

79909-1

Court of Appeals No. 58154-6-I
King County Superior Court Case No. 05-2-33667-6 SEA

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

QWEST CORPORATION,

Plaintiff/Respondent,

vs.

CITY OF BELLEVUE,

Defendant/Appellant.

**RESPONDENT QWEST CORPORATION'S SUPPLEMENTAL BRIEF
ADDRESSING *COMMUNITY TELECABLE V. CITY OF SEATTLE***

FILED
COURT OF APPEALS DIV. #1
STATE OF WASHINGTON
2007 FEB 20 PM 4:27

David M. Jacobson, WSBA No. 30125
John B. Schochet, WSBA No. 35869
DORSEY & WHITNEY LLP
1420 Fifth Avenue, Suite 3400
Seattle, Washington 98101
Phone: (206) 903-8800
Fax: (206) 903-8820

*Attorneys for Respondent
Qwest Corporation*

ORIGINAL

TABLE OF CONTENTS

I. INTRODUCTION..... 1

II. BACKGROUND.....2

III. ARGUMENT.....4

A. RCW 35A.82.060(1) and RCW 35.21.714(1) prohibit cities from taxing any charges for interstate services or for access to interstate services, not just charges “which represents charges to another telecommunications company.” 4

1. Read alone, the plain language of the statute prohibits cities from taxing any charges for interstate services or for access to interstate services..... 4

2. The legislative history of both RCW 35A.82.060(1) and RCW 35.21.714(1) clearly demonstrate that the statutes are and always have been intended to prohibit cities from taxing any charges for interstate service..... 5

B. The Court is not bound by the prior panel’s statement regarding the statute in *Community Telecable*. 9

IV. CONCLUSION 12

TABLE OF AUTHORITIES

STATE CASES

<i>Cosmopolitan Engineering Group, Inc. v. Ondeo Degremont, Inc.</i> , __ Wn.2d __, 149 P.3d 666 (2006)	5
<i>Community Telecable of Seattle, Inc. v. City of Seattle</i> , __ Wn. App. __, 149 P.3d 380 (Dec. 11, 2006)	<i>passim</i>
<i>Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles</i> , 148 Wn.2d 224, 59 P.3d 655 (2002).....	8
<i>John Doe v. Puget Sound Blood Ctr.</i> , 117 Wn.2d 772, 819 P.2d 370 (1991).....	10
<i>Marriage of Roth</i> , 72 Wn. App. 566, 865 P.2d 43 (1994).....	9
<i>Pacific Northwest Transport Services, Inc. v. Utilities and Transport Com'n</i> , 91 Wn. App. 589, 959 P.2d 160 (1998)	9
<i>Plankel v. Plankel</i> , 68 Wn. App. 89, 841 P.2d 1309 (1992)	9
<i>Rozner v. City of Bellevue</i> , 116 Wn.2d 342, 804 P.3d 582 (2000).....	6
<i>State v. Pawlyk</i> , 115 Wn.2d 457, 800 P.2d 338 (1990).....	9
<i>Strain v. West Travel, Inc.</i> , 117 Wn. App. 251, 70 P.3d 158 (2003).....	6
<i>Touchet Valley Grain Growers, Inc. v. Opp & Seibold General Const., Inc.</i> , 119 Wn.2d 334, 831 P.2d 724 (1992).....	10

STATUTES

RCW 35.21.714	<i>passim</i>
RCW 35.21.714(1)	<i>passim</i>
RCW 35A.82.060(1).....	<i>passim</i>

LEGISLATIVE HISTORY

1983 Wash. Laws, 2nd Ex. Sess., Ch. 3, § 37 6
Final Bill Report, *As Passed Legislature*, S.H.B. 1892 (1986) 8
House Bill Report, E.S.H.B. 1892 (1986) 8
House Bill Report, H.B. 1892 (1986)..... 8
Senate Bill Report, E.S.H.B. 1892 (1986)..... 8

OTHER

Laws of 1981, Ch. 144, § 10..... 6

I. INTRODUCTION

In *Community Telecable of Seattle, Inc. v. City of Seattle*, ___ Wn. App. ___, 149 P.3d 380 (Dec. 11, 2006), a panel of this Court addressed whether Seattle was permitted to apply its telephone utility tax to Comcast's¹ "internet transmission activities." *Id.* at 381. In rendering its opinion on this question, the panel stated that RCW 35.21.714(1) does not prohibit municipalities from taxing charges for interstate telecommunications services. In a letter to this Court, Appellant the City of Bellevue (the "City" or "Bellevue") apparently takes the position that *Community Telecable* precludes Respondent Qwest Corporation ("Qwest") from arguing in this appeal that RCW 35A.82.060(1) prohibits cities from taxing "charges for access to interstate service and charges for interstate service."² Bellevue Letter (Jan. 4, 2007). Because it disagrees, Qwest requested leave to file this supplemental brief. For the reasons set forth below, Qwest contends that RCW 35A.82.060(1) plainly prohibits taxation of charges for interstate services or for access to interstate

¹ The named plaintiffs in that case are Community Telecable of Seattle, Inc., Comcast of Washington I, Inc., and Comcast of Washington IV, Inc., collectively referred to as "Comcast."

² Bellevue's position is premised on the fact that the language of RCW 35A.82.060(1), the statute at issue in this appeal, is identical to the language of RCW 35.21.714(1), except for the word "code" before "city." In addition, the two statutes share identical legislative history.

services. To the extent it states to the contrary, *Community Telecable* is erroneous and is not binding on this Court.

II. BACKGROUND

In *Community Telecable*, “Comcast sued the City for a refund of the tax, arguing that the tax is illegal under Washington’s Internet Tax Moratorium and the federal Internet Tax Freedom Act.” *Community Telecable*, 149 P.3d at 381. The trial court ruled in favor of Comcast, but a panel of this Court reversed, identifying three bases for its holding: “(1) The tax is not barred by the Washington Internet Tax Moratorium; (2) The tax is exempt from the federal Internet Tax Freedom Act’s moratorium on taxes on Internet access under a grandfather clause; and (3) The tax is not discriminatory under the federal Internet Tax Freedom Act.” *Id.* The panel ***did not*** identify its remarks about RCW 35.21.714(1) as a basis for its holding. *See id.*

The panel’s failure to identify its statement about RCW 35.21.714 as a basis for its holding is not surprising because that issue was not before the panel. Neither Comcast nor Seattle assigned the issue as error or listed it among the issues on appeal. Nor did either party discuss RCW 35.21.714 in its appellate briefs. The only mention of the statute in the parties’ briefing was in a footnote in Comcast’s answering brief. In the footnote, Comcast did not interpret the statute. It simply noted that the

parties did not dispute that the statute prohibited taxation of interstate services. See Brief of Respondents at 15 n.2, *Community Telecable* (Wash. App., No. 57491-4-I). Seattle did not respond to the footnote in its reply brief.

Nonetheless, in its opinion the panel responded to Comcast's footnote. Unaided by briefing or analysis of the legislative history of the statute, the panel rejected Comcast's uncontested footnote about RCW 35.21.714, stating the "statute merely precludes the City from taxing the portion of network telephone service that represents *charges* to another telecommunications company for access to interstate services." *Community Telecable*, 149 P.3d at 386 (emphasis in original).

Qwest recognizes the substantial deference and respect this panel owes to the panel's decision in *Community Telecable*. Qwest respectfully submits, nonetheless, that the discussion of RCW 35.21.714 in *Community Telecable* should be disregarded because: (1) the panel's interpretation of RCW 35.21.714(1) is manifestly erroneous; (2) the interpretation is not identified as a holding in the case, and (3) the interpretation responds to an issue that was not properly before the Court.

III. ARGUMENT

A. **RCW 35A.82.060(1) and RCW 35.21.714(1) prohibit cities from taxing any charges for interstate services or for access to interstate services, not just charges “which represents charges to another telecommunications company.”**

1. **Read alone, the plain language of the statute prohibits cities from taxing any charges for interstate services or for access to interstate services.**

The language of RCW 35A.82.060(1) is plain: The Legislature has specifically prohibited cities from applying utility license taxes (or any other taxes) to charges for interstate telephone services or charges for access to interstate services. The structure of the statute makes this clear. The statute first grants cities the power to tax certain types of telephone business revenues. The initial affirmative grant is followed by a series of exceptions identifying what types of revenues cities may not tax:

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

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

The only taxing power the statute affirmatively grants to cities is the power to tax “the total gross revenue derived from intrastate toll telephone services.” *Id.* (emphasis added). This limited grant of taxing authority on its own should prohibit taxation of interstate services or access to interstate services. But the statute also specifically prohibits cities from taxing “that portion of network telephone service which represents . . . access to, or charges for, interstate service” *Id.* The fact that the statute lists several additional types of services on which cities are not permitted to impose taxes or fees does not change the fact that “access to, or charges for, interstate services” is an explicit, independent item on that list of exceptions to what cities can tax.

2. **The legislative history of both RCW 35A.82.060(1) and RCW 35.21.714(1) clearly demonstrate that the statutes are and always have been intended to prohibit cities from taxing any charges for interstate service.**

Qwest thus believes that RCW 35A.82.060(1) unambiguously prohibits cities from taxing revenue derived from access to interstate services or interstate services. In view of the prior panel’s treatment of the statutory language in *Community Telecable*, however, the Court here may consider the statutory language ambiguous. If so, it is appropriate to consider the statute’s legislative history. *See Cosmopolitan Engineering*

Group, Inc. v. Ondeo Degremont, Inc., ___ Wn.2d ___, 149 P.3d 666, 670, (2006).³ The legislative history provides indisputable confirmation of Qwest’s interpretation.⁴

The legislative history of RCW 35A.82.060(1)⁵ reveals that the Legislature added each of the exceptions in the statute separately, as stand alone exceptions. As discussed in Qwest’s Answering Brief, the original statute, put in place in 1981, allowed a “fee or tax” on “one hundred percent of the total gross revenue derived from toll telephone services subject to the fee or tax.” Laws of 1981, Ch. 144, § 10. The 1981 version of the statute did not distinguish between intrastate and interstate services. In 1983, the Legislature amended the statute to prohibit cities from taxing revenues derived from access to interstate services or interstate services. Specifically, the amendment made two changes: First, it added the limiting word “intrastate” to the affirmative grant of taxing powers to cities. 1983 Wash. Laws, 2nd Ex. Sess., Ch. 3, § 37. Second, it added the exceptions to the tax power, prohibiting cities from taxing “that portion of

³ “A statute is ambiguous when, either on its face or as applied to particular facts, it is fairly susceptible to different, reasonable interpretation.” *Strain v. West Travel, Inc.*, 117 Wn. App. 251, 254, 70 P.3d 158 (2003) (citing *Rozner v. City of Bellevue*, 116 Wn.2d 342, 347, 804 P.3d 582 (2000)).

⁴ Significantly, there is no indication in the *Community Telecable* opinion that the panel conducted a review of or considered in any way the legislative history of the statute when it prepared its opinion.

⁵ As noted above, the legislative history of RCW 35.21.714(1) is identical to that of RCW 35A.82.060(1).

network telephone service . . . , which represents access to, or charges for, interstate services for which rates are contained in tariffs filed with the Federal Communications Commission.” *Id.* The Legislature subsequently added other exceptions to cities’ taxing power, but it never removed this prohibition on taxing charges from access to interstate services or interstate services.

In 1986 the Legislature added the language the prior panel focused on, prohibiting cities from taxing charges to another telecommunications company. The legislative history makes absolutely clear, however, that this was a separate exception to the affirmative grant of taxing power, and was not intended by the Legislature to limit or affect in any way the prior statutory language that prohibits cities from taxing charges for “access to, or charges for, interstate services”. By adding the 1986 exception regarding “charges to another telecommunications company” and leaving in the 1983 exception for “access to, or charges for, interstate services,” the Legislature cannot have intended to eliminate the latter exception. If the Legislature had wanted to eliminate or limit the exception for access to interstate services and interstate services, it would have done so explicitly, either in express language or by removing it from the statute altogether.

However, could there be any doubt about the Legislature’s intention, it is put to rest by remarks in the bill reports for the 1986

amendment. The Legislative intent to retain the exception is explicitly noted in each of the relevant legislative reports. These reports repeatedly state that “[i]nterstate services continue to be exempt from taxation by cities.” Final Bill Report, *As Passed Legislature*, S.H.B. 1892 (1986); *accord* Senate Bill Report, E.S.H.B. 1892 (1986); House Bill Report, E.S.H.B. 1892 (1986); House Bill Report, H.B. 1892 (1986) (copies attached).⁶

“In interpreting a statute, the primary objective of the court is to ascertain and carry out the intent and purpose of the Legislature in creating it.” *Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles*, 148 Wn.2d 224, 59 P.3d 655 (2002) (internal citation omitted). In view of the legislative history in general, and the 1986 bill reports in particular, the intent of the Legislature is crystal clear—the Legislature wanted to ensure that “[i]nterstate services continue to be exempt from taxation by cities.” Final Bill Report, *As Passed Legislature*, S.H.B. 1892 (1986). The 1986 amendment cannot be construed as allowing cities to tax revenue derived from access to interstate services or interstate services. The language in the *Community Telecable* opinion that takes the contrary view is erroneous.

⁶ In 1989 and then again in 2002, the Legislature passed further amendments to the statute, adding two additional exceptions. Neither the City nor the *Community Telecable* panel have read the 1989 or 2002 amendments to have any effect on the pertinent part of the statute.

B. The Court is not bound by the prior panel's statement regarding the statute in *Community Telecable*.

The Court may disregard the *Community Telecable* panel's discussion of RCW 35.21.714(1) on the grounds that it is *dicta*. *Dicta* is language not necessary to a decision, and it is not binding. See, e.g., *Pacific Northwest Transp. Services, Inc. v. Utilities and Transp. Com'n*, 91 Wn. App. 589, 599 n.14, 959 P.2d 160 (1998) (citing *State v. Pawlyk*, 115 Wn.2d 457, 487, 800 P.2d 338 (1990); *Marriage of Roth*, 72 Wn. App. 566, 570, 865 P.2d 43 (1994); *Plankel v. Plankel*, 68 Wn. App. 89, 92, 841 P.2d 1309 (1992)). Here, *Community Telecable* identified three specific reasons for reversing the trial court: "(1) The tax is not barred by the Washington Internet Tax Moratorium; (2) The tax is exempt from the federal Internet Tax Freedom Act's moratorium on taxes on Internet access under a grandfather clause; and (3) The tax is not discriminatory under the federal Internet Tax Freedom Act." *Community Telecable*, 149 P.3d at 381. The discussion of RCW 35.21.714(1) is not one of the bases of the Court's holding and is thus *dicta*, which is not binding on this panel.

Furthermore, in *Community Telecable* the application of RCW 35.21.714(1) was not properly before the Court. The only mention of the

statute was in a footnote in Comcast's brief.⁷ Neither party briefed the meaning of the statute because the parties did not dispute its meaning. The parties had no reason to analyze the statutory language and they did not. For the same reason, the parties did not address the legislative history of the statute. A review of the oral argument before this Court also reveals no discussion of the statute. Seattle completely disregarded Comcast's footnote, presumably because it agreed with Comcast's statement of the meaning of the statute.⁸

Under these circumstances, this Court should not have addressed the issue. The Supreme Court has held that Washington courts "should not engage in the resolution of issues which arise, but are not briefed by the parties." *Touchet Valley Grain Growers, Inc. v. Opp & Seibold General Const., Inc.*, 119 Wn.2d 334, 352, 831 P.2d 724 (1992) (citing *John Doe v. Puget Sound Blood Ctr.*, 117 Wn.2d 772, 785, 819 P.2d 370 (1991)). Attempting to resolve "issues present, but not briefed" is necessarily "conjectural" because courts do not have the full benefit of argument by both parties. *Puget Sound Blood Ctr.*, 117 Wn.2d at 785. It is not reasonable to expect a court to consider both sides of an argument

⁷ Copies of Comcast's answering brief and Seattle's reply brief are attached for the Court's convenience.

⁸ The same is true in this case. Before the *Community Telecable* decision, Bellevue agreed that RCW 35A.82.060(1) prohibits taxation of charges for access to interstate service or interstate services. See Appellant's Brief at 23.

and reach a considered result if the parties do not brief it and present the court with a full array of legal and analytical argument for each party's position. Here, the statutory interpretation of RCW 35.21.714 was not before this Court in *Community Telecable* and should not have been addressed.

It warrants mention that Seattle agrees with this position. In its answer to Comcast's recent petition for Supreme Court review of *Community Telecable*, Seattle itself took the position that the scope of RCW 35.21.714(1) was not properly before this Court.⁹ The city argued that the Supreme Court should not grant review on the grounds that "Comcast did not properly raise this issue and failed to cite any legal authority to support its argument." Answer to Petition for Review at 19, *Community Telecable*. The city also noted that Comcast did not raise the issue in its complaint, nor was the issue raised anywhere outside of the one footnote discussed above. *See id.*

Qwest has demonstrated that the legislative history shows RCW 35.21.714(1) and RCW 35A.82.060(1) prohibit taxation of charges for access to interstate services or interstate services. The *Community Telecable* panel issued its contrary opinion without the full benefit of the

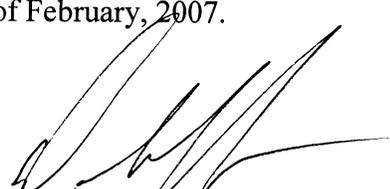
⁹ A copy of Seattle's answer to the petition for review is attached for the Court's convenience. Comcast's petition for review is Supreme Court Case No. 79702-1.

arguments Qwest has presented to this Court in this case and, indeed, without the benefit of any briefing or analysis by the parties. This presents a textbook example of why issues not properly before a court and not briefed by the parties should not be addressed. The Court here is entitled to disregard the decision.

IV. CONCLUSION

RCW 35A.82.060(1) plainly prohibits cities from taxing “that portion of network telephone service which represents . . . access to, or charges for, interstate service . . .” Qwest respectfully submits that the Court can disregard the erroneous discussion in *Community Telecable* and hold that the City may not tax charges for access to interstate service or for interstate services.

DATED this 20^I day of February, 2007.



David M. Jacobson, WSBA No. 30125
John B. Schochet, WSBA No. 35869
U.S. Bank Building Centre
1420 Fifth Avenue, Suite 3400
Seattle, Washington 98101
Phone: (206) 903-8800
Facsimile: (206) 903-8820

Attorneys for Respondent Qwest Corporation

CERTIFICATE OF SERVICE

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

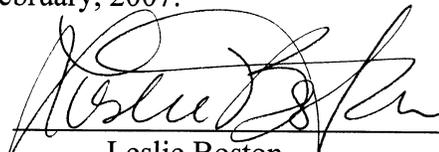
Kenneth A. Brunetti
Miller & Van Eaton
400 Montgomery Street, Suite 501
San Francisco, CA 94104
kbrunetti@millervaneaton.com
415-447-3652 fax

By Email and Regular US Mail

Cheryl A. Zakrzewski
Assistant City Attorney
City of Bellevue
450-110th Avenue NE
P. O. Box 90012
Bellevue, WA 98009
czakrzewski@ci.bellevue.wa.us
425-452-7256 fax

By Email and Regular US Mail

Dated this 20th day of February, 2007.



Leslie Boston

FILED
COURT OF APPEALS DIV. #1
STATE OF WASHINGTON
2007 FEB 20 PM 4: 27

FILED
COURT OF APPEALS DIV #1
STATE OF WASHINGTON
2007 FEB 22 AM 9:05

ATTACHMENT A

Appropriation: _____
Revenue: _____
Fiscal Note: _____

FINAL BILL REPORT

SHB 1892

BY House Committee on Energy & Utilities (originally sponsored by
Representatives Locke and Vander Stoep)

Limiting the taxation of telecommunications services by cities.

House Committee on Energy & Utilities

Senate Committee on Energy & Utilities

AS PASSED LEGISLATURE

BACKGROUND:

Cities may tax telecommunications companies for intrastate service. This has been and would continue to be the case if this bill is enacted. At issue - a new problem since the AT&T divestiture - is the matter of carrier access charges and any other charges unique to interconnecting the local telecommunications companies with long distance carriers. These charges are subjected twice to a utility tax by cities, once in the earnings of the long distance carrier and, again, in the earnings of the local telecommunications company.

SUMMARY:

Interstate services continue to be exempt from taxation by cities. Receipts by a local telecommunications company from a long distance telecommunications company for connecting fees, switching charges, or carrier access charges relating to intrastate toll services are not subject to utility tax, but are subject to the Business and Occupation (B&O) tax. To limit adverse fiscal impact on cities, the change is delayed until January 1, 1987. Also, the existing law which ramps down telephone utility taxes to six percent over several years is delayed one year. Additionally cities, for which the preceding provisions do not offset the revenue reduction, may reimpose for 1987 the rates that were in effect on telephone business during 1985.

The Joint Select Committee on Telecommunications will study the degree to which cities realize taxes from all intrastate long distance telephone calls, means to assure all valid taxes are collected, and if state agencies can assist cities in identifying providers of long distance services subject to taxation. The committee will report results to the legislature January 1, 1987.

VOTES ON FINAL PASSAGE:

House	87	5
Senate	47	0

ATTACHMENT B

SENATE BILL REPORT

ESHB 1892

BY House Committee on Energy & Utilities (originally sponsored by Representatives Locke and Vander Stoep)

Limiting the taxation of telecommunications services by cities.

House Committee on Energy & Utilities

Senate Committee on Energy & Utilities

Senate Hearing Date(s): February 19, 1986; February 24, 1986

Majority Report: Do pass.

Signed by Senators Williams, Chairman; McManus, Vice Chairman; Bailey, Benitz, Kreidler, McCaslin.

Senate Staff: Deborah Senn (786-7450)
February 24, 1986

AS REPORTED BY COMMITTEE ON ENERGY & UTILITIES, FEBRUARY 24, 1986

BACKGROUND:

Cities may tax telephone companies for intrastate service. This has been and would continue to be the case if this bill is enacted. At issue - a new problem since the AT&T divestiture - is the matter of carrier access charges and any other charges unique to interconnecting the local telephone companies with long distance carriers. These charges are subjected twice to a utility tax by cities, once in the earnings of the long distance carrier and, again, in the earnings of the local telephone company.

SUMMARY:

Interstate services continue to be exempt from taxation by cities. Receipts by a local telephone company from a long distance telecommunications company for connecting fees, switching charges, or carrier access charges relating to intrastate toll services are not subject to utility tax, but are subject to the Business and Occupation (B&O) tax. To limit adverse fiscal impact on cities, the change is delayed until January 1, 1987. Also, the existing law which ramps down telephone utility taxes to six percent over several years is delayed one year. Additionally, cities, for which the preceding provisions do not offset the revenue reduction, may reimpose for 1987 the rates that were in effect on telephone business during 1985.

The Joint Select Committee on Telecommunications will study the degree to which cities realize taxes from all intrastate long distance telephone calls, means to assure all valid taxes are collected, and if state agencies can assist cities in identifying providers of long distance services subject to taxation. The committee will report results to the legislature January 1, 1987.

Fiscal Note: available

Senate Committee - Testified: Dick Smythe, Pacific Northwest Bell; Stan Finkelstein, Association of Washington Cities; Mike Woodin, AT&T

ATTACHMENT C

Appropriation: _____
Revenue:
Fiscal Note: "I" Attached

HOUSE BILL REPORT

ESHB 1892

BY House Committee on Energy & Utilities (originally sponsored by Representatives Locke and Vander Stoep)

Limiting the taxation of telecommunications services by cities.

House Committee on Energy & Utilities

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. (14)

Signed by Representatives D. Nelson, Chair; Todd, Vice Chair; Armstrong, Barnes, Gallagher, Isaacson, Jacobsen, Long, Madsen, Miller, Nealey, Sutherland, Unsoeld and Van Luven.

House Staff: Fred Adair (786-7113) and Deborah Senn (786-7198)

AS PASSED HOUSE FEBRUARY 15, 1986

BACKGROUND:

Cities may tax telephone companies for intrastate service. This has been and would continue to be the case if this bill is enacted. At issue - a new problem since the AT&T divestiture - is the matter of carrier access charges and any other charges unique to interconnecting the local telephone companies with long distance carriers. These charges are subjected twice to a utility tax by cities, once in the earnings of the long distance carrier and, again, in the earnings of the local telephone company.

SUMMARY:

Interstate services continue to be exempt from taxation by cities. Receipts by a local telephone company from a long distance telecommunications company for connecting fees, switching charges, or carrier access charges relating to intrastate toll services are not subject to utility tax, but are subject to the Business and Occupation (B&O) tax. To limit adverse fiscal impact on cities, the change is delayed until January 1, 1987. Also, the existing law which ramps down telephone utility taxes to six percent over several years is delayed one year. Additionally, cities, for which the preceding provisions do not offset the revenue reduction, may reimpose for 1987 the rates that were in effect on telephone business during 1985.

The Joint Select Committee on Telecommunications will study the degree to which cities realize taxes from all intrastate long

distance telephone calls, means to assure all valid taxes are collected, and if state agencies can assist cities in identifying providers of long distance services subject to taxation. The committee will report results to the legislature January 1, 1987.

Fiscal Note: Attached.

House Committee - Testified For Original Measure in Committee: Mike Woodin and Jerry Lynch, American Telephone and Telegraph; and Dick Smythe and Bob Geppert, Pacific Northwest Bell.

House Committee - Testified Against Original Measure in Committee: Richard Newman, City of Tacoma (opposed to original bill - substitute acceptable); and Stan Finkelstein, Association of Washington Cities (did not speak in opposition - testified only on substitute, which he had helped to develop).

House Committee - Testimony For: The levying of utility tax twice on access charges raises telephone charges unfairly and excessively.

House Committee - Testimony Against: The bill was submitted late and fiscal impacts are uncertain. (Subsequent to this testimony, all testifiers cooperated in developing the mutually acceptable substitute).

ATTACHMENT D

Appropriation: _____
Revenue: _____
Fiscal Note: - Attached.

HOUSE BILL REPORT

HB 1892

BY Representatives Locke and Vander Stoep

Limiting the taxation of telecommunications services by cities.

House Committee on Energy & Utilities

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. (14)

Signed by Representatives D. Nelson, Chair; Todd, Vice Chair; Armstrong, Barnes, Gallagher, Isaacson, Jacobsen, Long, Madsen, Miller, Nealey, Sutherland, Unsoeld and Van Loven.

House Staff: Fred Adair (786-7113) and Deborah Senn (786-7198)

AS REPORTED BY COMMITTEE ON ENERGY & UTILITIES FEBRUARY 7, 1986

BACKGROUND:

Cities may tax telephone companies for intrastate service. This has been and would continue to be the case if this bill is enacted. At issue - a new problem since the AT&T divestiture - is the matter of carrier access charges and any other charges unique to interconnecting the local telephone companies with long distance carriers. These charges are subjected twice to a utility tax by cities, once in the earnings of the long distance carrier and, again, in the earnings of the local telephone company.

SUMMARY:

SUBSTITUTE BILL: Interstate services continue to be exempt from taxation by cities. Receipts by a local telephone company from a long distance telecommunications company for connecting fees, switching charges, or carrier access charges relating to intrastate toll services are not subject to utility tax, but are subject to the Business and Occupation (B&O) tax. To limit adverse fiscal impact on cities, the change is delayed one year. Also, the existing law which ramps down telephone utility taxes to six percent over several years is delayed one year. The Joint Select Committee on Telecommunications will study the degree to which cities realize taxes from all intrastate long distance telephone calls, means to assure all valid taxes are collected, and if state agencies can assist cities in identifying providers of long distance services subject to taxation. The committee will report results to the legislature January 1, 1987.

SUBSTITUTE BILL COMPARED TO ORIGINAL: The original bill simply removed the utility tax on local telephone companies for access charges. The substitute added the B&O tax replacement, the delayed effective date, the ramp down delay, and the study.

Fiscal Note: Attached.

House Committee - Testified For Original Measure in Committee: Mike Woodin and Jerry Lynch, American Telephone and Telegraph; and Dick Smythe and Bob Geppert, Pacific Northwest Bell.

House Committee - Testified Against Original Measure in Committee: Richard Newman, City of Tacoma (opposed to original bill - substitute acceptable); and Stan Finkelstein, Association of Washington Cities (did not speak in opposition - testified only on substitute, which he had helped to develop).

House Committee - Testimony For: The levying of utility tax twice on access charges raises telephone charges unfairly and excessively.

House Committee - Testimony Against: The bill was submitted late and fiscal impacts are uncertain. (Subsequent to this testimony, all testifiers cooperated in developing the mutually acceptable substitute).

ATTACHMENT E

57491-4

57491-4

No. 57491-4

**DIVISION I OF THE COURT OF APPEALS
FOR THE STATE OF WASHINGTON**

Community Telecable of Seattle, Inc., Comcast of Washington I, Inc., and
Comcast of Washington IV, Inc.,

Respondents,

vs.

City of Seattle,

Appellant,

Appellant's Reply Brief

THOMAS A. CARR
Seattle City Attorney

Kent C. Meyer, WSBA #17245
Assistant City Attorney
Attorneys for Appellant
City of Seattle

Seattle City Attorney's Office
600 - 4th Avenue, 4th Floor
P.O. Box 94769
Seattle, Washington 98124-4769
(206) 684-8200

FILED
COURT OF APPEALS DIV. #1
STATE OF WASHINGTON
2006 JUN 17 AM 11:08

TABLE OF CONTENTS

	<u>Page(s)</u>
I. ARGUMENT	1
A. Comcast Is Subject To Seattle’s Telephone Utility Tax Because Comcast Engages In Telephone Business In The City.	1
B. The State Statutes Distinguish Between Internet Services And Telephone Business And Permit The City To Impose Its Utility Tax On Telephone Business Activities In The City.	2
C. The City Requires Companies That Engage In Telephone Business And That Also Provide Internet Services To Pay The Telephone Utility Tax Based On The Revenue Attributable To The Telephone Business Activities.	6
D. Comcast Did Not Provide Records Requested By The City During The Audit And Is Barred Under SMC 5.55.060 From Challenging The Assessment.	8
E. The City Is Allowed To Tax Comcast’s Transmission Activities Under The Grandfather Clause Of The Federal Internet Tax Freedom Act.	12
1. The City is authorized by the State to tax telephone business.	12
2. The City meets the requirements of the ITFA grandfather clause because it notified taxpayers of the taxes before October 1998.....	13
3. In addition to providing notice, the City generally collected its telephone utility tax and B&O tax prior to October 1998.....	16
F. The City Telephone Utility Tax Is Not Discriminatory Under The ITFA Because It Is Imposed Upon, And Legally Collectible From, Companies Engaged In Telephone Business In The City.	18
G. The City Telephone Utility Tax Does Not Tax “Internet Access” As Defined By The ITFA.	19
II. CONCLUSION	20

TABLE OF AUTHORITIES

Page(s)

CASES

American Legion Post No. 32 v. City of Walla Walla, 116 Wn.2d 1, 802 P.2d 784 (1991)..... 10

Coluccio v. King County, 82 Wn. App. 45, 917 P.2d 145 (1996) 10

Concentric Network Corp. v. Commonwealth of Pennsylvania, 897 A.2d 6, 15 (Penn. 2006)..... 14, 18, 19

Dexter Horton Building v. King County, 10 Wn.2d 186, 116 P.2d 507 (1941)..... 11

General Motors v. Seattle, 107 Wn. App. 42, 25 P.3d 1022 (2001)..... 16

Henier v. Donnan, 285 U.S. 312, 53 S.Ct. 358, 76 L.Ed. 772 (1932) 11

Lacey Nursing Home v. Dept. of Revenue, 128 Wn.2d 40, 905 P.2d 338 (1995)..... 9

Pacific Telephone and Telegraph Co. v. City of Seattle, 172 Wash. 649, 21 Pac. 721 (1933).....10

STATUTES

47 U.S.C.A. § 151 (note) § 1104(5) (2001) 19

ITFA (2001) § 1104(2) 18

ITFA (2001), § 1101 (d) 13, 16, 17

ITFA (2003) § 1105(2) 18

ITFA § 1105(5) (2003) 20

RCW 35.21.714 3, 13

RCW 35.21.717 2, 5

RCW 35.22.280(32)..... 10

RCW 35.22.570 10

RCW 35.23.440(8)..... 10

RCW 82.04.065	3, 4, 5, 12, 13
RCW 82.04.065(2).....	5
RCW 82.04.297	2, 3, 4
RCW 82.32.070(1).....	9

ORDINANCES

SMC 5.30.060	5
SMC 5.30.060C.....	1, 2, 17, 20
SMC 5.45.050G	1
SMC 5.48.020B	6
SMC 5.48.050A	1, 5, 7, 16, 17, 20
SMC 5.48.055B	6
SMC 5.48.055C	7
SMC 5.55.060.....	i, 7, 8, 9
SMC 5.55.060D	11

MISCELLANEOUS

ETA 2029.04.245, p. 2.....	4, 12, 16
Seattle Business Tax Rule 5-44-155.....	7, 14, 15, 16, 17

I. ARGUMENT

A. Comcast Is Subject To Seattle's Telephone Utility Tax Because Comcast Engages In Telephone Business In The City.

Comcast attempts to avoid the City's telephone utility tax by bundling the charges for the use of its cable transmission system with the charges for the internet service transmitted over the system. Comcast does not dispute that it operates a cable transmission system in the City. Indeed, Comcast acknowledges that it owns and operates the infrastructure involved in transmitting internet services from its customers' homes to its head end in Burien. (Comcast Brief, p. 4.) Comcast instead argues that it is not subject to the utility tax because Comcast provides internet services as well as a transmission network and charges "one all-inclusive price."

Comcast is liable for the telephone utility tax even if it bundles its services into one price. Under the City's tax code, two separate taxes apply to Comcast's in-city activities. Comcast's operation of a cable transmission system is subject to the six percent telephone utility tax under *SMC 5.48.050A*. And the providing of internet services is subject to the City's business and occupations ("B&O") service tax at a rate of .415 percent under *SMC 5.45.050G*.

The City defines "telephone business" to include the business of transmitting via a cable or similar transmission system. *SMC 5.30.060C*. The definition of "telephone business" specifically includes transmission "to

and from the site of an internet provider via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system.” SMC 5.30.060C. The undisputed facts establish that Comcast transmits data via a cable transmission system in the City. Comcast, which considers itself an internet provider, transmits to and from the site of an internet provider via its transmission system. (Comcast Brief, pp. 4-5.) These activities are covered by the definition of “telephone business” and Comcast is therefore subject to the telephone utility tax.

B. The State Statutes Distinguish Between Internet Services And Telephone Business And Permit The City To Impose Its Utility Tax On Telephone Business Activities In The City.

It is undisputed that Comcast engages in data transmission in the City. The State Internet Tax Moratorium, RCW 35.21.717, distinguishes between data transmission and internet services and permits taxation of data transmission.¹ Per the statute, the State restricted a city’s right to impose taxes on internet service only. The Moratorium applies to “internet service,” which is defined in RCW 82.04.297(3) and does not include data transmission activities:

¹RCW 35.21.717 states: Until July 1, 2006, a city or town may not impose any new taxes or fees specific to internet service providers. A city or town may tax internet service providers under generally applicable business taxes or fees, at a rate not to exceed the rate applied to a general service classification. For the purposes of this section, “internet service” has the same meaning as in RCW 82.04.297.

"Internet service" means 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. "Internet service" includes provision of internet electronic mail, access to the internet for information retrieval, and hosting of information for retrieval over the internet or the graphical subnetwork called the world wide web.

RCW 82.04.297(3). This definition does not cover the data transmission activities that are covered by the City's telephone utility tax.

Indeed, the state legislature specifically distinguishes between taxable telephone business (data transmission) and internet services. Comcast concedes that under RCW 35.21.714 the City is authorized to tax "telephone business" as defined by RCW 82.04.065. (Comcast Brief, p. 14-15.) In RCW 82.04.065, the State defines "telephone business" as the "business of providing network telephone service." The definition of "network telephone service" includes data transmission and specifically excludes "internet service":

"Network telephone service" means the providing by any person of access to a telephone network, 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 telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. "Network telephone service" includes the provision of transmission to and from the site of an internet provider via a telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. "Network

telephone service" does not include the providing of competitive telephone service, the providing of cable television service, the providing of broadcast services by radio or television stations, nor the provision of internet service as defined in RCW 82.04.297, including the reception of dial-in connection, provided at the site of the internet service provider.

RCW 82.04.065(2) (emphasis added).

The Washington Department of Revenue has acknowledged that data transmission falls within this definition of network telephone services. The Department of Revenue issued an Excise Tax Advisory on February 24, 2006 that disagrees with Comcast's argument and confirms that the 1997 amendment to RCW 82.04.065 explicitly includes data transmission used to provide customers with internet services. Excise Tax Advisory 2029.04.25 (available at <http://taxpedia.dor.wa.gov>; attached as Appendix A.) The Advisory states:

This includes services used to connect an ISP to the Internet backbone or to ISP customer locations, such as the provision of transmission capacity over dial-up connections, coaxial cables, fiber optic cables, T-1 lines, frame relay service, digital subscriber lines (DSL), wireless technologies, or other means.

Washington has traditionally taxed the sale of these network telephone services to a consumer under the retailing classification of the business and occupation (B&O) tax and required the seller to collect retail sales tax. In 1997, RCW 82.04.065 was amended to explicitly include "the provision of transmission to and from the site of an internet provider via a local telephone network, toll line or channel, cable, microwave, or similar

communication or transmission system" as taxable network telephone service.

ETA, p. 1. The Advisory confirms that the Department of Revenue concurs with the City in that network telephone services include data transmission over cable networks to internet customer locations.

The definition of network telephone services in RCW 82.04.065 is virtually the same as the City's definition of "telephone business" in SMC 5.30.060. Contrary to Comcast's argument, the definition distinguishes between internet service and data transmission. The definition includes data transmission, including "transmission to and from the site of an internet provider." In RCW 82.04.065(2) the State specifically recognized that "network telephone services" include data transmission, which are taxable and distinct from internet services. Thus, the limitation in RCW 35.21.717 on taxing internet service providers does not apply to the telephone business activity of data transmission. Comcast's data transmission services conducted in Seattle do not fall within the definition of internet services. When engaged in data transmission activities, Comcast is engaging in telephone business under SMC 5.48.050A and is subject to the City's tax on that activity.

C. The City Requires Companies That Engage In Telephone Business And That Also Provide Internet Services To Pay The Telephone

Utility Tax Based On The Revenue Attributable To The Telephone Business Activities.

Comcast argues that it should not be required to apportion its gross income between telephone business and internet services. This is an attempt to avoid the telephone utility tax by combining income from different taxable activities. The City's tax code prevents this by defining "gross income" as "the value proceeding or accruing from the sale of tangible property or service" and includes receipts "however designated." SMC 5.48.020B. Under this definition, a company cannot evade taxes by designating its revenue in a particular way on its books or in its customer bills. The utility tax is based on income "however designated." SMC 5.48.020B. Comcast cannot avoid the telephone utility tax by charging one price for the transmission services and internet services.

Under the Seattle Municipal Code, if a taxpayer engages in an activity covered by the utility tax and another activity covered by the B&O tax, the City taxes each activity separately. (CP 43-45.) This is true for companies covered by the telephone utility tax as well as companies covered by other utility taxes such as the solid waste utility tax. For example, under SMC 5.48.055B, a company engaged in the collection of solid waste is subject to a tax of 11.5% of the gross income from collecting solid waste. But the solid waste company also must pay the

lower B&O tax under SMC ch. 5.45 for other activities such as selling or renting waste containers, collecting recyclable waste, and collecting bulky items. SMC 5.48.055C. According to Comcast's argument, a solid waste company could avoid the solid waste utility tax by charging its customers a high container-rental fee and by charging nothing for collecting the waste. The tax code does not permit this type of activity. Solid waste companies cannot avoid the higher utility tax on their collection activities by bundling their charges. CP 641-642. Similarly, Comcast cannot avoid the telephone utility tax by bundling the telephone business revenues with revenues that are subject to the lower B&O tax rate such as ISP services.

Comcast argues that the repeal of Seattle Business Tax Rule 5-44-155 ("Rule 155") at the end of 2001 relieves them of the apportionment requirement. CP 658. This is incorrect because, as explained above, the apportionment requirement is based on the Seattle Municipal Code as well as Rule 155. The repeal of Rule 155 after the first year of the audit period did not relieve Comcast of its obligation under SMC 5.48.050A to pay the telephone utility tax based on the revenues attributable to the telephone business.

- D. Comcast Did Not Provide Records Requested By The City During The Audit And Is Barred Under SMC 5.55.060 From Challenging The Assessment.

It is undisputed that Comcast refused to provide the City with access during the audit to Comcast's contracts with Excite@home and its successors. CP 40, 46-47. The City attempted to obtain these contracts in order to determine the amount of revenue related to the internet services received by Comcast's customers. CP 40, 46-47. Comcast refused to provide those agreements and the City was forced to finalize the audits without the contracts. Thus, under SMC 5.55.060, Comcast is barred from challenging the assessment as a result of its refusal to produce documents.

Comcast now claims that it provided the City with "the information" during the audit. (Comcast Brief, p. 10.) This is incorrect. The information sought by the City was the contracts. CP 40, 46-47, 831 lines 3-9. Comcast gave the auditor only an approximate oral figure, which the auditor was never able to confirm by viewing the written contracts. CP 40, 832. During the audit, Comcast never provided the contracts requested by the City. Consequently, Comcast failed to comply with SMC 5.55.060, which requires Comcast to "provide or make available records." Comcast is attempting to dictate how the City's auditors obtain and verify information. The tax code requires the taxpayer to provide records and does not require the auditor to rely on unsubstantiated oral representations.

In addition, Comcast contends that it met its obligation to provide records to the auditor by producing the documents during discovery in this lawsuit. Comcast's Brief, p. 11; CP 47, line 11. Comcast produced the documents nearly two years after the City issued the assessment letters in July 2003. The purpose of SMC 5.55.060 is to provide documents to the auditor during the audit, not two years later during litigation. In order to have a functioning tax system, a taxing authority must be able to obtain taxpayers' records without resorting to litigation.

The State of Washington has a virtually identical provision. Under RCW 82.32.070(1), a taxpayer that fails to allow the Department of Revenue to examine its books and records "shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes . . ." Similarly to the City's system, a taxpayer that fails to provide the State with tax records is estopped from challenging the tax assessment in court.

These production of records requirements do not interfere with the court's jurisdiction. The taxpayer is simply estopped from challenging an assessment if the taxpayer refuses to produce records. The court relied on a similar provision in *Lacey Nursing Home v. Dept. of Revenue*, 128 Wn.2d 40, 54-55, 905 P.2d 338 (1995). In *Lacey*, the court ruled that a group of taxpayers could not file a class action lawsuit because they could

not comply with the requirement of RCW 82.32.180 to “keep and preserve books, records, and invoices.” *Lacey*, 128 Wn.2d at 55. *See also Coluccio v. King County*, 82 Wn. App. 45, 917 P.2d 145 (1996) (no refund of property tax where taxpayer failed to avail himself of the statutory remedies of paying under protest or filing a claim for an administrative refund).

The fact that the City is enforcing an ordinance rather than a state statute does not affect the City’s authority. The ability to require the production of records is an integral part of the City’s tax system, which is authorized by the State.² The legislature would not have granted the City the power to tax without granting the power to obtain tax records in the same manner that the state obtains its taxpayers’ records. For example, in *American Legion Post No. 32 v. City of Walla Walla*, 116 Wn.2d 1, 802 P.2d 784 (1991), the taxpayer argued that the city had no power to impose penalties and interest to enforce a gambling tax. The court ruled that the legislature’s grant of authority included such power:

² Seattle is authorized by statute to impose taxes. RCW 35.22.280(32); RCW 35.23.440(8); RCW 35.22.570. *See Pacific Telephone and Telegraph Co. v. City of Seattle*, 172 Wash. 649, 653, 21 Pac. 721 (1933) (power to license for any lawful purpose includes power to impose tax on telephone business).

It cannot seriously be contended that the Legislature intended to provide municipalities with the authority to impose a tax but deprive them of the power to enforce the tax. We will not ascribe such an absurd interpretation to the gambling act.

Id. at 12. Here, the legislature's authorization to impose taxes includes the authority to enact the basic provisions of a tax code, including the requirement that a taxpayer produce relevant records. The City is exercising this authority under SMC 5.55.060D.

The City is not violating Comcast's due process rights by creating a "conclusive presumption." The City is not attempting to impose "a tax upon an assumption of fact which the taxpayer is forbidden to controvert." *Henier v. Donnan*, 285 U.S. 312, 53 S.Ct. 358, 76 L.Ed. 772 (1932).

Instead, Comcast is estopped from challenging the assessment because it failed to produce records. Comcast had an opportunity to controvert its refusal to produce records and did not do so. It is undisputed that Comcast failed to produce contracts sought by the City's auditor. Consequently, in light of that uncontroverted fact, Comcast is estopped from contesting the assessment.

Tax refund suits are suits in equity, not law. *Dexter Horton Building v. King County*, 10 Wn.2d 186, 116 P.2d 507 (1941). Refunds, therefore, should be allowed only when a taxpayer has properly complied with its obligations under the tax code.

E. The City Is Allowed To Tax Comcast's Transmission Activities Under The Grandfather Clause Of The Federal Internet Tax Freedom Act.

1. The City is authorized by the State to tax telephone business.

Comcast mistakenly contends that the State withdrew the City's ability to tax Comcast's data transmission activities in the 1997 State Internet Tax Moratorium. In reality, as discussed above, the State Moratorium applies to internet service and does not apply to telephone business. The Department of Revenue confirmed this in its February 24, 2006 Excise Tax Advisory in which it concluded that the State of Washington met the ITFA grandfather clause for taxation of network telephone services. Excise Tax Advisory 2029.04.25 (attached as Appendix A.) The Advisory states:

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

ETA, p. 2 (emphasis added). The Department acknowledges that data transmission to internet users is included in the definition of network telephone services and is distinct from internet services. The State's

interpretation of the statute is directly contrary to Comcast's contention that the State excluded data transmission activities from the definition of network telephone service.

The City is authorized to tax telephone business, which the State has defined in RCW 82.04.065 to include transmissions used to provide internet services. RCW 35.21.714. The City is therefore authorized to tax data transmission activities in the City.

2. The City meets the requirements of the ITFA grandfather clause because it notified taxpayers of the taxes before October 1998.

The City's telephone utility tax is exempt from the ITFA because prior to October 1, 1998, the City gave notice by "rule or other public proclamation" that the City "has interpreted and applied such tax to Internet access services." ITFA (2001), § 1101 (d).

The Washington Department of Revenue stated in its Excise Tax Advisory that the State's taxation of data transmission to internet customers is covered by the ITFA grandfather clause. Excise Tax Advisory 2029.04.25, p. 2. The Department concluded that taxpayers received notice by virtue of the amendments to the definition of network telephone service in RCW 82.04.065. ETA, p. 2. The amendments to that statute, which is part of the enabling legislation for the City's telephone

utility tax, applied equally to City taxpayers. The definition of network telephone service encompasses Comcast's data transmission.

The Pennsylvania Supreme Court has held that Pennsylvania's sales and use taxes qualified for the grandfather clause under ITFA. *Concentric Network Corp v Commonwealth of Pennsylvania*, 897 A.2d 6. 15 (Penn. 2006). In *Concentric*, the taxpayer, an internet service provider, purchased data transport services and equipment to transmit internet services to its customers. The taxpayer objected to the imposition of the sales and use tax on its purchases. The court ruled that the taxes were permissible under the ITFA because "the tax code provisions in question were generally imposed and actually enforced prior to October 1, 1998." *Concentric*, 897 A.2d at 15. The court relied on the Department of Revenue's publication of a policy and tax code provision that stated that "telecommunications services were taxable under the sales and use tax." *Concentric*, 897 A.2d at 15. Similarly, the City of Seattle generally imposed and actually enforced its taxes prior to 1998.

In addition to the tax code, the City provided notice through Seattle Business Tax Rule 5-44-155. CP 438. Comcast presents collateral attacks on the application of Rule 155. However, it is undisputed that Rule 155 was in effect prior to 1998. Thus, the Rule served as notice of the City's intent to impose its utility tax on data transmission companies such as

Comcast. As stated by the Director of the City's Revenue and Consumer Affairs ("RCA") Division:

The RCA amended Seattle Business Tax Rule 5-44-155 ("Rule 155") in October 1995 in order to establish that companies that provide internet service are subject to the service classification under the B&O tax and that companies that use data transmission networks in the City to transmit internet-related data are subject to the telephone utility tax. Under Rule 155, an internet service provider or other such company that is transmitting data in the City is required to pay the telephone utility tax based on revenue from its data transmission activities. The rule permits the City to apportion the company's revenue between the revenue received for data transmission and the revenue received for internet services. The RCA amended Rule 155 in 1995 following an audit of an internet company in order to confirm that companies using transmission systems in Seattle to transmit internet-related data were required to pay the telephone utilities tax based on the revenue from those transmission activities.

One of the purposes of Rule 155 was to make sure that all companies carrying on a telephone business that involved the transmission of internet-related data were treated equally and taxed on the same basis. Therefore, companies that provide data transmission service and also provide internet services such as e-mail or web pages, are required to apportion the revenue related to each activity. If this were not the case, telephone businesses could evade the telephone utility tax by bundling the transmission services with a small amount of revenue from internet services and claiming that all of the revenue was due to its activities as an internet service provider.

CP 43-44 (emphasis added). A reviewing court gives considerable deference to the construction of an ordinance by those officials charged with its enforcement. *General Motors v. Seattle*, 107 Wn. App. 42, 57, 25

P.3d 1022 (2001). Comcast's collateral attacks on Rule 155 are not applicable. The rule and tax code were in effect prior to 1998 and provided notice that companies engaged in data transmission were subject to the telephone utility tax.

3 In addition to providing notice, the City generally collected its telephone utility tax and B&O tax prior to October 1998.

The City is qualified for the ITFA grandfather clause because the City generally collected its telephone utility tax on internet-related transmissions prior to October 1998. (CP 45.) The City was not alone in collecting tax on this activity. The Washington Department of Revenue states in its Excise Tax Advisory that the State is subject to the grandfather clause because "B&O and retail sales taxes on the sale of network telephone service used to provide Internet access were generally imposed and actually enforced prior to October 1, 1998." ETA 2029.04.245, p. 2.

Similarly, the Director of the City's RCA Division stated that the City has enforced and collected the telephone utility tax from companies providing transmission systems to transmit internet-related data:

During my tenure as Director [since 1994], the City has conducted audits of taxpayers who have paid the telephone utility tax under SMC 5.48.050A for transmitting data over cable or other transmission system in the City. The RCA has applied this tax to a variety of companies, including traditional telephone companies, hotels that provide telephone service to their guests, companies that provide switchboard and telephone services to office suites, and to

other companies that use their transmission systems to transmit internet-related data. The RCA interprets the telephone utility tax under SMC 5.48.050A as applying to cable companies such as plaintiffs that use their transmission systems to transmit internet-related data. The RCA has imposed, enforced, and actually collected the telephone utility tax from these types of companies.

...

Since the amendment of Rule 155 in 1995, the RCA has enforced the tax code so that if a telephone business, internet service provider, or internet access provider business provides transmission activities to an end user (consumer) the telephone utility tax is due based on revenue from those activities. The RCA has enforced the tax code so that a company that owns transmission capability through wires, cable, microwave or other medium are considered a telephone businesses under SMC 5.30.060C and are subject to the telephone utility tax under SMC 5.48.050. The RCA enforced the tax code in this fashion prior to October 1, 1998.

CP 43-44 (emphasis added). The City generally imposed and actually enforced its telephone utility tax on internet-related data transmissions prior to 1998. The ITFA does not require that a taxing jurisdiction collect and enforce the tax with 100 percent accuracy. That would be impossible in a self-reporting system like the City's. CP 47, ¶ 16. The City generally collected utility taxes from companies transmitting data and collected B&O taxes from companies providing services. The City generally enforced its tax code and therefore qualifies for the ITFA grandfather clause.

F. The City Telephone Utility Tax Is Not Discriminatory Under The ITFA Because It Is Imposed Upon, And Legally Collectible From, Companies Engaged In Telephone Business In The City.

The ITFA's moratorium on discriminatory taxes does not apply to the City's telephone utility tax because the tax applies to all companies engaged in telephone business in the City. ITFA (2001) § 1104(2); ITFA (2003) § 1105(2). A company that engages in both telephone business and providing internet services will be taxed on both activities. A company engaged in only one activity will be taxed only on that activity. CP 658. Comcast contends that other companies providing internet services are taxed at the lower B&O rate. However, those companies do not provide data transmission to their customers.

The Pennsylvania Supreme Court recently held that Pennsylvania's sales and use taxes did not discriminate under the ITFA. *Concentric Network Corp. v. Commonwealth of Pennsylvania*, 897 A.2d 6, 15 (Penn. 2006). In *Concentric*, an internet service provider that purchased data transport services and equipment to transmit internet services appealed the state's imposition of a sales and use tax on its purchases. The taxpayer made the reverse argument made by Comcast here. *Concentric* contended that the code "gave a preference to cable based and facilities based Internet service providers to the detriment of non-facilities based Internet service providers." *Id.* at 14. The court rejected the argument and stated:

Moreover, Taxpayer pays sales and use tax because it uses other companies' wirelines to provide its services. Taxpayer is not prohibited by the Tax Code from installing its own wirelines or from using some other technology to provide its service. If it chooses an alternate solution, it will not pay sales and use tax on purchases of telecommunications services. In short, the tax at issue here results not from a discriminatory tax on electronic commerce but from Taxpayer's business decisions

Concentric, 897 A.2d at 15. The court ruled that Concentric was not subject to discrimination under the ITFA merely because Concentric paid sales and use tax on the purchase of data transmission services which other ISPs did not have to purchase.

In the present case, Comcast must pay the City's telephone utility tax because it provides data transmission services to its customers. Any other company providing those services is subject to the same tax. There is no discrimination.

G. The City Telephone Utility Tax Does Not Tax "Internet Access" As Defined By The ITFA.

The ITFA does not bar the City's taxation of Comcast's data transmission activities because those activities do not fall under the definition of "internet access" under the ITFA. 47 U.S.C.A. § 151 (note) § 1104(5) (2001). Comcast argues that the amendments to the ITFA definition of "internet access" that took effect in 2003 affect the City's

telephone utility tax.³ First, those amendments took effect after the audit period, so they do not affect the assessed taxes. Second, the 2003 amendments to the definition of "internet access" establish that, prior to the amendments, transmission services or other such telecommunications services were not included in the definition of "internet access." Congress specifically amended the ITFA to state that telecommunications services were excluded from the definition except to the extent the services were used to provide internet access. ITFA § 1105(5) (2003). The fact that Congress made the amendment indicates that, prior to the amendment, any such services were not included in the definition of internet access. Congress distinguishes in the ITFA between telecommunications and internet access. Similarly, the transmission of data over a cable network is not included in the definition of internet access.

II. CONCLUSION

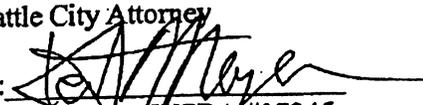
The undisputed facts establish that Comcast operates a cable transmission system in the City. The operation of this system is a telephone business under 5.30.060C and is subject to the City's telephone utility tax under SMC 5.48.050A. The state moratorium on taxing internet

³ Effective November 1, 2003, the ITFA's definition of "internet access" stated that the term "does not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access." ITFA § 1105(5) (2003).

service providers does not apply to the taxation of network telephone services, which includes Comcast's activities in the City. Comcast cannot avoid the telephone utility tax by bundling its internet service revenue with its telephone business revenue. In addition, the Internet Tax Freedom Act does not prohibit the City's tax because the City's tax was generally imposed and actually enforced prior to October 1998. Indeed, prior to 1998, the City notified Comcast and the other cable company operating in Seattle that they would be subject to the telephone utility tax. Accordingly, the Court should reverse the trial court.

DATED this 14 day of July, 2006.

THOMAS A. CARR
Seattle City Attorney

By: 
Kent C. Meyer, WSBA #17245
Attorneys for Defendant
City of Seattle

CERTIFICATE OF SERVICE

I, certify that on this date I caused a copy of appellant City of Seattle's Reply Brief to be filed with the court and served by first class U.S. Mail, postage prepaid on:

Randy Gainer
Davis Wright Tremaine LLP
1501 Fourth Avenue, Suite 2600
Seattle, WA 98101-1688

Signed at Seattle, Washington, this 14 day of July, 2006.



Marisa Johnson

ATTACHMENT F

R. Gane

RECEIVED

FEB 09 2007

Davis Wright Tremain

No. 79702-1

**IN THE SUPREME COURT
OF THE STATE OF WASHINGTON**

Community Telecable of Seattle, Inc., Comcast of Washington I, Inc., and
Comcast of Washington IV, Inc.,

Petitioners,

vs.

City of Seattle,

Respondent,

Answer to Petition for Review

THOMAS A. CARR
Seattle City Attorney

Kent C. Meyer, WSBA #17245
Assistant City Attorney
Attorneys for Respondent

Seattle City Attorney's Office
600 - 4th Avenue, 4th Floor
P.O. Box 94769
Seattle, Washington 98124-4769
(206) 684-8200

COPY

TABLE OF CONTENTS

	<u>Page(s)</u>
I. INTRODUCTION.....	1
III. STATEMENT OF THE CASE	2
IV. ARGUMENT.....	4
A. Comcast Is Not Entitled To Review Under The Considerations Stated In RAP 13.(4)(b).	4
B. Comcast Is Subject To Seattle’s Utility Tax Because Comcast Engages In Telephone Business In The City.....	5
C. The City Is Not Prohibited By The State Internet Tax Moratorium From Imposing Its Utility Tax On Comcast’s Telephone Business Activities In The City.	6
D. The City Requires Companies That Engage In Telephone Business And That Also Provide Internet Services To Pay The Telephone Utility Tax Based On The Revenue Attributable To The Telephone Business Activities.....	10
E. The City Is Allowed To Tax Plaintiffs’ Data Transmission Activities Under The Federal Internet Tax Freedom Act Because The City Imposed Its Tax Prior To 1998.....	11
1. The Federal Internet Tax Freedom Act does not apply to the City’s telephone utility tax.....	11
2. The City is authorized to tax telephone business.....	13
3. Comcast had a reasonable opportunity to know by virtue of a rule or other public proclamation that the City applied its telephone utility tax to companies transmitting internet services.....	14
4. The City’s telephone utility tax is subject to the ITFA grandfather clause because the City generally collected the telephone utility tax.	16
F. The City Telephone Utility Tax Is Not Discriminatory Under The ITFA Because It Is Imposed Upon And Legally Collectible From Companies Engaged In Telephone Business In The City.....	16

G. The Brand X Case Does Not Prohibit The City From Imposing Its Telephone Utility Tax On Data Transmission In The City	18
H. The Court Of Appeals Correctly Held That The City Is Not Barred From Taxing Comcast Under RCW 35.21.714.	19
V. CONCLUSION.....	20

TABLE OF AUTHORITIES

Page(s)

CASES

Concentric Network Corp. v. Commonwealth of Pennsylvania, 897 A.2d 6, 15 (Penn. 2006)..... 15, 18

National Cable & Telecommunications Ass'n v. Brand X Internet Services, ___ U.S. ___, 162 L. Ed. 2d 820, 125 S. Ct. 2688 (2005)..... 19

Pacific Telephone and Telegraph Co. v. City of Seattle, 172 Wash. 649, 21 Pac. 721 (1933)..... 14

Western Telepage v. City of Tacoma, 140 Wn.2d 599, 998 P.2d 884 (2000) 14

STATUTES

47 U.S.C.A. § 151 (note) § 1101(a) (2001) 12

47 U.S.C.A. § 151 (note) § 1101(a) (2004) 12

IFTA (2001), § 1101 (a)..... 13

IFTA (2001), § 1101 (d) 13, 14

IFTA (2001), § 1101 (d)(1)..... 15

IFTA (2001), § 1101 (d)(2)..... 16

ITFA (2001) § 1104(2)(A)(iv) 17

ITFA (2003) § 1105(2)(A)(iv) 17

RCW 35.21.714 14, 19

RCW 35.21.717 7, 8

RCW 35.21.870(1)..... 14

RCW 35.22.280(32)..... 14

RCW 35.22.570 14

RCW 82.04.065 8, 9, 10, 15

RCW 82.04.065(2)..... 9

RCW 82.04.297	7, 9
RCW 82.04.297(3)	8

COURT RULES

RAP 13.4(b)	2, 4, 7, 20
-------------------	-------------

ORDINANCES

SMC 5.30.060C	6
SMC 5.45.050	17
SMC 5.45.050G	7
SMC 5.48.020B	11
SMC 5.48.050A	3, 5, 7, 10, 17

MISCELLANEOUS

Excise Tax Advisory 2029.04.25	10, 15
Seattle Business Tax Rule 5-44-155(6)	14

I. INTRODUCTION

Defendant/Respondent City of Seattle ("City") asks the Supreme Court to deny the petition for review submitted by plaintiffs/respondents Community Telecable of Seattle, Inc., Comcast of Washington I, Inc., and Comcast of Washington IV, Inc. ("Comcast"). Comcast owns a cable transmission network leading to many homes and businesses in Seattle. In addition to transmitting cable television over the network, Comcast also uses the network to transmit data that allows their customers to use the internet.

The City of Seattle imposes a telephone utility tax on companies that transmit data over cable networks in Seattle. The City assessed the utility tax against Comcast for engaging in this business in Seattle and Comcast appealed the tax assessment. The parties brought cross-motions for summary judgment and the trial court denied the City's motion and granted Comcast's motion. In a unanimous opinion written by Judge Coleman, the court of appeals reversed the trial court and granted summary judgment in favor of the City. (Court of Appeals No. 57491-4-I.)

The court of appeals correctly ruled that Comcast operates a cable transmission system in the City. The operation of this system is a telephone business and is subject to the City's telephone utility tax. The court of appeals correctly held that the Washington State moratorium on taxing internet service providers does not apply to Comcast's activities in the City.

Comcast cannot avoid the telephone utility tax by bundling internet service revenue with telephone business revenue. In addition, the court of appeals properly ruled that, under the federal Internet Tax Freedom Act, the tax is non-discriminatory and is permitted under the grandfather clause of the Act. The court of appeals' decision does not meet the criteria for review under RAP 13.4(b) and this Court should deny Comcast's petition for review.

III. STATEMENT OF THE CASE

Comcast transmits cable television services and internet services to homes and businesses in Seattle. CP 176, ¶¶ 8-9. Comcast owns a transmission system in Seattle that includes cable running to individual properties and a network of fiber optics, cables, and other equipment to transmit between its Seattle customers and Comcast's "head end" in Burien, Washington. CP 188-189, 193-194, 202-205. Comcast offers its customers the ability to use the cable network for a high-speed broadband internet connection. CP 176, 190-192, 200-201, 208. The use of the cable network for this purpose began in approximately early 1998. CP 199.

The transmission of the internet signal to and from a Comcast customer's house runs through coaxial cable that leads to a pole outside the house, then through fiber optic cable to hubs in Seattle, and from there through fiber optic cable to Comcast's head end in Burien, Washington. CP 132-133, 188-189, 193-194, 202-205. From Burien the signal travels by

fiber optic cable to a facility at the Westin Building in Seattle. CP 132-133, 193-194, 202-205. The signal leaves the Westin Building by fiber optic cable. CP 132, 204-205. Comcast owns all of the cable, fiber optics and other transmission equipment from the outside of the customer's house to the head end in Burien. CP 176, 187, 189, 194.

Comcast's customers receive, through the network, internet services such as e-mail and the ability to use a browser to access web pages on the world wide web. CP 194-195, 206-207. Comcast has entered into contracts with other entities to provide such internet services to Comcast's customers. During much of the audit period, Comcast's customers received internet services from a company known as Excite@home. In effect, Comcast provided the final portion of the transmission system from the subscriber's home to the head end and Excite@home provided other infrastructure and the internet services received by the subscribers.

The City imposes a telephone utility tax on entities engaged in the business of transmitting data over a network in Seattle. Seattle Municipal Code ("SMC") 5.48.050A. CP 219. Such businesses must pay a tax of six percent of the revenue from that business. Comcast's use of its cable network in Seattle to transmit data provided by Excite@home and other internet service providers is subject to the telephone utility tax imposed by SMC 5.48.050A.

The City determined that Comcast was not correctly reporting the tax owed the City and notified Comcast on June 18, 2002 that the City would conduct an audit of Comcast's business activities in Seattle. CP 46, 510. The City subsequently issued tax assessments to Comcast on July 25, 2003 and assessed its utility tax against Comcast CP 404-436.

Without question, Comcast's use of its cable transmission system in the City constitutes a "telephone business" as defined by the Seattle Municipal Code. Comcast contends that because it provides internet services in addition to data transmission, it is not liable for the City's utility tax under State and Federal laws. Comcast cannot avoid the City's telephone utility tax by bundling the billing for its data transmission services with internet services. The undisputed facts establish that Comcast operated a transmission system in the City and is therefore subject to the telephone utility tax. The court of appeals correctly ruled in favor of the City and denied Comcast's cross-motion for summary judgment.

IV. ARGUMENT

A. Comcast Is Not Entitled To Review Under The Considerations Stated In RAP 13.4(b).

Comcast argues that it is entitled to review under all of the considerations governing review in RAP 13.4(b). In reality, none of the considerations apply here. This case involves a tax appeal by a cable modem provider. The federal grandfather clause issue is based on unique facts that

will not likely exist in other jurisdictions. The court of appeals' decision in this case does not conflict with decisions of this Court or other decisions of the court of appeals. The decision here does not involve significant state or federal constitutional issues. The court of appeals decision correctly applied unambiguous state and federal statutes and does not involve an issue of substantial public issue that should be determined by this Court.

B. Comcast Is Subject To Seattle's Utility Tax Because Comcast Engages In Telephone Business In The City.

The court of appeals decision interpreting Seattle's tax code is not in conflict with any state or federal cases and is not a significant issue requiring review by the Supreme Court. The City of Seattle's telephone utility tax is a tax on the privilege of engaging in "telephone business" in the City. SMC 5.48.050A. CP 219. The tax is imposed:

Upon everyone engaged in or carrying on a telephone business, a fee or tax equal to six (6) percent of the total gross income from such business provided to customers within the City . . .

SMC 5.48.050A. CP 291. The City defines "telephone business" to include activities other than traditional telephone service and includes the business of providing data transmission over a cable system. The definition states:

"Telephone business" means the providing by any person of access to a local telephone network, local telephone network switching service, toll service, cellular or mobile telephone service, coin telephone services, pager service 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. The term includes cooperative or farmer line telephone companies or associations operating exchanges. The term also includes the provision of transmission to and from the site of an internet provider via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. "Telephone business" does not include the providing of competitive telephone service, or providing of cable television service, or other providing of broadcast services by radio or television stations.

SMC 5.30.060C (emphasis added). CP 215-216. The relevant language for Comcast is that "telephone business" includes "the providing of . . . data, or similar communication or transmission for hire via a . . . cable, or similar communication or transmission system." SMC 5.30.060C. CP 215-216. In addition, the definition of telephone business specifically includes the "provision of transmission to and from the site of an internet provider via a . . . cable . . . or similar communication or transmission system." *Id.* Comcast engaged in telephone business when it used its cable system to transmit data over its cable transmission system. Comcast transmitted to and from the site of an internet provider by transmitting from its customers' homes to Comcast's facility in Burien and to the Westin building.

C. The City Is Not Prohibited By The State Internet Tax Moratorium From Imposing Its Utility Tax On Comcast's Telephone Business Activities In The City.

The court of appeals' interpretation of the State Internet Tax Moratorium is consistent with the plain language of the statute and

provides no basis for review under RAP 13.4(b). Under the City's tax code, two separate taxes apply to Comcast's in-city activities. Comcast's operation of a cable transmission system is subject to the six percent telephone utility tax under SMC 5.48.050A. And the providing of internet services is subject to the City's business and occupations ("B&O") service tax at a rate of .415 percent under SMC 5.45.050G. The undisputed facts establish that Comcast transmits data via a cable transmission system in the City. Comcast, which considers itself an internet provider, transmits to and from the site of an internet provider via its transmission system. (Comcast Court of Appeals Brief, pp. 4-5.) These activities are covered by the definition of "telephone business" and subject to the City's utility tax.

Comcast contends that it is exempt from the City's utility tax under the State Internet Tax Moratorium, RCW 35.21.717. The State Internet Tax Moratorium, RCW 35.21.717, imposes limits on taxes on internet services, but does not apply to telephone business. Under RCW 35.21.717, the state restricted a city's right to impose new taxes on internet service:

Until July 1, 2006, a city or town may not impose any new taxes or fees specific to internet service providers. A city or town may tax internet service providers under generally applicable business taxes or fees, at a rate not to exceed the rate applied to a general service classification. For the purposes of this section, "internet service" has the same meaning as in RCW 82.04.297.

RCW 35.21.717. The statute applies to "internet service," which is defined in RCW 82.04.297(3):

"Internet service" means 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. "Internet service" includes provision of internet electronic mail, access to the internet for information retrieval, and hosting of information for retrieval over the internet or the graphical subnetwork called the world wide web.

This definition does not cover the telephone business activities that are covered by the City's telephone utility tax.

Comcast wants the Court to ignore the legislature's distinction in the State Internet Tax Moratorium between data transmission and internet services. The legislature specifically permitted taxation of telephone business. In RCW 82.04.065, the State defines "telephone business" as the "business of providing network telephone service." The definition of "network telephone service" includes data transmission and excludes "internet service":

"Network telephone service" means the providing by any person of access to a telephone network, 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 telephone network, toll line or channel, cable, microwave, or similar communication or transmission system. "Network telephone service" includes the provision of transmission to and from the site of an internet provider via a telephone

network, toll line or channel, cable, microwave, or similar communication or transmission system. "Network telephone service" does not include the providing of competitive telephone service, the providing of cable television service, the providing of broadcast services by radio or television stations, nor the provision of internet service as defined in RCW 82.04.297, including the reception of dial-in connection, provided at the site of the internet service provider.

RCW 82.04.065(2) (emphasis added). The statute distinguishes between telephone business and internet service and allows a City to tax the data transmission activities defined as telephone business.

Comcast's activities are covered by the definition of network telephone service in RCW 82.04.065. First, Comcast provides data transmission over a cable system in accordance with the first part of the definition. Second, Comcast provides "transmission to and from the site of an internet provider" via a cable transmission system as described in the second portion of the definition. The undisputed facts show that Comcast provides a transmission system from its customers' homes or businesses to Comcast's facility in Burien and then to the Westin Hotel. The fact that Comcast bundles the charge for the use of the system with charges for other services does not exempt Comcast from the tax.

The court of appeals interpretation of the State Internet Tax Moratorium is consistent with the interpretation published by the Washington Department of Revenue ("DOR"). The DOR issued an

Excise Tax Advisory on February 24, 2006 that disagrees with Comcast's argument and confirms that the 1997 amendment to RCW 82.04.065 explicitly includes data transmission used to provide customers with internet services. Excise Tax Advisory 2029.04.25. (Appendix A to City's Court of Appeals Reply Brief.) The Advisory states:

This includes services used to connect an ISP to the Internet backbone or to ISP customer locations, such as the provision of transmission capacity over dial-up connections, coaxial cables, fiber optic cables, T-1 lines, frame relay service, digital subscriber lines (DSL), wireless technologies, or other means.

Washington has traditionally taxed the sale of these network telephone services to a consumer under the retailing classification of the business and occupation (B&O) tax and required the seller to collect retail sales tax. In 1997, RCW 82.04.065 was amended to explicitly include "the provision of transmission to and from the site of an internet provider via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system" as taxable network telephone service.

ETA, p. 1. The DOR agrees that network telephone services include data transmission over cable networks. When engaged in data transmission activities, Comcast is engaging in telephone business under SMC 5.48.050A and is subject to the City's tax on that activity.

D. The City Requires Companies That Engage In Telephone Business And That Also Provide Internet Services To Pay The Telephone Utility Tax Based On The Revenue Attributable To The Telephone Business Activities.

The City is not unfairly imposing its telephone utility tax on Comcast while taxing internet service providers at the lower B&O tax rate. The City simply requires that Comcast apportion its gross income between telephone business and internet services. Comcast is attempting to avoid the telephone utility tax by combining income from different taxable activities. The City's tax code prevents this by defining "gross income" as "the value proceeding or accruing from the sale of tangible property or service" and includes receipts "however designated." SMC 5.48.020B. Under this definition, a company cannot evade taxes by designating its revenue in a particular way on its books or in its customer bills. The utility tax is based on income "however designated." SMC 5.48.020B. Comcast cannot avoid the telephone utility tax by charging one price for bundled transmission services and internet services. Under the Seattle Municipal Code, if a taxpayer engages in an activity covered by the utility tax and another activity covered by the B&O tax, the City taxes each activity separately. (CP 43-45.)

E. The City Is Allowed To Tax Plaintiffs' Data Transmission Activities Under The Federal Internet Tax Freedom Act Because The City Imposed Its Tax Prior To 1998.

1. The Federal Internet Tax Freedom Act does not apply to the City's telephone utility tax.

Comcast is asking this Court to override Congress' intent to preserve taxes such as Seattle's that were in effect prior to 1998. The court of appeals correctly held that the Federal Internet Tax Freedom Act ("ITFA") does not affect the City's ability to tax Comcast's telephone business. The ITFA provides exceptions for cities, such as Seattle, that imposed and enforced taxes prior to October 1998. 47 U.S.C.A. § 151 (note) § 1101(a) (2001); 47 U.S.C.A. § 151 (note) § 1101(a) (2004).¹

The City's telephone utility tax is eligible for the grandfather clause exemption in the ITFA, 47 U.S.C.A. § 151 (note) § 1101(a) (2001) (hereafter "ITFA (2001)"). The City is eligible for the grandfather clause exemption because the City imposed and actually enforced the telephone utility tax prior to October 10, 1998. The ITFA (2001) states:

(a) Moratorium. – No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending on November 1, 2003 -

(1) taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998 . . .

¹ There have been three different versions of the ITFA since its enactment in 1998. (All versions at CP 441.) Because the audit period in this case is 2001-2002, the first and second versions apply to the audit period and the third version applies after November 1, 2003. The same grandfather clause applies to all periods.

IFTA (2001), § 1101 (a). The ITFA defines the terms “generally imposed and actually enforced” to mean that the law was authorized by statute and that either notice was given or that the tax was generally collected:

For purposes of this section, a tax has been generally imposed and actually enforced prior to October 1, 1998, if, before that date, the tax was authorized by statute and either--

(1) a provider of Internet access services had a reasonable opportunity to know by virtue of a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services; or

(2) a State or political subdivision thereof generally collected such tax on charges for Internet access.

IFTA (2001), § 1101 (d). Here, the City’s telephone utility tax is exempt from the ITFA because prior to 1998, the tax was authorized by statute and the City gave notice of the tax by rule. The City also generally collected the tax. The court of appeals decision on this point is based on the undisputed facts regarding Seattle’s tax code and practices prior to 1998. This decision does not grant a blanket exemption to other jurisdictions.

2. The City is authorized to tax telephone business.

First, cities in Washington are authorized by statute to impose taxes such as the City’s telephone utility tax and B&O service tax. *See*

RCW 35.22.280(32); RCW 35.22.570; RCW 35.21.714; RCW 35.21.870(1); *Pacific Telephone and Telegraph Co. v. City of Seattle*, 172 Wash. 649, 653, 21 Pac. 721 (1933) (power to license for any lawful purpose includes power to impose tax on telephone business); *Western Telepage v. City of Tacoma*, 140 Wn.2d 599, 998 P.2d 884 (2000)). Thus, the City's telephone utility tax is authorized by statute.

3. Comcast had a reasonable opportunity to know by virtue of a rule or other public proclamation that the City applied its telephone utility tax to companies transmitting internet services.

The next requirement under the ITFA (2001) is that an internet access provider ("IAP) have notice by rule or other proclamation "that such agency has interpreted and applied such tax to Internet access services." IFTA (2001), § 1101 (d). The City amended Seattle Business Tax Rule 5-44-155(6) in 1995 to advise internet companies that provided data transmission services that they were subject to the telephone utility tax and that internet services were subject to the B&O service tax. CP 43, 439. By enacting Rule 155 the City notified the public that the City imposed its telephone utility on companies that transmitted data related to the internet. The City notified the public in Rule 155 that it would apportion an internet provider's revenue based on its transmission costs

and other costs of doing business. Through Rule 155, the City met the notice requirement of IFTA (2001), § 1101 (d)(1).

Similarly, the DOR stated in its Excise Tax Advisory that the State's taxation of data transmission to internet customers is covered by the ITFA grandfather clause. Excise Tax Advisory 2029.04.25, p. 2. The DOR concluded that taxpayers received notice by virtue of the amendments to the definition of network telephone service in RCW 82.04.065. ETA, p. 2.

The Pennsylvania Supreme Court ruled that Pennsylvania's sales and use taxes qualified for the grandfather clause under ITFA. *Concentric Network Corp. v. Commonwealth of Pennsylvania*, 897 A.2d 6, 15 (Penn. 2006). In *Concentric*, the taxpayer, an internet service provider, purchased data transport services and equipment to transmit internet services to its customers. The taxpayer objected to the imposition of the sales and use tax on its purchases. The court ruled that the taxes were permissible under the ITFA because "the tax code provisions in question were generally imposed and actually enforced prior to October 1, 1998." *Concentric*, 897 A.2d at 15. The court relied on Pennsylvania's publication of a policy and tax code provision that stated that "telecommunications services were taxable under the sales and use tax." *Concentric*, 897 A.2d at 15. Similarly, the City of Seattle generally

imposed and actually enforced its taxes prior to 1998. Thus, the court of appeals application of the ITFA grandfather clause is consistent with interpretations of the same statute by the DOR and the Pennsylvania court.

4. The City's telephone utility tax is subject to the ITFA grandfather clause because the City generally collected the telephone utility tax.

The ITFA grandfather clause also applies to taxes that a City "generally collected." IFTA (2001), § 1101 (d)(2). The ITFA states that it applies to taxes that met the notice requirement or were generally collected. *Id.* The City's tax is valid under either section. As stated above, the City met the notice requirement. And, prior to October 1, 1998, the City generally collected its telephone utility tax on internet-related transmissions and its service B&O tax on internet service. CP 44-45. Accordingly, the ITFA moratorium does not apply to the City's telephone utility tax or to the B&O service tax

- F. The City Telephone Utility Tax Is Not Discriminatory Under The ITFA Because It Is Imposed Upon And Legally Collectible From Companies Engaged In Telephone Business In The City.

The City's telephone utility tax is not barred by the ITFA's moratorium on discriminatory taxes because the tax applies to all companies engaged in telephone business in the City. Similarly, the service B&O tax applies to all companies providing internet services in the City. The City's taxes do not fit any of the definitions of "discriminatory tax" under the ITFA. The

first three subsections defining discriminatory tax apply to other types of “electronic commerce” under the ITFA and do not apply to this case, which involves Comcast’s use of its transmission network. The first three subsections apply to transactions and are intended to apply to a city’s attempt to tax transactions occurring over the internet differently than other transactions. *Id.* The City’s telephone utility tax is not a tax on transactions. The utility tax is a tax on the privilege of engaging in business in the City. SMC 5.48.050A. Thus, the first three subsections of the definition of discrimination do not apply here.²

Under the fourth subsection, a tax is discriminatory if it “establishes a classification of internet access service providers” and imposes a higher tax rate on those providers. ITFA (2001) § 1104(2)(A)(iv); ITFA (2003) § 1105(2)(A)(iv). The City’s taxes are permissible because the telephone utility tax applies uniformly to all companies engaged in telephone business in Seattle. The tax is based on the gross income from that business. Similarly, the City’s service B&O tax applies to companies providing internet services in the City. SMC 5.45.050; Rule 155. The tax is based on the gross income from providing

² Even if these sections did apply to this case, the City’s taxes would not be affected. The City uniformly applies its telephone utility tax to companies engaged in the telephone business. The service B&O tax applies uniformly to companies providing services, such as internet services. There is no discrimination.

internet services. Neither of these taxes creates a separate class of internet access service providers that are taxed at a higher rate. All companies in Seattle that engage in telephone business are subject to the utility tax.

The court of appeals interpretation of ITFA is consistent with the interpretation of the Pennsylvania Supreme Court in *Concentric Network Corp. v. Commonwealth of Pennsylvania*, 897 A.2d 6, 15 (Penn. 2006). In *Concentric*, the taxpayer made the reverse argument made by Comcast here. Concentric contended that the code “gave a preference to cable based and facilities based Internet service providers to the detriment of non-facilities based Internet service providers.” *Id.* at 14. The court rejected the argument and stated:

Moreover, Taxpayer pays sales and use tax because it uses other companies’ wirelines to provide its services. . . . In short, the tax at issue here results not from a discriminatory tax on electronic commerce but from Taxpayer’s business decisions.

Concentric, 897 A.2d at 15. The court ruled that Concentric was not subject to discrimination under the ITFA merely because Concentric paid sales and use tax on the purchase of data transmission services which other ISPs did not have to purchase.

G. The Brand X Case Does Not Prohibit The City From Imposing Its Telephone Utility Tax On Data Transmission In The City

The court of appeals decision does not conflict with *National Cable & Telecommunications Ass’n v. Brand X Internet Services*, __ U.S.

162 L. Ed. 2d 820, 125 S. Ct. 2688 (2005). The *Brand X* case did not involve the ITFA or the taxation of cable modem companies. The case involved the regulation of cable companies under the Telecommunications Act and did not involve taxation. The Court in *Brand X* addressed the issue of the “proper regulatory classification under the Communications Act of broadband cable Internet service.” *Brand X*, 125 S. Ct. at 2696. The Court in *Brand X* did not address the issue of how states and cities can tax companies that provide cable modem service.

H. The Court Of Appeals Correctly Held That The City Is Not Barred From Taxing Comcast Under RCW 35.21.714.

Comcast challenges the court of appeals application of RCW 35.21.714 and argues that the City cannot tax Comcast because Comcast provides an intrastate service. First, Comcast never raised this issue in its complaint and the issue is not properly before the court. CP 3-8. Despite failing to raise this issue in its complaint, Comcast raised the issue in a footnote in its brief to the trial court and the court of appeals. (Comcast Brief, p. 2; CP 139.) Comcast did not properly raise this issue and failed to cite any legal authority to support its argument. The Supreme Court should not now accept review of this argument.

In addition, the court of appeals correctly held that the City is not barred from imposing its tax by RCW 35.21.714. The City is imposing its

tax on Comcast's use of a transmission network in the City that transmits data from the customers' house to the head end in Burien to the Westin Hotel. The City is not imposing tax on charges for interstate services. Finally, Comcast quotes only a portion of the statute in its petition. The court of appeals reviewed the relevant portion of the statute and correctly ruled in favor of the City.

V. CONCLUSION

The court of appeals' decision is a straightforward interpretation of federal and state statutes and does not meet the criteria for review under RAP 13.4(b). The City imposes a telephone utility tax on companies that operate a data transmission system in the City. Comcast cannot escape the tax by bundling internet service revenue with its telephone business revenue. Neither the state nor the federal internet tax statutes prohibit the City's telephone utility tax. This Court should deny Comcast's petition.

DATED this 8 day of February, 2007.

THOMAS A. CARR
Seattle City Attorney

By: 
Kent C. Meyer, WSBA #V245
Attorneys for Defendant
City of Seattle

CERTIFICATE OF SERVICE

I, certify that on this date I caused a copy of appellant City of Seattle's Answer to Petition for Review to be filed with the court and served by legal messenger on:

Randy Gainer
Davis Wright Tremaine LLP
1501 Fourth Avenue, Suite 2600
Seattle, WA 98101-1688

Signed at Seattle, Washington, this 8th day of February, 2007.



Marisa Johnson