No. 38347-1-II

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION II

SPRINT INTERNATIONAL COMMUNICATIONS CORPORATION,

Appellant,

vs.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

AMICUS CURIAE BRIEF OF MICROSOFT CORPORATION IN SUPPORT OF APPELLANT

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I. INTRODUCTION

This case addresses the proper taxation of computer-to-computer data communication services offered by Sprint International Communications Corporation ("Sprint") from January 1, 1989 through December 31, 1993, a period when the internet was just beginning to be used for commercial purposes. Specifically, this case concerns whether such services were exempt internet services under the 1997 version of Revised Code of Washington (RCW) 82.04.065(2) during the 1989 – 1993 audit period.

II. IDENTITY AND INTEREST OF AMICUS CURIAE

Microsoft Corporation ("Microsoft") is a computer technology company headquartered in Redmond, Washington. In 1995 Microsoft launched a dial-up online content service known as "The Microsoft Network" or "MSN," which coincided with the commercial release of its computer operating system, Windows 95. Microsoft was a Sprint customer, using Sprint's X.25 packet-switching network to receive dial-in connections from MSN subscribers. Microsoft submits this amicus curiae brief pursuant to RAP 10.1(e) in support of Sprint.

III. STATEMENT OF THE CASE

Microsoft accepts Sprint's statement of the case and offers the following information as additional background for the Court.

For most of the 20th century, the telecommunications industry was viewed as a natural monopoly. Prior to 1981, the Legislature imposed a public utility tax on traditional telephone services. Former RCW 82.16.010 (1965); Western Telepage v. City of Tacoma, 95 Wn. App. 140, 974 P.2d 1270 (1999).

A significant structural change occurred in 1982, when the US Department of Justice and AT&T settled their antitrust dispute. W. John Blyth and Mary M. Blyth, Telecommunications Concept, Development and Management (1990), at 61-68. As part of that settlement, AT&T was required to divest its Bell Operating Companies. Id. Effective January 1, 1984, the Bell Operating Companies were consolidated into seven independent Regional Bell Operating Companies (RBOCs): NYNEX, Bell Atlantic, BellSouth, Ameritech, Southwestern Bell, US West, and Pacific Telesis Group. Id. The RBOCs were granted control of the local telephone service in their respective regions but were not permitted to provide long distance telephone service; instead, that service was provided by AT&T and its relatively few competitors, such as MCI and GTE. Id. With the divestiture, deregulation of the telecommunications industry began. Id.

Unlike the traditional telephone industry, which dates back to the late 1800s, the origins of the internet trace to the 1950s and the national security concern that this country's military communications could be

compromised in the event of an attack. James Gillies & Robert Cailliau, How the Web was Born (2000). After years of research, the US Department of Defense commissioned its Advanced Research Projects Agency (ARPA) in 1969 to set up a computer network called ARPANET. Id. ARPANET linked military computers and university computers using packet-switching technology. Id. ARPANET served two functions: to keep intact military communications during an attack, and to allow university researchers and the military to share military defense research. Id. ARPANET's popularity increased among university faculty and students when email was created in 1971. Josepha Sherman, The History of the Internet (2003). In 1982, ARPA decided to use Transmission Control Protocol (TCP) and Internet Protocol (IP), commonly known as TCP/IP, as the standard language for ARPANET. Katie Hafner & Matthew Lyon, Where Wizards Stay Up Late, at 248-51 (1996). Effective January 1, 1983, all computers connecting to ARPANET had to speak the same language – namely, TCP/IP. Id. According to some historians, "that was the day the Internet as we now know it came into existence." Gillies & Cailliau, supra, at 44.

NSFNET, another network of computers similar to ARPANET, was developed and funded by the National Science Foundation (NSF) in 1986 to interconnect several regional university networks and supercomputer centers. Hafner & Lyon, supra, at 245-246. At a cost of several million

dollars a year, the federal government paid for the "backbone" that allowed NSFNET to operate. Id. Before 1991, use of NSFNET was restricted to the higher educational system; no commercial users were allowed access. Robert T. Griffiths, History of the Internet, Internet for Historians, chapter 2, *From ARPNET to World Wide Web.*[1] In 1990, ARPA transferred its "backbone" responsibility for the internet in the US to NSFNET as part of the official decommissioning of ARPANET. Hafner & Lyon, supra, at 254-256. It was ARPANET and later NSFNET that were commonly referred to as the "Internet." Id.

By the end of the 1980s, however, the internet still did not resemble today's internet:

> [T]he Internet is still quite a forbidding place for the uninitiated. Access commands to find data range from the complicated to the impenetrable, the documentation available is mostly (highly) scientific and the presentation unattractive (courier script, no colour), finding stuff is a pain in the neck and transfer times are relatively slow. The main attractions for the commercial sector are the e-mail facilities and access to e-mail, newsgroups, 'chat' facilities and computer games. Although commercial exploitation of the net had started, the expansion of the Internet continued to be driven by the government and academic communities.

Griffiths, supra.

[1] Available at http://www.let.leidenuniv.nl/history/ivh/chap2.htm (last updated Oct. 11, 2002).

In the early 1990s, not long after ARPANET's decommissioning, three major events occurred. Griffiths, supra. First, in 1991 Tim Berners-Lee released, for free, his "World Wide Web" program, which organized the information located on the internet. Id. Second, in December 1993, at the end of the audit period at issue here, a program called Mosaic was released that allowed users to browse the World Wide Web as if it were a library (such programs are now referred to as web browsers). Id. Mosaic is often credited with starting the internet boom of the 1990s, because it made the internet accessible to anyone with a computer – a PhD in computer science and a mainframe were no longer necessary to navigate online. Id. Finally, in 1995, the backbone service provided by NSFNET was transitioned to commercial network service providers, also referred to as access providers or internet service providers. Id.

These events contributed to the surge in internet usage in the mid-1990s. Robert H. Zakon, Hobbes' Internet Timeline.[2] Businesses were taking notice of the internet. Id. In 1994 Pizza Hut accepted its first online order; shopping malls and banner ads were making their debut on the internet; and communities such as Cambridge, Massachusetts were establishing a presence on the internet. Id. Companies that had traditionally

[2] Available at http://www.zakon.org/robert/internet/timeline/ (last updated November 1, 2006).

offered online dial-up systems to "walled-in gardens" and proprietary subscriber networks began providing direct access to the internet. Id.

As the information posted on the internet became more commercial in nature and more services and types of information became available there, more companies started providing access to the internet. Most of these companies did not provide their own content and information to the user, but instead focused on providing access to the internet. Ed Krol & Paula Ferguson, The Whole Internet for Windows 95 (1995); Barry M. Leiner et al., Internet Society (ISOC), A Brief History of the Internet (2003); Daniel P. Dern, The Internet Guide for New Users (1994).

Because of the changes in customer demand and the increased content available beyond the provider's website, many businesses, including Microsoft, began to use Sprint's services to provide their customers with access to the internet rather than merely access to those businesses' servers, which stored information such as news and weather reports. This newer model for the provision of internet services, which is primarily the one in use today, post-dates the audit period and is not at issue here.

As the world of traditional telephone companies converged with the internet/digital world, distinctions between the two industries blurred. In today's marketplace, traditional telephone companies provide internet access and email services. Technology companies provide telephone

service over the internet. While this case nominally concerns the taxation of computer-to-computer data communication services, the decision will serve as a guide to taxation of future innovations at the intersection of computer technologies and communication services.

IV. ARGUMENT

A. Sprint's services are internet services under RCW 82.04.297.

The Department of Revenue contends that Sprint's services are subject to retail sales tax because they are network telephone services; Sprint disagrees. Although Sprint and the Department of Revenue have made a variety of statutory arguments, both parties overlook important aspects of this issue.

First, the Legislature has defined "internet service" as "a service that includes computer processing applications, provides the user with additional or restructured information, or permits the user to interact with stored information through the internet or a proprietary subscriber network." Laws of 1997, ch. 304, § 4. The statute sets forth three examples of an internet service: (1) "the provision of internet electronic mail," (2) "access to the internet for information retrieval," and (3) "hosting of information for retrieval over the internet or the graphical subnetwork called the world wide web." RCW 82.04.297(3) (emphasis supplied). The Department of

Revenue promulgated Washington Administrative Code (WAC) 458-20-15501, which elaborates "[t]he [internet service provider] must provide the service through use of computer processing applications that either provide the user with additional or restructured information or permit the user to interact with stored information through the internet or a proprietary subscriber network." Based on the foregoing, an internet service has two elements: (1) it involves the use of computers, and (2) it provides users with information or access to the internet or a proprietary subscriber network.

During the period at issue, Sprint's X.25 service had both of these elements. First, it provided computer-to-computer data transmission over a packet-switched network. CP 315 (Stip. Facts ¶¶ 26-28). Sprint's services used computers in the same manner and degree as other internet access providers, such as MSN, i.e., Sprint provided access for its customer's host computers to remote computers elsewhere on the network. CP 315 (Stip. Fact ¶ 27). Second, Sprint provided the user with access to stored information from computers elsewhere on Sprint's packet-switched network. Sprint's X.25 network is an internet service because it uses computer-to-computer data communications over a packet-switched network to provide its users with access to the internet or a proprietary subscriber network.

The Legislature specifically intended to level the playing field between telephone companies and their competitors. In 1981 the Legislature observed that federal deregulation in the telephone business created a taxing scheme which had "become discriminatory when applied to regulated telephone company transactions that are similar in nature to those consummated by nonregulated competitors . . . . " Laws of 1981, ch. 144, § 1 (emphasis supplied). The Legislature desired "to place telephone companies and nonregulated competitors of telephone companies on an equal excise tax basis with regard to the providing of similar goods and services." Id. To achieve this goal, the Legislature broadly defined "telephone business" to include the business of "providing access to a local telephone network, local telephone network switching service, toll service, or coin telephone services, or providing telephonic, video, data, or similar communication or transmission for hire, via a local telephone network, toll line or channel, or similar communication or transmission system . . . ." Laws of 1983, 2nd ex.s., ch. 3, § 24. Sprint's X.25 service is not a telephone service as contemplated by the Legislature and should not be taxed as such merely because it is provided by a telephone business.

The Legislature purposefully excluded internet services from the network telephone service taxing regime. Recognizing that some internet

services were inherently communication activities and that taxes levied on telephone businesses would be inappropriate for those internet services, the Legislature amended the definition of "network telephone services" to specifically exclude the "provision of internet services as defined in RCW 82.04.297." RCW 82.04.065. For example, an electronic mail service is inherently a data transmission activity, an activity falling within the network telephone service definition, but because it is an internet service, it is excluded from the definition. The Department of Revenue concluded that the Legislative amendments clarified an existing ambiguity in the law and therefore applied retroactively to Sprint's audit period. Determination No. 98-193, 18 WTD 338 (1998). Like e-mail, Sprint's services are inherently communication activities that are excluded from the definition of network telephone service.

Changes in technology and business platforms have blurred the Legislature's distinctions between network telephone service and internet service. Traditional facilities-based telephone companies provide internet access, and technology companies provide telephone service. The convergence of telephone and internet businesses has eroded the utility of status-based tax classifications. As a result of the convergence, any rational tax classification must be activity-based without regard to the taxpayer's legacy business. The Department of Revenue has recognized this. One

example is the tax treatment of "voice over internet protocol" or "VoIP." VoIP is a "technology used to transmit voice conversations over a data network using the Internet Protocol. Such data network may be the Internet or a corporate Intranet, or managed networks typically used by long and local service traditional providers and ISPs that use VoIP." Harry Newton, Newton's Telecom Dictionary (2003). The Department of Revenue taxes VoIP as a network telephone service if the service provider allows a subscriber to place calls to persons using the public switched telephone network, presumably because the activity is similar in nature to a telephone service. See WAC 458-20-245. Sales of VoIP services are internet services, however, if the system permits calls to be made only computer-to-computer and does not involve the use of the public switched telephone network. See Telecommunications Tax Policy in Washington, Department of Revenue (2007). Here, Sprint's X.25 service provided computer-to-computer data transmission over a packet-switched network that did not involve the use of the public switched telephone network. Thus, Sprint's X.25 service is not similar in nature to a telephone service and should be taxed as an internet service.

B. Sprint's services during the audit period also were "internet services" under RCW 82.04.065(2) because Sprint provided a dial-in connection to an internet service provider.

In 1997, the Washington Legislature explained that taxable "network telephone services" do not include "internet services." As amended, RCW 82.04.065(2) provides that "'[n]etwork telephone service' includes the provision of transmission to and from the site of an internet provider via a local telephone network . . ." (emphasis supplied). The statute further states that "'[n]etwork telephone service' does not include . . . the provision of internet services as defined in RCW 82.04.297, including the reception of dial-in connection, provided at the site of the internet service provider." Id. (emphasis supplied).

Here, internet service providers and proprietary subscriber networks used Sprint's X.25 network to accept calls from dial-in customers. CP 317-318 (Stip. Facts ¶¶ 42-46). The dial-in customers generally used the local public telephone network to dial into the Sprint X.25 network through the nearest network access point. CP 318 (Stip. Fact ¶ 46). The Sprint X.25 network then connected the customer to the internet service provider (or proprietary subscriber network). CP 317-318 (Stip. Facts ¶¶ 42-46). This latter transmission constitutes the "reception of a dial-in connection" by the internet service provider (or proprietary subscriber network) and should be

excluded from retail sales tax under RCW 82.04.065(2), because the internet service provider (or proprietary subscriber network) used the data communication service to receive calls from its subscribers.

The Department reasons that the data communication services offered by Sprint to proprietary subscriber networks and internet service providers are "network telephone services" because such services constitute the "provision of transmission to and from the site of an internet service provider via a local telephone network . . . ." Respondent's Brief at 18. However, the Department ignores both the term "local" in RCW 82.04.065(2) as well as the exclusion for "reception of a dial-in connection." All words in a statute must be given legal effect. Clark v. Pacificorp, 118 Wn.2d 167, 822 P.2d 162 (1991). Sprint's X.25 network is not local. CP 318 (Stip. Fact ¶ 46). Furthermore, internet service providers (and proprietary subscriber networks) use Sprint's data communication service to receive dial-in connections.

The Department further asserts that data communication services qualify for the exclusion from network telephone service under RCW 82.04.065(2) only when sold by an internet services provider (or proprietary subscriber network) as part of a bundled transaction consisting of both information and data communication services, rather than when purchased and used by an internet service provider (or proprietary

subscriber network) to provide internet services. Respondent's Brief at 18. The exclusion from network telephone service, however, is not limited to sales by internet service providers. The statute includes the specific activity of "the reception of a dial-in connection, provided at the site of the internet services provider . . ." within the definition of the general term "internet services." RCW 82.04.065(2). Thus, persons providing data communication services used to receive connections at the site of an internet service provider are themselves engaged in the provision of "internet services." The courts cannot supply words to narrow the clear application of a statute unless the omission is plainly indicated. Matter of Marriage of Dalthorp, 23 Wash. App. 904, 598 P.2d 788 (1979). If the Legislature intended to limit the exclusion from network telephone service to sales by persons already engaged in an internet service activity, it certainly could have done so. It did not. The Department's reading, which imports a limitation into the statute that the Legislature neither expressed nor intended, should be rejected.

C. Internet Gateway services are exempt internet services.

Industry developments post-dating the audit period changed the internet services that providers such as Microsoft offered to their customers. Because of the changes in customer demand and the increased content available beyond the provider's website, many businesses, including

Microsoft, began providing customers with direct access to the internet (referred to as "Internet Gateway" services) rather than limit their customers to the content available on the provider's servers.

These providers used Sprint to supply the Internet Gateway services in the post-audit period, even as the content that customers were accessing through that connection was growing exponentially. There can be no question that it is appropriate to classify Sprint Internet Gateway services as internet access services at that time, for Sprint's services were precisely the means by which MSN customers accessed the internet.

During the audit period at issue, the Sprint's X.25 packet-switched network was not part of the internet. CP 315 (Fact Stip. ¶ 24). After the audit period, Sprint provided Internet Gateway services. Such services are internet services under RCW 82.04.297 because they provide the user with access to the internet. Accordingly, the Court must be careful to distinguish Internet Gateway services from Sprint's services provided during the audit period, either by finding such services exempt or by limiting its decision to the appropriate treatment of Sprint's services as they were used during the audit period.

V. CONCLUSION

For the reasons set forth above, *amicus curiae* respectfully requests that the Court reverse the trial court's summary judgment order and find that

Sprint's services during the period in question were "internet services" as a matter of law.

Respectfully submitted this 21st day of May, 2009.

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