary purpose of Qualcomm's OmniTRACS service is to determine the location and load status of customer vehicles—that is to collect data and then make it available to Qualcomm's customers. While the OmniTRACS system undoubtedly contains the ability to transmit "free form" text messages, acquiring this capability is not the principal aim of its purchasers. Nor does the system's capacity for sending "macro" messages

transform it into a telecommunications service since these so-called “messages” do little more than allow information concerning a vehicle’s status to be combined with information on its location. Even then, these “macro” messages must still be retrieved by the customer. As agreed below, the ability to ascertain a vehicle’s location and load status is the primary reason that customers purchase OmniTRACS. The fact that a service might employ, involve, or be accessed by telecommunications, without more, will not transform it into a taxable telecommunications service.

Qualcomm Incorporated v. Chumley, 2007 WL 2827513 (Sep. 26, 2007).⁴

The Tennessee Court of Appeals had before it the same facts before this Court today. This Court should also conclude that the true object of OmniTRACS service is information, not transmission, and that Qualcomm therefore correctly paid service B&O on its gross receipts.

VI. CONCLUSION

For the foregoing reasons, this Court should reverse the trial court and direct that judgment be entered denying the Department’s motion for summary judgment and granting Qualcomm’s motion for summary judgment.

⁴ A copy of the opinion is attached hereto as Appendix A. Rule 12 of the Tennessee Rules of the Court of Appeals permits citation.

RESPECTFULLY SUBMITTED this 21st day of July, 2008.

Davis Wright Tremaine LLP
Attorneys for Qualcomm Incorporated

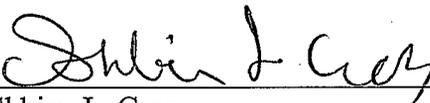
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CERTIFICATE OF SERVICE

I, Shbien Cross, hereby certify and declare under penalty of perjury under the laws of the State of Washington that on July 21, 2008, I caused a copy of **OPENING BRIEF OF APPELLANT** to be served via United States First Class Mail on the following counsel for Respondent:

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Executed at Seattle, Washington, this 21st day of July, 2008.



Shbien L. Cross

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Page 1

Qualcomm Inc. v. Chumley
 Tenn.Ct.App.,2007.
 Only the Westlaw citation is currently available.

SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee.
QUALCOMM INCORPORATED

v.

Loren L. CHUMLEY, Commissioner of Revenue,
 State of Tennessee.
 No. M2006-01398-COA-R3-CV.

June 27, 2007 Session.
 Sept. 26, 2007.

Appeal from the Chancery Court for Davidson County, No. 04-1127-IV;Richard Dinkins, Chancellor.

Robert E. Cooper, Jr., Attorney General and Reporter, Michael E. Moore, Solicitor General, Richard H. Sforzini, Jr., Assistant Attorney General, and Jonathan N. Wike, Assistant Attorney General, for the appellant, Loren L. Chumley, Commissioner of Revenue.
 Michael D. Sontag and Stephen J. Jasper, Nashville, Tennessee, for the appellee, Qualcomm Incorporated.

WALTER C. KURTZ, Sp. J., delivered the opinion of the court, in which DAVID R. FARMER and HOLLY M. KIRBY, JJ., joined.

OPINION

WALTER C. KURTZ, Sp. J.

*1 In this appeal we consider application of Tennessee's sales and use tax on telecommunications as "telecommunications" was formerly defined. See T.C.A. § 67-6-102(a)(32) (2003). The taxpayer plaintiff-appellee provides a service which allows its customers (commercial trucking companies) to

locate and determine the status of individual vehicles as well as communicate with its drivers. The defendant-appellant Commissioner of Revenue determined that this service constituted taxable "telecommunications" during the audit period in question. The taxpayer filed this suit in the Chancery Court for Davidson County seeking a refund. The chancellor below granted the taxpayer's motion for summary judgment and denied the Commissioner's cross-motion. The Commissioner appeals this decision. Applying the "true object" test as it has been developed by prior decisions of this Court rendered in the context of telecommunications taxation, we agree with the court below that telecommunication was not the true object or primary purpose of the service at issue. Accordingly, we affirm.

This case arises from a dispute concerning sales and use taxes paid by the plaintiff-appellee, Qualcomm Incorporated (Qualcomm), to the defendant-appellant, the Commissioner of the Tennessee Department of Revenue (Commissioner), for a specified audit period—the calendar months ending May 31, 2002 and June 30, 2002. Qualcomm seeks a refund of sales taxes attributable during these months to its OmniTRACS information management service.

On March 11, 2004, the Commissioner, acting pursuant to T.C.A. § 67-1-1802(c)(2), granted a written waiver that allowed Qualcomm to file suit in chancery court without first requesting from the Commissioner a refund of the taxes that had been paid. Qualcomm timely filed this action on April 15, 2004 in the Chancery Court for Davidson County, see T.C.A. § 67-1-1801 *et seq.*, and the case came before the trial court on the parties' cross-motions for summary judgment.

The issue for the court below was the same as that presented on appeal: whether Qualcomm's OmniTRACS is a taxable telecommunications service within the meaning of T.C.A. § 67-6-102(a)(32)

(2003). That court concluded that OmniTRACS did not fit within the scope of the statute. Thus, it denied the Commissioner's motion for summary judgment and granted Qualcomm's. The Commissioner appeals, arguing that the trial court's decision was erroneous as a matter of law. We affirm.

I.

Qualcomm is a Delaware corporation which has its principal place of business in San Diego, California. It is authorized to do business in Tennessee and has several Tennessee customers engaged in commercial trucking.

Both Qualcomm and the Commissioner agree that Qualcomm's OmniTRACS service "is a means by which customers gather information about the vehicles within their fleets[.]" Customers contract for this service to enable their fleet management centers or fleet dispatchers to track and manage their vehicles more efficiently. Use of OmniTRACS requires that a Mobile Communications Device (MCD) be installed in the vehicles of a customer's fleet. At the time relevant to this appeal, Qualcomm leased transponder space on two satellites which served as the link between individual trucks and Qualcomm's Network Operations Center (NOC). One of these satellites sent and received data while the other triangulated the vehicle's location. The information collected from each truck includes its "position or location, the vehicle[] identification number, the date and time stamp[,] and [its] latitude and longitude."

*2 Qualcomm collects this data regarding customer vehicles and processes it at its NOC. Another feature of the OmniTRACS service allows text messages to be sent to and from vehicles by way of the NOC. Information as to a vehicle's location is automatically ascertained at regular intervals established by the customer-typically each hour on the hour-and also anytime a driver sends a text message. (Furthermore, it is possible for a customer to specifically request the location of an individual

vehicle at any given time through a procedure referred to as initiating a "ping.") After being processed at the NOC, this data is sent to a "queue" where it is accessible to each customer through its own internet connection. Special software purchased for a one-time fee from Qualcomm and a password are required to log onto its system. As the individual customer must initiate the query to the NOC, it is the customer who determines how frequently this stored information is accessed.

Qualcomm does not, except in a few special instances,^{FN1} provide the landline or internet service between the customer and the NOC. Rather, the customer is left to access the NOC computer in much the same manner as any website would be visited. The data provided by OmniTRACS allows customers to in turn generate their own reports and evaluations for use in improving operational efficiency.

FN1. The record indicates that Qualcomm did arrange connections to the NOC for a few customers, but it billed separately for this and did not mark up the price. These arrangements are not important for consideration of this case, and the Commissioner's argument does not rely upon them.

In conjunction with this vehicle location service, Qualcomm's customers are secondarily provided a messaging component. Like its vehicle positioning feature, the OmniTRACS service's text messaging capability operates through the same "store-and-forward" technology that is used with most of the internet, including e-mail systems. According to the record, between six and ten million messages are processed by Qualcomm's NOC each day. Text messages in OmniTRACS may be either "macro" messages, which are templated or formulaic communications sent with little to no addition of information by the sender, or they may be "free form" text messages, which are messages actually composed by the sender. The Commissioner admitted in the court below that the "vast majority of the messages ... processed by the NOC" are "macro"

messages. She further admitted that OmniTRACS is "seldomly ... used as a means of 'communication' through back-and-forth free form messages." These "macro" messages are sent by the pressing of numbers (1 through 99) which correspond to commonly and routinely used shipping phrases. Whenever any message is sent from a vehicle, the NOC processes the data and, before forwarding it to the customer's queue, adds such pertinent information as the vehicle's location and the time of the message. Messages may also be sent to vehicles from the customer's fleet management center, and, once received by the destination vehicle or vehicles, a confirmation receipt is sent back to the NOC and then to the customer's queue.

In the court below, the Commissioner agreed with Qualcomm that its "OmniTRACS service is principally used to provide information regarding the location and status of each vehicle in the customer's fleet." Similarly, the parties agreed that the "majority of information which flows through the OmniTRACS service relates to the vehicle's status and position." The Commissioner even admitted that "[f]rom Qualcomm's customer's perspective, the primary purpose or use of the OmniTRACS service is to determine the location of the vehicles" and that "the location/positioning feature and the macro messaging features of the OmniTRACS system are the primary reasons why Qualcomm's customers contracted for this service." Finally, both sides agreed below that the "OmniTRACS service does not replace the driver's personal cell phone, in that the service is seldomly, if ever, used to carry on a conversation between the truck driver and the customer's fleet management center." Conversations are instead still typically conducted by means of a driver's cellular phone.

II.

*3 "The standard for reviewing a grant of summary judgment by a trial court is de novo without a presumption that the trial court's conclusions are correct." *Butterworth v. Butterworth*, 154 S.W.3d 79,

81 (Tenn.2005) (citing *Mooney v. Sneed*, 30 S.W.3d 304, 306 (Tenn.2000)). The inquiry is itself entirely a question of law. *Messer Griesheim Indus., Inc. v. Cryotech of Kingsport, Inc.*, 131 S.W.3d 457, 462 (Tenn.Ct.App.2003).

"Summary Judgment is appropriate where 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.'" *Godfrey v. Ruiz*, 90 S.W.3d 692, 695 (Tenn.2002) (quoting Tenn. R. Civ. P. 56.04); see *Byrd v. Hall*, 847 S.W.2d 208, 211 (Tenn.1993). The party seeking summary judgment bears the burden of persuading the Court that it has met these requirements. *Godfrey*, 90 S.W.3d at 695 (citations omitted). "Summary judgment is appropriate only when the facts and inferences permit a reasonable person to reach only one conclusion." *Doe v. HCA Health Svs. of Tennessee, Inc.*, 46 S.W.3d 191, 196 (Tenn.2001) (citations omitted).

"If a factual dispute exists, we must then determine whether the fact is material to the claim or defense upon which the summary judgment is predicated and whether the disputed fact creates a genuine issue for trial." *Pendleton v. Mills*, 73 S.W.3d 115, 122 (Tenn.Ct.App.2001) (citations omitted); see *Rutherford v. Polar Tank Trailer, Inc.*, 978 S.W.2d 102, 104 (Tenn.Ct.App.1998). "The court must take the strongest legitimate view of the evidence in favor of the non-moving party, allow all reasonable inferences in favor of that party, discard all countervailing evidence, and, if there is a dispute as to any material fact or if there is any doubt as to the existence of a material fact, summary judgment cannot be granted." *Frame v. Davidson Transit Org.*, 194 S.W.3d 429, 434 (Tenn.Ct.App.2005) (citations omitted). "Summary judgments are proper in virtually any civil case that can be resolved on the basis of legal issues alone ... [but they are not] appropriate when genuine disputes regarding material facts exist." *Pendleton*, 73 S.W.3d at 121

(citations omitted).

III.

The task for this Court is to determine whether the court below correctly applied the law to the undisputed facts that had been established in consideration of the parties' cross-motions for summary judgment. In construing a statute, "the plain import of the language of the act is to be given effect [.]"*Int'l Harvester Co. v. Carr*, 466 S.W.2d 207, 260 (Tenn.1971) (citing *United Inter-Mountain Telephone Co. v. Moyers*, 221 Tenn. 246, 426 S.W.2d 177 (1968)). It is well settled in this state, however, that "tax statutes are to be liberally construed in favor of the taxpayer and strictly construed against the taxing authority."*White v. Roden Elec. Supply Co.*, 536 S.W.2d 346, 348 (Tenn.1976) (citing *Memphis Peabody Corp. v. MacFarland*, 211 Tenn. 384, 365 S.W.2d 40 (1963)); see *Steele v. Industrial Dev. Bd.*, 950 S.W.2d 345, 348 (Tenn.1997); *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn.1992); *Memphis St. Ry. v. Crenshaw*, 155 Tenn. 536, 55 S.W.2d 758, 759 (1933); *SunTrust Bank v. Johnson*, 46 S.W.3d 216, 224 (Tenn.Ct.App.2000).

*4 "Courts may not extend by implication the right to collect a tax 'beyond the clear import of the statute by which it is levied.'" *American Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 504 (Tenn.Ct.App.2000) (quoting *Boggs v. Crenshaw*, 157 Tenn. 261, 7 S.W.2d 994, 995 (1928)). Thus, "[w]here there is doubt as to the meaning of a taxing statute, the doubt must be resolved in favor of the taxpayer." *Memphis Peabody Corp.*, 365 S.W.2d at 43 (citing *Commercial Standard Ins. Co. v. Hixson, County Court Clerk et al.*, 175 Tenn. 239, 242, 133 S.W.2d 493 (Tenn.1939)); see also *Carl Clear Coal Corp. v. Huddleston*, 850 S.W.2d 140, 147 (Tenn.Ct.App.1992).

A. Tennessee Telecommunications Taxes

At the time governing the taxes paid in this case the

statute relied upon by the Commissioner defined "telecommunications" as follows:

(A) "Telecommunications" means communication by electric or electronic transmission of impulses;

(B) "Telecommunications" includes transmission by or through any media, such as wires, cables, microwaves, radio waves, light waves, or any combination of those or similar media;

(C) Except as provided in subdivision (a)(32)(D), "telecommunications" includes, but is not limited to, all types of telecommunication transmissions, such as telephone service, telegraph service, telephone service sold by hotels or motels to their customers or to others, telephone service sold by colleges and universities to their students or to others, telephone service sold by hospitals to their patients or to others, WATS service, paging service, and cable television service sold to customers or to others by hotels or motels;

(D) "Telecommunication" does not include public pay telephone services, television or radio programs which are broadcast over the airwaves for public consumption, coaxial cable television (CATV) which is offered for public consumption, private line service, or automatic teller machine (ATM) service, wire transfer or other services provided by any corporation defined as a financial institution under § 67-4-804(a)(9), unless the company separately bills or charges its customers for specific telecommunication services rendered[.]

T.C.A. § 67-6-102(a)(32) (2003).

The audit period at issue here extended from May 1, 2002 to June 30, 2002 and was governed by the definition of "telecommunications" quoted above. The General Assembly has subsequently made substantial changes to this definition of "telecommunications," see T.C.A. § 67-6-102(46) (2006),^{FN2} but this revised definition is not implic-

ated by the current appeal.^{FN3}

FN2. Such changes were first enacted in 2004. See 2004 Tenn. Pub. Acts Ch. 782 (H.B.3479).

FN3. We express no other opinion as to the effect or meaning of these amendments in the law.

B. The "True Object" Test

1. The "True Object" Test Generally

Recognizing that undertakings do not always fit clearly and indisputably within the discrete categories contemplated by taxation laws, the courts of this state have developed a method whereby judicial inquiry is made into the "primary purpose" or "true object" of the activity or business at issue. For instance, in deciding whether a gondola and chair lift at the 1982 World's Fair in Knoxville constituted a means of transportation or rather an amusement ride, our Supreme Court examined the facts surrounding its design and use to determine its primary function. *Sky Transpo, Inc. v. City of Knoxville*, 703 S.W.2d 126, 129 (Tenn.1985). Although Justices Harbison and Drowota disagreed with the Court's ultimate conclusion that the gondola and lift did not constitute a taxable amusement, they did not take issue with the majority's methodology. See *id.* at 132-33 (Harbison, J., concurring in part and dissenting in part).

*5 Likewise, in *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405 (Tenn.1976), the Supreme Court declined to extend the sales tax on tangible personal property to the purchase of computer programs. See *id.* at 408. The Court concluded that the transfer of the tangible instantiations of the programs (i.e., magnetic tapes and punch cards) was "merely incidental" to the true object of the sale, which was the transfer of information, an intangible. *Id.* at 407.

In a subsequent case, the Court characterized this prior holding by stating: "[T]he basis for the tax as-

essment [in *Commerce Union*], the tangible personal property-the tapes and cards-was not a 'crucial element' of the true object of the transactions, the intangible information." *Thomas Nelson, Inc. v. Olsen*, 723 S.W.2d 621, 622 (Tenn.1987) (citing *Commerce Union*, 538 S.W.2d at 407). The Court in that case, however, rejected the argument of the taxpayer that various advertizing design models^{FN4} were simple drawings and sketches used by the advertizer to convey the creative idea to the client. *Thomas Nelson*, 723 S.W.2d at 623. Distinguishing *Commerce Union*, the Court concluded that these advertizing models were "more than merely incidental by-products to the purchase of intangible intellectual property" since they "were inherently related to the commissioned advertizing ideas [and thus they] were the very embodiment of the ideas." *Thomas Nelson*, 723 S.W.2d at 624. According to the Court, the models were better viewed as analogous to the celluloid film upon which movies were once captured and which had been held to be a tangible, taxable product by the Court many years earlier in *Crescent Amusement v. Carson*, 187 Tenn. 112, 213 S.W.2d 27, 29 (1948).

FN4. "In the jargon of the advertizing industry," the Court said, "the tangible personal property acquired by Taxpayer included layouts, keylines, chromalins, camera-ready art, and mock-ups." *Thomas Nelson*, 723 S.W.2d at 623.

2. The "True Object" Test in the Context of Telecommunications

The same true object test that was applied in the above evaluations of the terms "amusement" and "tangible personal property" is likewise not foreign to inquiries into whether an activity is a taxable "telecommunication" as that term is used in Tennessee's tax statutes. Indeed, it has been applied in a trio of cases determining the reach of this state's telecommunications tax.

The first of these cases, *Equifax Check Servs., Inc. v. Johnson*, 2000 WL 827963 (Tenn. Ct.App. June

27, 2000), involved the Commissioner's attempt to assess telecommunications sales taxes against Equifax for check approval services it provided to merchants. This Court's opinion described the operation of Equifax's services in detail:

In a typical transaction, the telecommunication began and ended at the merchant's point-of-sale terminal. The merchant was responsible for entering certain identifying information into its point-of-sale device. The point-of-sale device's modem then transmitted the information to Equifax over telephone lines owned by third-party carriers. In most cases, the merchant's modem contacted Equifax by dialing a 1-800 number. Equifax provided the 1-800 number to its merchants, and the third-party carrier billed Equifax for use of the number. In some cases, rather than using a 1-800 number, Equifax or the merchant leased a dedicated telephone line from a third-party provider. In the small remainder of cases, the merchant communicated with Equifax by using an existing telecommunication network provided by a third-party vendor, such as American Express, MasterCard, or Visa.

*6 The third party's telephone lines transmitted the call from the merchant's modem to one of Equifax's modems at its facility in Tampa, Florida. Usually, the entire transmission took place between the merchant's and Equifax's respective modems. The merchant's modem transmitted the check identifying information to Equifax's modem. Equifax's modem then transmitted this information to its computer system, which had a database containing information about millions of check writers. Based on the information received, Equifax's computer system either approved or declined the check, and it sent an approval or declination code back to the merchant using the same modems and telephone lines that were used to submit the check approval request.

Equifax charged the merchant a fee for its check approval services that was based primarily on a percentage of the check's face amount. Equifax

did not itemize its invoices to show telecommunication costs, nor did it separately bill merchants for telecommunication costs. Instead, telecommunication costs were considered to be part of Equifax's overhead costs.

Equifax, 2000 WL 827963, at *1.

The Commissioner argued that "because telecommunication services were an essential element of Equifax's check guarantee services, Equifax was furnishing taxable telecommunication services to its Tennessee customers." *Id.* at *2. This Court rejected that argument, holding that the "purpose of the check guarantee services provided by Equifax ... was to approve or decline checks written by the merchants' customers." *Id.* at *3. Given that "the primary purpose of the services provided by Equifax was not to furnish telecommunication services but, instead, to furnish check guarantee services," the telecommunications tax was inapplicable. *Id.* at *5.

The next examination of Tennessee's telecommunications tax came in *Prodigy Servs. Corp., Inc. v. Johnson*, 125 S.W.3d 413 (Tenn.Ct.App.2003), *perm. app. denied* (Tenn. Dec. 22, 2003). At issue there was whether the internet program provided by Prodigy fell within the scope of the sales tax. Judge Cantrell, speaking for this Court, described Prodigy's services this way:

Prodigy furnishes a software program that can be downloaded on the subscriber's personal computer. The program furnishes tax information, computer services, and conversion services. In short, the program allows the subscriber to access information and to perform certain functions through the internet. A command from the subscriber's computer is converted to computer language and transmitted by use of a modem through the subscriber's telephone line to a Prodigy computer somewhere within the state. Some of the desired information or service may come from the local computer or it may involve communicating with Prodigy's main computers in

Yorktown Heights, New York. The link between the local computer and the New York computer is through lines leased from common carriers or through services leased from other networks that have their own carrier capabilities or that sub-let to Prodigy the carrier capabilities leased from others. The Prodigy programs provide a link to the internet, which allows the subscriber to send and receive e-mail. Thus, the ability to communicate is an important feature of the Prodigy service.

*7 *Id.* at 415.

In evaluating Prodigy's services, the Court carefully examined the legislative history surrounding the law setting taxes on telecommunications. It also looked to the distinction made at the federal level between "basic" and "enhanced" communications services. *See id.* at 418-19 (quoting *California v. F.C.C.*, 905 F.2d 1217, 1223 n. 3 (9th Cir.1990)). "[C]ompanies that provide communication services through the use of the [i]nternet[] are not regulated as 'telecommunication service providers.'" *Id.* at 419. The Court then held that "the chancellor was correct in concluding that the Legislature did not intend for the services Prodigy provides to come within the statutory definition." *Id.*

Moreover, the Court concluded that "telecommunications services were not the 'true object' of the Prodigy sale, even if some of the services fit that definition." *Id.* (citing *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405 (Tenn.1976)). "Although Prodigy's programs allowed their users to communicate through the internet, that capability is one of those enhanced services that does not come within the definition of 'telecommunication services.'" *Id.* Accordingly, Prodigy's services did not fall within the purview of the telecommunications tax.

The third such interpretation by this Court of the statute came last year in *BellSouth Telecommunications, Inc. v. Johnson*, 2006 WL 3071250

(Tenn.Ct.App. Oct. 27, 2006). At issue were various services provided by BellSouth, which were described as follows:

BellSouth's MemoryCall service is an electronic voice mailbox made available to its customers via computers at BellSouth's facilities. The service is accessible via BellSouth phone service. The MAS service includes the same service as MemoryCall, but it offers features enabling subscribers to contact an attendant by dialing "0," to receive pages notifying them of new messages, and to have additional control over messaging, which includes the ability to specify a message as urgent. The Basic Messaging Service affords the subscriber all the features of MAS, along with features allowing subscribers to exchange information through messaging with other subscribers of MemoryCall, as well as control over future delivery of messages, an extended absence greeting, and guest and home "mailboxes." The Deluxe Messaging Service has all the features of the Basic Messaging Service, but it also provides subscribers with group distribution lists.

Id. at *3.

BellSouth's MemoryCall was deemed not taxable by the Commissioner because it was "little more than [a] basic answering machine service" and thus was not considered in the case on appeal. *Id.* at *1 n. 1. This Court had little difficulty in concluding that the true object of the other services in question, however, was to "facilitate, albeit delayed, the transmission and receipt of a telephone communication." *Id.* at *3. "As stated by the trial court, 'the fact that the oral message is held in abeyance in a computer memory does not change the service provided[;] that is, the customer can communicate with a specific person or persons through telephonic means.'" *Id.* Application of the telecommunications tax was therefore proper.

IV.

*8 On appeal in this case, the Commissioner argues that the trial court erred in its application of the law. As will be seen, the Court rejects this contention and agrees with the decision of the chancellor below. The Court does not write on a clean slate in its construction of the term "telecommunications" as used in our taxation statutes since prior panels of this Court have previously expounded upon its meaning and significance. Were matters otherwise, the Commissioner's arguments might require more detailed consideration, but, given that the law in this area has already been developed, our path is clear.

Having thoroughly analyzed the facts as they were agreed upon by the parties before the trial court, we conclude that the true object or primary purpose of Qualcomm's OmniTRACS service is to determine the location and load status of customer vehicles—that is, to collect data and then make it available to Qualcomm's customers. While the OmniTRACS system undoubtedly contains the ability to transmit "free form" text messages, acquiring this capability is not the principal aim of its purchasers. Nor does the system's capacity for sending "macro" messages transform it into a telecommunications service since these so-called "messages" do little more than allow information concerning a vehicle's status to be combined with information on its location. Even then, these "macro" messages must still be retrieved by the customer. As agreed below, the ability to ascertain a vehicle's location and load status is the primary reason that customers purchase OmniTRACS. The fact that a service might employ, involve, or be accessed by telecommunications, without more, will not transform it into a taxable telecommunications service. See *Prodigy*, 125 S.W.3d at 419; see also *Equifax*, 2000 WL 827963, at *3.

Analogizing the use of OmniTRACS to the placing of a telephone call, the Commissioner contends that the trial court was wrong to conclude that the true object of Qualcomm's services is the provision of information rather than communication services.

According to the Commissioner, the purpose of OmniTRACS is merely to transfer messages created by customers. The Commissioner's characterization, however, is belied by the facts to which she agreed before the trial court, including her acknowledgment that OmniTRACS does not serve as a replacement for a driver's cell phone. Indeed, the record reflects that, at least during the tax period at issue, customers purchased this service from Qualcomm mainly so that they might be able to track their vehicles, and OmniTRACS was never primarily used as a means for free-flowing conversations between a customer and its drivers. Similarly, the facts already established contradict the Commissioner's argument on appeal that OmniTRACS is primarily a means of person-to-person communication. It therefore warrants emphasizing that Qualcomm itself, using its own technology, generates information regarding the location of customer vehicles, and this is a key component of what its customers purchase.

*9 Additionally, the Commissioner argues that the trial court misapplied *Prodigy*. According to her reading of that case, the reviewing court must ask who created the information in question. She asserts that, if the taxpayer does not create the information being transmitted, then *Prodigy* does not apply and the service should be considered a form of taxable telecommunications. Even assuming arguendo that this distinction could ever be meaningful, it must be rejected in this case for several reasons. First, a distinction based upon the creator of content cannot trump inquiry into the true object of a potentially taxable service. See, e.g., *Sky Transpo*, 703 S.W.2d at 129; *Equifax*, 2000 WL 827963, at *4-5 (applying *Sky Transpo*). Here, that true object is to locate vehicles and determine their status. Second, as previously discussed, the undisputed facts of this case make evident that Qualcomm does in fact generate information apart from the content created by its customers and their drivers. This is, after all, the point of the OmniTRACS service: to locate vehicles without need for person-to-person communication. Moreover, its vehicle tracking

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function operates automatically and independently of any message that might be sent by or to a driver. Only when a "free form" message is sent can it be said that information from the customer predominates in importance over information generated by Qualcomm itself, but use of this capability, the parties agree, is relatively rare.

Finally, the Commissioner argues that the trial court's ruling is inconsistent with this Court's recent decision in *BellSouth*. This assertion, however, begins its analysis with the wrong starting point. In *BellSouth*, the services the Commissioner sought to tax possessed telecommunications as their true object ab initio. On those facts, under the totality of the circumstances, this Court concluded that, even though those services involved delays, these delays did not alter the fundamental nature of the service being provided. *BellSouth*, 2006 WL 3071250, at *3 (Tenn. Ct.App. Oct. 27, 2006). This conclusion is particularly compelling since the point of *BellSouth*'s services was, at least in part, to hasten the delivery of messages. In this case, Qualcomm's services are never primarily aimed at providing telecommunications between Qualcomm and its customers. The only aspect of OmniTRACS truly analogous to the services considered in *BellSouth* is its ability to send "free form" text messages, but, as has been stated repeatedly, this is not OmniTRACS' principal feature. Thus, any comparison between the *BellSouth* services and those provided by Qualcomm in the instant case is misplaced.

V.

For the reasons stated above, the Court concludes that the true object or primary purpose of Qualcomm's OmniTRACS service is not-at least as the service has been described throughout this litigation-telecommunications. Qualcomm generates and collects information, which it then stores and which its customers access by means of their own internet connections. The chancellor below therefore correctly applied the law to the undisputed facts of this case. Accordingly, his decision granting summary

judgment to Qualcomm and denying the Commissioner's cross-motion is affirmed in all respects.

*10 Costs of this appeal are taxed to the appellant, and this case is remanded for further proceedings not inconsistent with this opinion. Upon remand the trial court shall determine reasonable attorneys' fees and expenses of litigation to be awarded to Qualcomm pursuant to T.C.A. § 67-1-1803(d).

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APPENDIX B-1

Cite as 9 WTD 280-1

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

| | | |
|---------------------------------|---|---|
| In the Matter of the Petition |) | <u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> |
| <u>N</u> |) | |
| For Correction of Assessment of |) | No. 90-128 |
| |) | |
| |) | Registration No. . . . |
| |) | . . . /Audit No. . . . |
| |) | |

[1] **RULES 138, 155, 245 and RCW 82.04.065:** INFORMATION AND COMPUTER SERVICES -- FURNISHING TELEPHONE LINES FOR DATA TRANSMISSION -- SERVICE B&O TAX. Charges to customers for "dedicated" telephone lines furnished by taxpayers for use in connection with on-line data processing services rendered by taxpayer are subject to Service B&O tax. Providing telephone lines is incidental to service activity and is not "network telephone service" as defined by RCW 82.04.065 and Rule 245.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

DATE OF TELEPHONE CONFERENCE: . . .

NATURE OF ACTION:

Taxpayer seeks a correction of assessment from an audit determination that taxpayer's furnishing dedicated telephone lines to its customers in connection with data processing services falls within the B&O Service classification.

FACTS AND ISSUES:

Heller, A.L.J. (successor to Potegal, A.L.J) -- The taxpayer is engaged in the business of providing data processing

services The taxpayer is the owner of computer software and hardware which it makes available to its customers for use in connection with the performance of its services. The taxpayer furnishes the customer with a telephone modem device which allows the customer to have on-line access to a central processing unit located on the taxpayer's premises. The transmission of data between the taxpayer and its customers occurs over "dedicated" telephone lines which the taxpayer purchases from the telephone company.

The agreement between the taxpayer and its customers provides that the customer is to bear the expense (as assessed by the taxpayer) of all terminal devices, maintenance, telephone lines and modems. In accordance with this arrangement, the taxpayer separately bills the customer for the cost of the telephone lines. The taxpayer refers to this income as "Network Charges". Believing that the furnishing of the telephone lines constitutes a retail sale under Washington law, the taxpayer also collects retail sales tax from the customer which it remits to the Department of Revenue ("Department"). The taxpayer reports its income from data processing services under the Service classification of the business and occupations tax. However, the taxpayer reports its Network Charges as taxable under the Retailing classification as a "telephone service."

An audit of the taxpayer conducted for the period beginning . . . and ending . . . resulted in a reclassification of taxpayer's Network Charges from Retail to the Service classification. This reclassification resulted in an assessment in the amount of \$. . . plus accumulated interest.¹ The taxpayer appeals this assessment.

TAXPAYER'S EXCEPTIONS:

The taxpayer argues that providing dedicated telephone lines to its customers constitutes the furnishing of "network telephone service" as that term is defined in RCW 82.04.065 and WAC 458-20-245. According to the taxpayer, it purchases eight dedicated lines from . . . and in turn leases the lines for a flat fee to customers in fifty locations. The taxpayer asserts that this "network telephone service" is a separate product from the furnishing of computer services which is not

¹The taxpayer was assessed \$. . . as the amount of Service B&O tax on Network Charges. This amount was offset by a credit of \$. . . resulting from Retailing B&O tax reported in error for a total tax due of \$

used by all of its customers. Because those customers using the "product" are the consumers of the telephone service, the taxpayer concludes that the fees charged for the service is retailing income and taxable as such.

DISCUSSION:

WAC 458-20-155 ("Rule 155") is the duly adopted administrative regulation which governs the taxation of information and computer services. Rule 155 provides in pertinent part:

Persons rendering information or computer services and persons who manufacture, develop, process, or sell information or computer programs are subject to ~~business and occupation taxes and retail sales or use taxes~~ as explained in this rule.

The term "information services" means every business activity, process, or function by which a person transfers, transmits, or conveys data, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium. The term does not include transfers of tangible personal property such as computer hardware or standard prewritten software programs. Neither does the term include telephone service defined under RCW 82.04.065 and WAC 458-20-245.

The term "computer services" means every method of providing information services through the use of computer hardware and/or software. (Emphasis supplied.)

It is this exception from the coverage of Rule 155 relating to telephone service which the taxpayer argues is applicable here.

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:

Liability for sales tax or use tax depends upon whether the subject of the sale is a product or a service. If information services, computer services or data processing services are performed, such that the only tangible personal property in the transaction is the paper or medium on which the information is printed or carried, the activity constitutes the rendering of professional services, similar to those rendered by a public accountant, architect, lawyer, etc., and the retail sales tax or use tax is not applicable to such charges. (Emphasis supplied.)

Here, it is clear that the furnishing of the telephone lines is not the object of the transaction, but merely incidental to the personal services being rendered. The representative form of agreement used by the taxpayer which was submitted in support of the petition is instructive in this regard. The

agreement repeatedly refers to "services" or "data processing services" in describing the taxpayer's obligations to the customer. Several pages of the agreement are devoted exclusively to a detailed description of the types of data processing services to be rendered and the manner in which these services are to be performed. The only reference to the telephone lines is contained in the provision dealing with the customer's obligation to bear the cost of the same in connection with the "on-line availability" of the data processing services.

WAC 458-20-138 ("Rule 138") is the administrative regulation which defines personal services. Rule 138 has this to say about costs incidental to the rendering of personal services:

There must be included within gross amounts reported for tax all fees for services rendered and all charges recovered for expenses incurred in connection therewith, such as transportation costs, hotel, restaurant, telephone and telegraph charges, etc. (Emphasis supplied.)

We cannot accept the taxpayer's argument that because less than all customers contract for on-line services, the telephone lines are a separately furnished product. This argument misses the point. The relevant inquiry is whether the transactions which include the Network Charge are sales or services. The fact that certain customers choose not to contract for on-line service has no bearing on this issue. By focusing on the real objective sought by the taxpayer's customers, we have concluded that the taxpayer's Network Charges should be taxed under the Service classification. For purposes of the retail sales tax, the taxpayer is the consumer of the telephone service and as such is obligated to pay the tax on its purchases. Since the taxpayer has previously collected retail sales tax on the fees charged for telephone service, it is entitled to a credit to the extent these taxes have been refunded to customers.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED the 27th day of March 1990.

APPENDIX B-2

Cite as Det. No. 89-009A, 12 WTD 1 (1993).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition) F I N A L
For Correction of Assessment) D E T E R M I N A T I O N
of)
)
) No. 89-009A
)

) Registration No. . . .
) /Audit No. . . .
)

[1] RCW 82.04.290: B&O TAX -- RETAIL SALES TAX -- SERVICE AND OTHER CLASSIFICATION -- SALES OF "COUPON BOOKS" AND ENTERTAINMENT "MEMBERSHIPS." Where a transaction consists of elements of both a service and a retail sale, the taxability is determined by the "true object" of the transaction, i.e., what the buyer was objectively seeking in exchange for the amount paid to the seller. When the activity does not fall under any specific tax classification, it falls under the catch-all "service and other" classification of the B&O tax.

TAXPAYER REPRESENTED BY: . . .
DATE OF CONFERENCE: . . .
DEPARTMENTAL REPRESENTATIVE: . . .

FACTS AND ISSUES:

Hesselholt, Chief A.L.J. -- The taxpayer's books and records were audited for the period . . . through The taxpayer petitioned the Director for direct review. The Audit Division assessed tax, asserting that the taxpayer was selling tangible personal property. Because the taxpayer did not obtain resale certificates from the organizations to which it sold memberships for resale, the Audit Division asserted retailing B&O tax and retail sales tax under RCW 82.04.050. Later file audits were done for the period . . . through . . . and . . . through The Department upheld the assessment By letter dated January 17, 1989 taxpayer petitioned for reconsideration

Taxpayer contracts with various vendors to advertise their goods and services. The taxpayer provides this advertising service by selling "memberships" for various geographic areas. The contract between the taxpayer and the vendors provides that the vendor "wishes to attract additional customers and advertise his goods or services" and that taxpayer agrees "to provide advertising for [vendor] in the form of discount offers. . . ." The advertising services can be provided in various ways, but the items involved in this appeal consist of what the taxpayer refers to as "memberships." These memberships consist of a plastic membership card and a book. The books contain listings of restaurants, hotels, and other vendors that will grant a discount to the member when the card is presented, and coupons that entitle the bearer to free or discounted goods or services. The vendors are located both inside and outside of Washington. The taxpayer provides the membership book and cards to various clubs, usually nonprofit service clubs, which in turn sell the memberships to the public. The benefit to the vendor is the advertisement of its goods or services. The benefit to the taxpayer is the revenue it receives for the "memberships" it provides. The benefit to the consumers is the reduced price of the goods or services purchased. The book provided to the "members" explains how the membership is to be used and the rules of use. The Department assessed retail sales tax and retailing B&O tax on the sales of the books by the taxpayer.

The taxpayer raised a variety of issues. More generally, the taxpayer argues in its memoranda as follows:

. . . the analysis that we urge starts with the recognition that the property does indeed contain both tangible and intangible components. The question is which of these components should dominate for purposes of tax characterization. We contend that the analysis in this case should be exactly like that in all cases where a tangible piece of paper represents an intangible promise to give a performance in the future. Promissory notes and tickets are examples of situations calling for the same analysis. The focus by the Connecticut court in *Dine Out Tonight* on relative "value" of the intangible component as compared to the tangible, is the right one in our opinion. In determining which characteristic deserves to dominate for tax purposes one should look for the value or "true object" sought by the parties.

The issue we raise is whether a "property" which admittedly has "value" should be characterized as "tangible" or "intangible" for tax purposes.

DISCUSSION:

Taxpayer believes that the issue is whether the tangible or intangible component of a property should dominate its tax characterization when the property consists of a tangible paper evidencing an intangible promise to give a performance in the future, and it requests that the intangible component of the property also be taken into account in determining its tax status.

Taxpayer provided a copy of a Connecticut case, Dine Out Tonight Club, Inc. v. Department of Revenue Services, 210 Conn. 567 (1989), arguing that the analysis used in that case should be applicable here.

In Dine Out, the taxpayer sold memberships in its club to Connecticut residents. Members received a membership card that entitled them to a free meal with the purchase of a second meal at restaurants participating in taxpayer's program. They also received a directory of participating restaurants. Members present the card when dining. The card is punched at each restaurant once it has been used there. The memberships are not transferable. The Connecticut Department of Revenue determined, in 1985, that the sale of the membership card was a "sale of tangible personal property" and therefore subject to the sales tax. The Connecticut Supreme Court found that "[t]he membership card and directory are merely indicia of that intangible right [to receive free meals and access to the knowledge of an expanding list of restaurants that provide them] and incidental aids to its exercise." [Citations omitted; brackets supplied.] The court held that because the transaction was "essentially the conveyance of an intangible right to free meals" the taxpayer's membership fees were intangible and not subject to Connecticut's sales tax.

Administratively, the states of California, Colorado, New York, Illinois, Texas, Minnesota and New Jersey have also ruled that the sale of similar memberships is not a retail transaction, although these rulings do not contain any explanation for the ruling.

A somewhat similar business to that involved here was discussed in State ex rel. Fishback v. Universal Serv. Agency, 87 Wash. 413 (1915). The issue in Universal was whether the corporation was doing an insurance business without complying with the statutes

regulating insurance. Therefore, the nature of the corporation's business was explored at some length in the court's opinion.

Universal had contracts with various vendors, including a physician, pharmacist, and dealers in shoes, clothing, groceries, and harness. The contracts with the vendors recited that Universal "proposes to act as agent of various persons in securing for them certain privileges and benefits." 87 Wash. at 415-416. After procuring the contracts under which the vendors agreed to provide goods and services at stated discounts from their regular rates to any consumer contracting with Universal, Universal sold, for a fixed consideration, the privileges specified in the vendor contracts to various consumers. The application signed by the consumers stated that they applied "for the service furnished by the Universal Service Agency" for one year and agreed to abide by the rules and regulations in the contracts issued to them. The contracts subsequently issued to the consumers stated that Universal Service Agency "is acting as the agent of the holder in securing the propositions" contained in contracts with various vendors, that these "propositions are contingent offers which become contracts upon their acceptance by the holder," and that "acceptance thereof shall at all times be evidenced by the payment to the agency of the compensation hereinafter provided." Universal issued each consumer/holder a card showing the vendors offering the discounts and the time period for which the holder had paid the compensation due the agency. The consumer contracts with Universal stated that "[i]n presenting the various offers herein contained the agency acts only as the agent of the parties and assumes no liability for the breach of any one of all of said contracts."

The court in Universal held that Universal was not an insurance company, but was instead acting as an agent of the vendors.

In this case, while none of the contracts identify the taxpayer as an agent, the book provided to the "members" contains a disclosure specifically stating that

[Taxpayer] and/or its subsidiaries, will not be responsible if any establishment breaches its contract or refuses to accept cards/coupons; however, we will attempt to secure compliance. [Taxpayer] and/or its subsidiaries, will not be responsible in the event of Acts of God, fire, casualties, strike or other events beyond its control.

The membership book also specifically states that the membership is nontransferable.

RCW 82.04.050 defines a retail sale, in part, as:

every sale of tangible personal property (including articles produced, fabricated, or imprinted) to all persons irrespective of the nature of their business .

It was under the authority of this section that the Audit Division asserted the retailing B&O tax and retail sales tax. But we believe that taxpayer's activities are more properly classified under the service and other classification of the B&O tax:

any business activity other than or in addition to those enumerated in RCW 82.04.230, 82.04.240, 82.04.250, 82.04.255, 82.04.260, 82.04.270, and 82.04.280 . . . This section includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale."

RCW 82.04.290.

The application of the retail sales tax and retailing B&O tax to these facts depends on the "true object" of the transactions. The true object test is the prevailing test applied by the courts for distinguishing between nontaxable sales of services versus taxable sales of tangible property. See, e.g., *Culligan Water Conditioning v. State Board of Equalization*, 17 Cal. 3d 86, 550 P.2d 593, 130 Cal. Rptr. 321 (1976); *Hartford Parkview Assocs. Ltd. Partnership v. Groppo*, 211 Conn. 246, 558 A.2d 993 (1989); *Commissioner of Revenue v. Houghton Mifflin Co.*, 396 Mass. 666, 487 N.E.2d 1388 (1986); *Emery Indus., Inc. v. Limbach*, 43 Ohio St. 3d 134, 539 n.E. 2d 608 (1989); *WTAR Radio-TV Corp. v. Commonwealth*, 217 Va. 877, 234 S.E.2d 245 (1977).

The true object test, however, is a subjective test and is more a conclusion than a true test. The inquiry as to the true object of the transactions involved in this matter should focus on the issue of what the buyer is seeking in exchange for the amount paid to the seller. See *Emery Indus., Inc. v. Limbach*, 539 N.E.2d at 613; *Commissioner of Revenue v. Houghton Mifflin Co.*, 487 N.E. 2d at 1391, *Hellerstein, Significant Sales and Use Tax Developments During the Past Half Century*, 39 Vand. L. Rev. 961, 970 (1986), Det. No. 90-128, 9 WTD 280.1 (1990). In this case, the purchaser of the taxpayer's memberships is buying the service

that the taxpayer has provided by arranging for all of the discounts available to the purchaser of the membership.

We believe that taxpayer's activity is not covered under any specific tax classification and, therefore, falls under the service and other classification of the B&O tax. RCW 82.04.290. Persons taxable under this classification are defined as consumers (RCW 82.04.190) and subject to the retail sales tax on all purchases of tangible property used in the performance of their business activities.

DECISION AND DISPOSITION:

Taxpayer's petition is granted.

DATED this 31st day of December 1992.

APPENDIX B-3

Cite as Det. No. 98-202, 19 WTD 771 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

| | | |
|---|---|----------------------------------|
| In the Matter of the Petition For Correction of |) | <u>D E T E R M I N A T I O N</u> |
| Assessment and Refund of |) | |
| |) | No. 98-202 |
| ... |) | Registration No. . . |
| |) | FY. . . /Audit No. . . . |

[1] RULE 108: RETAIL SALES TAX -- MEASURE -- DISCOUNTS -- PRODUCTIVITY/VOLUME -- COMMISSIONS. Productivity discounts based on the number of reservations booked on a reservation system and used to offset monthly equipment, software and communication charges are not true discounts and cannot be deducted from the measure of the tax.

[3] RULE 155: RETAIL SALES TAX -- SERVICE B&O -- COMPUTER SERVICES -- INFORMATION SERVICES -- ON-LINE ACCESS -- TELEPHONE LINE CHARGES. Charges for having on-line access to a reservation system are a service activity even though a portion of the charges is for the telephone lines used to convey the information or service to the customer.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.¹

NATURE OF ACTION:

A travel agency protests the assessment of use tax assessed on computer equipment, access charges and support licenses in an audit report.²

FACTS:

¹ Nonprecedential portions of this determination have been deleted. See RCW 82.32.410.

² Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Okimoto, A.L.J. -- . . . (Taxpayer) operates a travel agency located in . . . Washington. Taxpayer's books and records were examined by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1993 through December 31, 1996. The audit examination resulted in a \$. . . credit owing to Taxpayer and Document No. . . . was issued in that amount on October 8, 1997. Taxpayer protested the assessment of use taxes imposed on charges for computer equipment and other services performed by a reservation service.

Schedule 4 – Use and/or Deferred Sales Tax Due on Lease

Audit explained in its audit report that use tax was due on:

. . . the value of the lease of computer equipment which has been leased to you by [System] for your use in making travel reservations through them. The lease charges were reduced by credits to you for the number of reservations made by you through their system. Retail sales tax is due on the full value of the lease. See WAC 458-20-155 Attached. The amount received as a reduction from the cost of the lease is commission revenue to you and should be reported the same as your other commission revenue, under the Travel Agent classification for Business & Occupation tax.

Taxpayer makes several arguments. First, Taxpayer points out that it received a productivity discount³ that was applied to lease charges that totally or substantially offset monthly charges made by [System]. Taxpayer argues that if use tax is due, it should be computed based on the cash exchanged between the two companies and not the originally invoiced amounts.

Finally, Taxpayer pointed out that only \$. . . of its monthly charge was for computer hardware. Taxpayer stated that it also paid \$. . . for software license & support and \$. . . for a communication support fee. Taxpayer explained that the communication support fee was a charge for having access to System's reservation system and database. This monthly charge also included the cost of telephone lines necessary to connect Taxpayer's terminals to the reservation system.

ISSUES:

- 1) When computing use taxes owed on tangible personal property, does the amount of productivity discounts granted reduce the measure of tax?

³Under the Production Credit Agreement dated February 14, 1992, Taxpayer received a \$1 credit against its monthly charges for each car rental or hotel booking made through System.

3) Are software charges and charges for having on-line access to a reservation system subject to use and/or deferred retail sales tax?

DISCUSSION:

WAC 458-20-108 (Rule 108) is the Department's rule on discounts. It states in part:

(5) DISCOUNTS. The selling price of a service or of an article of tangible personal property does not include the amount of bona fide discounts actually taken by the buyer and the amount of such discount may be deducted from gross proceeds of sales providing such amount has been included in the gross amount reported.

~~(a) Discounts are not deductible under the retail sales tax when such tax is collected upon the selling price before the discount is taken and no portion of the tax is refunded to the buyer.~~

(b) Discount deductions will be allowed under the extracting or manufacturing classifications only when the value of the products is determined from the gross proceeds of sales.

(c) Patronage dividends which are granted in the form of discounts in the selling price of specific articles (for example, a rebate of one cent per gallon on purchases of gasoline) are deductible. (Some types of patronage dividends are not deductible. See WAC 458-20-219.)⁴

[Footnote added.]

[1] Volume discounts are reductions in the sales price of the article purchased based on the quantities of items actually purchased. The example in Rule 108(5)(c) allowing a one-cent per gallon rebate is one type of volume discount. Such discounts constitute a reduction in the original sales price and may be deducted from the gross proceeds of sale. In contrast, Taxpayer's productivity discount is not computed based on the volume of products or services purchased (since the number of leased computer units remains fixed) but instead is computed based on the amount of business generated by each leased terminal. In this respect, the productivity discount is similar to a commission for services rendered and not a true discount.

Indeed, Taxpayer explained during the hearing that System allows airlines, hotels, and car rental agencies to utilize its reservation system. In exchange, System receives a monetary fee from hotels and rental car agencies for each reservation booked through its reservation system. Therefore, the greater number of reservations booked by Taxpayer through its leased computer terminals, the more fees generated for System. It is the generation of these fees that allows System to credit/offset charges against Taxpayer's leased equipment liability. Under these facts, we find that these fees constitute commission income received by Taxpayer for the service of booking Taxpayer's clients through the reservation system. Deductions for bona fide discounts are not available where a purchaser is required to provide any significant service to the seller in

⁴WAC 458-20-219 (Rule 219) has been repealed. WSR 92-23-021 (filed November 10, 1992).

return for the reductions. See, Det. No. 83-180, 11 WTD 5 (1983). Accordingly, we find that Taxpayer's productivity discounts are not true discounts within the meaning of Rule 108, and they may not be deducted from Taxpayer's monthly lease charges to reduce its use tax liability⁵. Taxpayer's petition is denied on this issue.

...

[3] Taxpayer also argues that the software application and communication support charges are not for tangible personal property and, therefore, exempt from use tax. WAC 458-20-155 (Rule 155) is the rule explaining the proper tax application for computer software and computer services. It states in part:

The term "standard, prewritten program," sometimes referred to as "canned" or "off-the-shelf" software, means software which is not originally developed and produced for the user.

...

The retail sales tax applies to all amounts taxable under the retailing classification of business and occupation tax explained earlier. Providers must collect the sales tax from users of computer systems, hardware, equipment, and/or standard, prewritten software and materials delivered in this state. This includes outright sales, leases, rentals, licenses to use, and any other transfer of possession and the right to use such things, however physically packaged, represented, or conveyed. (Emphasis ours.)

The software application received by Taxpayer was not originally developed or produced for the Taxpayer. It was previously designed and only incidentally adapted to Taxpayer's computer equipment. Consequently, we find that it is a standard, prewritten program within the meaning of Rule 155 and fully subject to the retail sales tax.

The communication support charge is another matter. Rule 155 also explains how data information and information services are to be taxed. It states in part:

SERVICE: Persons who charge for providing information services or computer services (other than retailing or wholesaling as defined above) are subject to the service and other activities classification of business and occupation tax measured by the gross income of such business. This includes charges for custom program development, charges for on-line information and data, and charges in the nature of royalties for the reproduction, use, and reuse of patented systems and technological components of hardware or software, whether tangible or intangible.

⁵ We further note that RCW 82.12.010(1) allows the Department to impose use tax based on sales of similar products where the item was "...acquired by lease...or is sold under conditions wherein the purchase price does not represent the true value..."

The tax classifications and distinctions explained above will prevail regardless of how the federal government or other tax jurisdictions may classify these transactions for other tax purposes. (Emphasis ours.)

Rule 155 further defines the following terms:

The term "information services" means every business activity, process, or function by which a person transfers, transmits, or conveys data, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium. The term does not include transfers of tangible personal property such as computer hardware or standard prewritten software programs. ~~Neither does the term include telephone service defined under RCW 82.04.065 and WAC 458-20-245.~~

The term "computer services" means every method of providing information services through the use of computer hardware and/or software.

Taxpayer explained that it pays \$. . . per month for the privilege of being on line and having access to System's reservation system. This reservation system allows it to receive current information on airline, hotel, and rental car availability and prices. In addition, the reservation system allows Taxpayer to actually book the reservation with the service provider. We believe that this business activity falls within the definition of "information services" within the meaning of Rule 155. Since System provides these information services through the use of computer hardware and/or software, they constitute "computer services" and are taxed under the service and other activities tax classification. See, Det. No. 90-86, 9 WTD 165 (1990); Det. No. 87-346, 4 WTD 267 (1987).

Although Audit apparently contends that telephone line charges included in the \$... monthly payments convert the entire charge to network telephone services, we disagree. In Det. No. 90-128, 9 WTD 280-1 (1990), the Department considered the proper tax classification of telephone line charges related to a data processing service. In finding that itemized telephone line charges were only incidental to the data processing services being rendered, we stated:

[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:

Liability for sales tax or use tax depends upon whether the subject of the sale is a product or a service. If information services, computer services or data processing services are performed, such that the only tangible personal property in the transaction is the paper or medium on which the information is printed or carried, the activity constitutes the rendering of professional services, similar to those rendered by a public accountant, architect, lawyer, etc., and the retail sales tax or use tax is not applicable to such charges. (Emphasis supplied.)

Here, it is clear that the furnishing of the telephone lines is not the object of the transaction, but merely incidental to the personal services being rendered. 9 WTD at 280-3,4.

In this case, we similarly believe that the true object of the \$... monthly communication charge is for the ability to access the information in System's reservation system and to make the reservation with the service providers on behalf of Taxpayer's client. These services are information services and since the services are rendered through computer hardware or software, they fall within Rule 155's definition of "computer services". We further find that the telephone line charges are merely incidental to the information services being supplied by System and may not be bifurcated and separately taxed from the object of the transaction. Taxpayer's petition is granted on this issue.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part and denied in part. Taxpayer's file shall be remanded to Audit for the proper adjustments consistent with this determination.

Dated this 30th day of November 1998.