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I. Introduction

The Department of Revenue (“DOR”) maintains that if a service contains “data transmission for hire” it has to be “network telephone service” as that term was defined in former RCW 82.04.065. In doing so, DOR ignores the fact that many services involve a combination of transmission, data processing, and information. It is not easy to separate these items in the context of the digital world, and, as the parties’ use of legislative history demonstrates, this separation has been the subject of continuing legislative tinkering.¹ In its brief, DOR attempts to recast this history and to reject other sources for characterizing telecommunications, such as the Federal Communications Commission. DOR also ignores the similarity of Sprint’s service at issue here and internet access services. The Court should reject DOR’s efforts and reverse the trial court.

II. Argument

A. Sprint’s enhanced X.25 service is excluded from the definition of “network telephone service” because it is more than a transmission service, and not simply because it is unregulated.

1. The X.25 network is a core element of Sprint’s enhanced services, but it is not the service.

Sprint’s enhanced X.25 service allowed dial-up access to its customers’ databases, even though the modem and mainframes normally

¹ As this brief was being written, the Legislature was trying to define “digital goods and services” and subject them to the retail sales tax. *See* 2009 H.B. 2075.

were not compatible. This required protocol conversion, which is discussed in part II.C and which was not necessary for transmission.

Yet DOR contends Sprint does not dispute its service was primarily transmitting information for hire. Resp. Br. at 25. DOR's oft-repeated argument is that SprintNet services utilizing the X.25 network were primarily used to transmit data over a telecommunications network, (Resp. Br. at 8), and for this DOR relies heavily upon a passage contained in the *Introduction to a SprintNet Services-Sales Kit*:

The core of SprintNet services ... has long been recognized as an extremely flexible, cost-effective and reliable way to transmit information between geographically dispersed locations. Countries and multinational organizations, from financial institutions to manufacturers to service providers have chosen X.25 for data transport for nearly two decades.

Resp. Br. at 1, citing CP 973, SprintNet Services-Sales Kit (1994) at p. 2.

DOR's supposes the introductory passage defines Sprint's services as mere data transport, and even counts it as an apparent admission on Sprint's part. Resp. Br. at 25. The passage simply states that the core or "backbone" network used in the provision of SprintNet services is an X.25 protocol packet switched network. This is revealed later, when DOR includes the complete quotation in its Argument:

The core of SprintNet services – X.25 services (also referred to as packet switching) has long been recognized as an extremely flexible, cost-effective and reliable way to

transmit information between geographically dispersed locations. ***

CP 973, SprintNet Services-Sales Kit at 2 (Omitted phrase underscored).

The fact that transmission is a necessary part of the service does not mean that only transmission is involved.

2. DOR did not give “appropriate” consideration to federal and state regulatory characterizations of Sprint’s service.

DOR chafes at the possibility that its interpretation of former RCW 82.04.065(2) (1997) might be informed by regulatory distinctions drawn between enhanced and basic services by the Federal Communications Commission (“FCC”) and the Washington Utilities and Transportation Commission (“WUTC”). Resp. Br. at 44. DOR insists on starting from scratch with its own artificial “distinction” between transmission for hire and “information service,” rather than follow the fact-based distinction between basic and enhanced transmission services drawn by the FCC after 30 years of study. Resp. Br. at 8, 44-49; See, Corr. Op. Br. at 14-20.

DOR ignores the Supreme Court of Washington’s recent tip of the hat to the concept of interpreting RCW 82.04.065(2) in a manner consistent with FCC decisions. The pertinent facts in *Community Telecable of Seattle, Inc. v. City of Seattle*, (“*Community Telecable*”) 164 Wn.2d 35, 186 P.3d 1032 (2008) were that Comcast provided internet

service via a cable connection between the subscriber's computer modem and Comcast's "head end" office in Burien. *Id.* at 35, 38. Equipment at the head end office assigned an Internet Protocol (IP) address to each subscriber's computer, converted the signal back into a digital signal, and converted the data into IP packets that could be sent across the Internet via another entity known as the At Home Corporation, which sent the data onto the Internet. *Id.* at 38-39.

The City of Seattle ignored the internet access capabilities of Comcast's service and contended Comcast's cable internet service was a "network telephone service" because it literally provided data via a cable as RCW 82.04.065(2) requires. This is similar to the short shrift DOR gives Sprint's enhanced services capabilities simply because data transits Sprint's core X.25 network. *Resp. Br.* at 1, 8-11, 25-26. The *Community Telecable* Court rejected this simplistic view: "But the provision of data via a cable *is* cable 'Internet services' as defined by RCW 82.04.297(3)" and "[t]he transmission component of Internet service cannot be separated from the actual service." *Community Telecable*, 164 Wn.2d at 43-44. Similarly here, Sprint's core X.25 backbone network is simply the interior transmission component of its broader, end-to-end internet access-like enhanced services. The Court held that even though Comcast passed the data to At Home Corporation to be sent onto the Internet, the data would

not be useful unless Comcast “transformed” and “manipulated” it along the way, “[t]herefore, 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).” *Id.* at 44.

The Court noted that RCW 82.04.065(2) is consistent with the FCC’s view of high-speed Internet services, and stated, “[i]t is appropriate that our state statute, consistent with federal and other state laws, disfavors the kind of artificial division of Internet service components the City advocates.” *Id.* at 44-45.

Here, DOR did not divide Sprint’s service between basic and enhanced service; DOR simply labeled the whole service “network telephone service” because it transmits data, ignoring its computer processing features.

3. Regulatory classifications are established for different purposes than tax classifications; however, facts developed in regulatory proceedings are relevant in assessing the applicability of tax statutes to regulated and unregulated services.

Sprint supplied DOR with facts developed in the course of the FCC’s various proceedings that led the FCC to conclude Sprint’s service was enhanced or value added service rather than basic transmission. Corr.



Op. Br. at 14-20. DOR itself relied on facts established in FCC regulatory proceedings. Resp. Br. at 46-49. But DOR summarily dismisses the FCC's facts establishing the enhanced nature of Sprint's service because the federal regulatory scheme is unrelated to state tax law. Resp. Br. at 48. As noted above, however, many of Sprint's facts are highly similar to the facts that led the Supreme Court of Washington to conclude Comcast's entire service was Internet service under the same statute, including the fact that Internet service includes the transformation and manipulation of data, whether it be by giving it an address (in this case an IP address, in Sprint's case an X.25 address), putting it into a packet (an IP packet, or here an X.25 packet), or doing all of the other technical things that are "an integral and necessary part of the provision of Internet services." *Community Telecable*, 164 Wn.2d at 44. These facts were important to the Supreme Court, but their similarities to the facts in the case at bar are lost on DOR.

DOR contends that adopting the FCC's regulatory distinctions would conflict with the Legislature's intent to tax all regulated and unregulated "network telephone service." Resp. Br. at 45. The relevant inquiry is whether the service in question has the characteristics of "network telephone service" or is something more, or different. If it does,

it will be subject to that classification, regulated or not. There simply is no conflict.

B. “Value-added nonvoice data service” is not included in “telecommunications service.”

DOR contends “value-added nonvoice data service” is included in the definition of “telecommunications service” until such time as the Legislature removes it. Resp. Br. at 27-30. DOR finds support for its position in an Issue Paper approved by the Streamlined Sales Tax Project. Resp. Br. at 28, A-51 to 52.

Sprint disagrees. Value-added nonvoice data service” is not included in “telecommunications service.” A review of the pertinent language contained in both provisions reveals that they are mutually exclusive, and for that reason alone, “value-added nonvoice data service” is not “telecommunications service.” Since it is not mentioned in RCW 82.04.050(5), “value-added nonvoice data service” is not subject to the retailing classification. “Telecommunications service” is defined as follows:

Telecommunications service’... includes...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 ... classified by the federal communications commission as enhanced or value added. * * *

RCW 82.04.065(8) (emphasis added). This definition refers to transmission using computer applications for purposes of transmission, which would for that reason be treated as telecommunications service under Washington law even if the FCC decided the service was enhanced.

“Value-added nonvoice data service” is defined as follows:

Value-added nonvoice data service” “means a service that otherwise meets the definition of telecommunications services in which computer processing applications are used to act on the form, content, code, or protocol of the information or data ***primarily for a purpose other than transmission, conveyance, or routing.***

RCW 82.04.065(17) (emphasis added). This definition refers to transmission using computer applications for a purpose other than transmission, and there is notably no prohibition against using the FCC’s characterization of a service as enhanced or value-added.

The two provisions are mutually exclusive. If the transmission uses computer applications to act on the content *for purposes of transmission* it is deemed telecommunications service, and if the transmission uses computer applications to act on data or information *primarily for purposes other than transmission*, it is value-added.

DOR argues that the Legislature’s creation of a “value-added” category was merely to mirror the Streamlined Sales and Use Tax Agreement. Resp. Br. at 27. Yet nothing in the Agreement required the

State to adopt definitions that have no use under its tax law. “Only if an exclusion or exemption is needed would the state need to define one of the subsets of “telecommunications services.” Streamlined Sales Tax Project Issue Paper, Resp. Br. at A-51. Thus, the Legislature’s definition of value-added services strongly suggests that it recognized that these services had not been taxed as “network telephone services” and thus should not be taxed as “telecommunications services.”

DOR questions why separately defined “paging services” and “mobile wireless services” that also are not mentioned in RCW 82.04.050(5) would be subject to sales tax if separately defined “value-added nonvoice data service” is not. Resp. Br. at 29. The answer is simple. “Paging services” and “mobile wireless services” by their very nature meet the full definition of “telecommunications service,” whereas “value-added nonvoice data service” do not.

C. Sprint’s enhanced service is “value-added nonvoice data service” because it uses computer applications primarily for purposes other than transmission, conveyance, or routing.

Sprint performs protocol conversions in connection with most dial-up sessions. DOR contends these protocol conversions are for purposes of transmission. Sprint contends they are primarily for purposes other than transmission.

As a preliminary matter, the restriction against considering FCC classifications of services that appears in the definition of “telecommunications service,” is absent from the definition of “value-added nonvoice data service” and is, in any event, limited to the classification of a service as basic or enhanced. Accordingly, the FCC’s articulation of what is meant by protocol conversion for, or not for, purposes of transmission is instructive.

The phrase “act on the form, code, or protocol” used in both of the above provisions is highly similar to the phrase “act on the format, content, code, protocol” used in the FCC’s rule defining enhanced services. *See* Corr. Op. Br. at 18; 47 C.F.R. § 64.702(a). The FCC separates “protocol processing” into two categories, basic and enhanced. CP 426 at 449, ¶ 106, *In the Matter of the Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, First Report and Order, FCC 96-489, 1996 WL 734160 (F.C.C.) (1997). Protocol processing is “basic” when it results in no net-protocol conversion to the end user. *Id.* An example given by the FCC of “basic” protocol processing refers to “conversions taking place solely within the carrier’s network to facilitate provision of a basic network service, that results in no net conversion to the end-user. *Id.* According to the FCC, these “no net” protocol conversions are used for

the management, control, or operation of a telecommunications system or the management of a telecommunications service, and constitute telecommunications services. *Id.* Conversely, protocol processing that does result in net protocol conversion to the end user, that enables an end-user to send information into a network in one protocol and have it exit the network in a different protocol, would be considered information or enhanced service. *Id.*, ¶¶ 104-106.

With this background, it is reasonable to conclude that the “for purposes of transmission” language contained in the definition of “telecommunications service” was intended to prevent telecommunications services from escaping taxation by claiming they were converting protocols when all they were doing was converting protocols as part of the internal operations of their networks. In this case, however, it is clear that Sprint’s end-users experienced net protocol conversion by sending information into the network in asynchronous protocol and having it exit the network in X.25 protocol. This was a primary attraction of Sprint’s service, since it was necessary for remote dial access to host computers. Therefore, Sprint’s service performed protocol processing primarily for purposes other than transmission, conveyance or routing, and its service was “value-added nonvoice data service.”

DOR argues that allowing an enhanced service provider with only a “small amount” of protocol conversion to escape classification as “network telephone service” would ignore the intent that competing telecommunications services be taxed the same. Resp. Br. at 48. This argument fails for three reasons. First, protocol conversion is an integral part of Sprint’s enhanced network, not a “small” feature. Corr. Op. Br. at 20. Second, if a service is enhanced, it is not in competition with basic service because only a basic service is considered telecommunications service. In addition, basic service is used as an input by enhanced services rather than an output. For example, Sprint purchased telecommunications circuits from telephone companies in order to provide its enhanced service. Stip. Facts. ¶ 26, CP 315. Third, once it is determined that a service is an enhanced service, it cannot be split up into an enhanced piece and a basic piece. This was pointed out in *Community Telecable*, when the Supreme Court chided the Court of Appeals for relying upon DOR’s Excise Tax Advisory - the same ETA 2029.04.245 (2006) DOR cites here for the proposition that internet service can have a network telephone service element - because the ETA was “in error.” “The ETA reasoning is predicated on the assumption that the taxpayer at issue provides network telephone service, *not* Internet service.” *Community Telecable*, 164 Wn.2d at 44, n. 2; see Resp. Br., at 18, CP 348. It follows that since Sprint’s

service is enhanced, none of the transmission components can be construed as “network telephone service.”

D. DOR’s artificial distinction between “information service” and “network telephone service” obscures the proper classification of Sprint’s enhanced services.

DOR argues the definition of “network telephone service” broadly encompasses *all* services that transmit information electronically, excepting only those services expressly excluded² or purchased for a different purpose than transmission, namely electronically transmitted “information services” purchased for their “substance,” “information,” “actual data” and “content.” Resp. Br. at 9, 14-17. DOR’s established policy is to treat enhanced services such as Sprint’s as “network telephone service” because they furnish a medium for transmission of information for hire, rather than information content.³ Resp. Br. at 15-16.

This approach is simplistic and ignores the difficulty of categorizing services which involve transmission, but not only transmission. To support this approach, DOR has to gloss over or “spin” the legislative history.

² Television and radio broadcasters along with cable television providers were expressly excluded from the definition of “network telephone service.” RCW 82.04.065 (1983) Resp. Br. at 15.

³ DOR contends Sprint’s argument is that its enhanced network services were “information” services under RCW 82.04.297. Resp. Br. at 24, citing Opening Br. at 22-24. Sprint’s argument is that its service was either “internet service”, i.e., internet access service, or it was not specifically described by statute but sufficiently like internet access service to be properly placed in the same general service classification.

Internet access is a good example. When internet access service emerged in the mid-1990's, the issue was raised whether it too should be taxed as a "network telephone service" - or as a business service - since it required the use of telecommunications facilities. House Bill Report, 1997 SSB 5763, CP 422. The City of Tacoma had attempted to tax internet access service as "network telephone service." *Id.* at 4, CP 424.

In response to these concerns, the Legislature clarified during 1997 that "internet service" was not "network telephone service." SSB 5763 Laws 1997, ch. 304, § 5, Resp. Br. at A-46. "Internet service" was classified as a "selected business service," with the proviso that it would default to the general service classification if the former classification was repealed, as happened a year later. EHB 1821, Laws of 1997, ch. 7, § 5, eff. July 1, 1998; *see* Final Bill Report, 1997 EHB 1821, CP 418-419.

1. Internet access service and online service are two different types of "internet service."

"Internet service" was defined to include services permitting users to interact with stored information through two different types of networks, the "internet" and "proprietary subscriber network[s]." SSB 5763, Laws 1997, ch. 304, § 4. Internet service using the internet is generally referred to as "internet access service" and is the type of internet service commonly associated with cable television companies, local

telephone companies and others. Internet service using a proprietary subscriber network is generally referred to as “online service” and is commonly associated with companies like America Online (AOL) and Microsoft Network (MSN), some of whom also offer internet access service. *See* House Bill Report, SSB 5763, Resp. Br. A-37. The Legislature excluded both types of “internet service” - internet access service and online service - from the definition of “network telephone service.” Resp. Br. A-37.

Online services typically charge their users for access to information content. Internet access services, on the other hand, do not typically charge their users for information content:

Some information on the Internet is available at no charge, while other information is available only if the user pays a subscription or use fee.

Id. Thus, it is simply not true that that there is a clear distinction between transmission and information.

There is no meaningful difference between the charging models for Sprint’s enhanced service and Internet access service. In each case, someone pays for the interactive connection, and the host may or may not charge the user for the information retrieved.

2. The 1997 Legislation did not “ratify” a distinction between internet services and information services.

DOR notes that in 1997 the Legislature “expressly ratified” DOR’s prior treatment of internet and information service providers, and indeed DOR did have an established record of treating online services such as America Online and CompuServe as “information services.” Resp. Br. at 17.⁴ DOR traces its prior treatment of online services as “information service” to its 1985 Rule 155 (WAC 458-20-155), and to the Legislature’s 1993 enactment of RCW 82.04.055(1)(c). Laws 1993, Ex. Sess., ch. 25, § 201. Resp. Br. at 15-16. This treatment of online services predated internet access service, which did not emerge in its current form until 1994.⁵ It also predates the 1997 legislation combining the two types of service into the definition of “internet service.”

The Legislature could not ratify DOR’s prior treatment of internet access service, however, because DOR had no policy or history with regard to the internet. In contrast to its long standing treatment of online services as “information service,” DOR had no “prior treatment” of internet access service. It was a new service, barely two years old, when the Legislature became concerned that it might be subject to sales tax as “network telephone service.” DOR contends the Legislature ratified its

⁵ Resp. Br. at 15, n 9, CP 1264.

“prior treatment” of internet access service as “information service,” but there is no evidence DOR treated it as “information service” prior to being instructed to do so by the Legislature in 1997.

3. Including internet access service in the selected business service classification did not render it a true information service.

DOR speculates that, by including “internet service” within the definition of “information service” in former RCW 82.04.055 (1993), the Legislature in 1997 further demonstrated that “internet service” is an information service and not a transmission service. Resp. Br. at 18.

Like the supposed legislative ratification of DOR’s “prior treatment,” there is an alternative explanation for the Legislature’s inclusion of internet access service, and even online service, in the definition of “information service.” The alternative explanation is that the Legislature did not want sales tax to apply to either type of service, but it did want to subject both of them to the higher B & O tax rate imposed on other computer-related services, and that is why it dropped them into the “information services” bucket; strictly to bring them within the higher tax rate of selected business service. This alternative explanation lines up well with the admitted fact that the purpose of the 1993 legislation was to enhance state revenues. *See* Corr. Op. Br. at 23;. Resp. Br. at 16. “Internet service” was included in the definition of “information service”

for only a short period of time, from May 9, 1997 until July 1, 1998, which further suggests it was included only as temporary revenue enhancement measure. SSB 5763 Laws 1997, ch. 304; ESSB 1821, Laws of 1997, ch. 7, § 5.

4. The early legislative history cited by DOR is not relevant.

DOR argues circuitously that the history of RCW 82.04.065 confirms that the definition of “network telephone service” was broadly worded to cover both regulated and unregulated “network telephone service.” Resp. Br., at 11-14. DOR cites the description of Telenet’s electronic mail service and high speed electronic switching packages, contained in testimony by a General Telephone Company of the Northwest (GTE) representative, as if it were proof the Legislature intended to tax enhanced services in 1981. Resp. Br. at 13. However, DOR has never contended that electronic mail service was intended to be classified as network telephone service, and the phrase “electronic switching package” is neither a sufficient description of Sprint’s service nor inconsistent with generic telephone service. The testimony does not state that the electronic switching package is a value-added or enhanced service - terms that were in common usage by 1981 - and the Legislature did not specifically tax value-added or enhanced services. The

Legislature’s subsequent but retroactive clarifications that “internet service” and “value-added nonvoice data services” were never included within the meaning of network telephone service confirm they were not contemplated as within the meaning of network telephone service in 1981. SSB 5763, Laws 1997, ch. 304, § 5 (internet service is not network telephone service); SSB 5089, Laws 2007, ch. 6, § 1004 (value-added nonvoice data service is not telecommunications service); *see also* Final Bill Report, SSB 5089, Laws 2007, ch. 6, CP 282 (changes in terminology do not affect current law).

E. Private line service and frame relay service are excluded from the definition of “network telephone service.”

DOR states that private line service is included in the catchall provision of former RCW 82.04.065(2), which only taxes transmissions “via...toll line or channel, cable, microwave, or similar communication or transmission system.” The word “toll” is key, because to be included in the definition, the non-local service must be via a toll system. The word “toll” refers to standard long distance service, not private lines. *See* Corr. Op. Br. at 38-42.

Similarly with respect to DOR’s argument that service does not need to be public to be “network telephone service,” “network telephone service *is* public telephone service, by definition, because of regulatory

policy that all telephone services but private lines be part of an interconnected system so that every phone can reach every other phone on the public system.

Finally, DOR's argument that a 1981 fiscal note from a telephone company can change the meaning of a 1983 statute that is plainly worded to refer to public telephone service is a stretch. *See Tingey v. Haisch*, 159 Wn.2d 652, 657, 152 P.3d 1020 (2007).

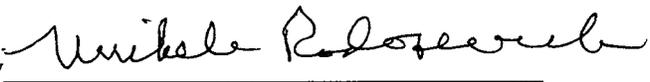
If there is doubt as to the meaning of a taxing statute, it is to be construed in favor of the taxpayer and against the taxing body. *Paccar, Inc. v. Washington Department of Revenue*, 85 Wn.App.48, 930 P.2d 954 (1997) (citations omitted). Pro-taxpayer construction of tax statutes protects citizens "by informing [them] in unambiguous terms as to the amount and nature of [their] duty to pay taxes. Singer, *Sutherland Stat. Const.* § 66.1. Strict construction is also desirable as a way to secure equality and uniformity in the imposition of tax burdens. *Id.* (citing, among other authority, *State v. Lawton*, 25 Wn.2d 750, 172 P.2d 465 (1946); Blum, *State and Local Taxing Authorities Taking More Than Their Fair Share of the Electronic Information Age*, 14 J. MARSHALL J. COMPUTER & INFO. L. 493 (1996).

III. Conclusion

For the reasons set forth above, Sprint requests this court reverse the trial court and order that summary judgment be denied to DOR and granted to Sprint.

DATED this 16th day of March, 2009.

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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 March 16, 2009, I caused a copy of this Reply Brief of Appellant to be served via e-mail and United States first class mail on the following counsel for Respondent:

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