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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

QUALCOMM, INCORPORATED,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

BRIEF OF RESPONDENT

ROBERT M. MCKENNA
Attorney General

Brett S. Durbin, WSBA No. 35781
Assistant Attorney General
Cameron G. Comfort, WSBA No. 15188
Sr. Assistant Attorney General
P.O. Box 40123
Olympia, WA 98504-0123
(360) 753-5528

TABLE OF CONTENTS

I. INTRODUCTION 1

II. RESTATEMENT OF THE ISSUES 1

III. RESTATEMENT OF THE CASE 2

A. Automatic Position Reporting 5

B. Mobile Messaging 6

C. Procedural History 7

IV. SUMMARY OF ARGUMENT 8

V. ARGUMENT 9

A. Standard Of Review 9

B. Qualcomm's Sales Of Its OmniTRACS Service Are Taxable As Sales Of "Network Telephone Service." 10

1. A service is classified as a "network telephone service" if it is used primarily as a means of transmitting information. 12

2. "Network telephone service" is not limited to pure transmission services. 15

C. The OmniTRACS Service Is Not An "Information Service" Because Customers Do Not Primarily Purchase The Service To Acquire New Information Or Processed Data. 18

1. The true object test applies only when there is not a reasonable basis to bifurcate the charges 18

2. The OmniTRACS service is composed of two distinct and identifiable services, mobile messaging and automatic position reporting. 20

3. The messaging component of the OmniTRACS service is taxable as a "network telephone service" because it primarily involves the transmission of data over a satellite communications system. 22

4. The automatic position reporting component of the OmniTRACS service is taxable as a network telephone service because customers primarily purchase it to transmit location information from the equipment on the truck to the software at the dispatch center. 23

5. If the OmniTRACS service components are viewed on a combined basis, and not bifurcated, the transmission aspect further outweighs the data processing aspect. 28

D. The Qualcomm Inc. v. Chumley Decision Is Not A Persuasive Precedent Because It Was Decided On Materially Different Facts And It Appears To Conflate The Functionality Of The OmniTRACS System With The OmniTRACS Service. 28

VI. CONCLUSION 30

APPENDIX

Appendix A – Voice & Data Communications Handbook (1995), p. 588.
Appendix B – Determination No. 90-128, 9 WTD 280-1 (1990).
Appendix C – Determination No. 97-111ER, 19 WTD 116 (2000).
Appendix D – Excise Tax Advisory No. 2011-1S.32 (2003)
Appendix E – Determination No. 89-433A, 11 WTD 313 (1992).
Appendix F – Determination No. 93-158, 13 WTD 302 (1994).
Appendix G – Determination No. 00-159E, 20 WTD 372 (2001).

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Cases

Community Telecable of Seattle, Inc. v. City of Seattle,
164 Wn.2d 35, 186 P.3d 1032 (2008) 16, 17

Ford Motor Co. v. City of Seattle,
160 Wn.2d 32, 156 P.3d 185 (2007), cert. denied, 128 S. Ct. 1224 (2008) 9, 13

Inland Empire Distrib. Sys., Inc. v. Utils. & Transp. Comm'n,
112 Wn.2d 278, 770 P.2d 624 (1989) 13

Western Telepage v. City of Tacoma,
140 Wn.2d 599, 998 P.2d 884 (2000) 9, 11, 22, 30

Statutes

Laws of 2002, ch. 67, § 2 10

Laws of 2007, ch. 6 13

Laws of 2007, ch. 6, § 1002(8) 10

Mobile Telephone Sourcing Act, Pub. L. No. 106-252 (2000) 10

RCW 82.04.065 ..... 10, 15, 30

RCW 82.04.065(2) 8, 10

RCW 82.04.065(2) (1997) 10, 12, 16

RCW 82.04.065(8) 13, 14, 16

RCW 82.04.065(8)(a) 14

RCW 82.04.440(1) 19, 21

RCW 82.32.180 8

Other Authorities

DOR Determination No. 89-433A, 11 WTD 313(1992)	20
DOR Determination No. 90-128, 9 WTD 280-1 (1990)	13
DOR Determination No. 93-158, 13 WTD 302 (1994)	20
DOR Determination No. 97-111ER, 19 WTD 116 (2000)	19
DOR Determination No. 98-202, 19 WTD 771 (2000)	20
DOR Determination No. 00-159E, 20 WTD 372 (2001)	20
DOR Excise Tax Advisory 2011.32 (2003)	19

I. INTRODUCTION

This case involves the taxation of Qualcomm's OmniTRACS service, the satellite transmission and position data processing component of its OmniTRACS Mobile Communications System. Qualcomm's OmniTRACS Mobile Communications System provides satellite communications and automatic position reporting. The system is made up of hardware and software purchased by Qualcomm's customers and satellite transmission capacity and position data processing provided by Qualcomm.

The Department of Revenue (Department) determined the OmniTRACS service was taxable as a "network telephone service" because it was primarily used to provide communications and to transmit data and location information between Qualcomm's customers' trucks and their dispatch centers. Qualcomm disputes the Department's assessment, alleging that its customers were primarily purchasing an information service, not a communications service.

II. RESTATEMENT OF THE ISSUES

1. Did Qualcomm prove that the Department erred in classifying the OmniTRACS service as a "network telephone service"?

2. Do the undisputed facts in the record show that the primary purpose of the OmniTRACS service is to provide satellite communications and data transmission services?

III. RESTATEMENT OF THE CASE

Qualcomm sells the OmniTRACS Mobile Communications System primarily to trucking companies. CP 29 ¶ 2. This system allows trucking companies to send and receive text messages between their drivers and their dispatch centers as well as receive position information and sensor data from the truck. CP 241. The OmniTRACS Mobile Communications System contains hardware and software purchased by the customers as well as satellite communications and position data processing provided by Qualcomm. CP 241-42.

There are two main aspects of the OmniTRACS Mobile Communications System: (1) real-time data communication; and (2) automatic position reporting. CP 86. To acquire these capabilities, each customer purchases three different components: (1) the Mobile Communications Terminal (MCT) located on the truck,[1] (2) the

[1]The Mobile Communications Terminal consists of the Outdoor Unit (ODU) that contains the antenna that communicates with Qualcomm's satellites, the Display Unit that has a keyboard and display that the driver uses to communicate with the dispatcher, and the Communications Unit that contains the circuitry and memory for the Mobile Communications Terminal. CP 244. Each Mobile Communications Terminal has a unique address that is used to route messages to the correct vehicle. The driver uses the Mobile Communications Terminal's display screens for creating, sending, and reading messages. CP 244.

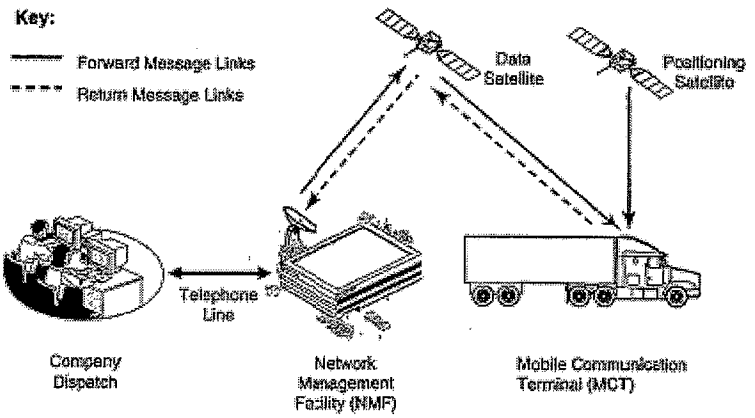
OmniTRACS software (QTRACS) installed at the customer's dispatch center, and (3) the OmniTRACS service, the satellite communications service that transmits the text and position messages from the equipment on the truck to the software at the dispatch center as well as processing the raw position information coming from the trucks. CP 184-85, 241-42.

The Mobile Communications Terminal costs $2,950 - $4,000 per unit and is installed on the customer's trucks. CP 193, 242. The Mobile Communications Terminal allows drivers to exchange messages with the customer's dispatch center and it also transmits information about the truck's location via satellite to Qualcomm's Network Management Facility where it is forwarded to the customer's dispatch center. CP 242, 244.

The QTRACS software costs $15,000 per license and allows the customer's dispatcher to exchange messages with the Mobile Communications Terminal on the truck, request location information from the Mobile Communications Terminal, and view the truck's location. CP 84, 110, 184, 241.

The OmniTRACS service provides the satellite communications service needed to transmit signals from the Mobile Communications

Terminal on the truck to the Qualcomm Network Management Facility.[2] For customers using Qualcomm's proprietary location service, the OmniTRACS service also converts the positioning information transmitted by the Mobile Communications Terminal into latitude and longitude coordinates.[3] The diagram below from Qualcomm's MCT Instillation Guide illustrates the data transmission paths.



CP 243.

A customer can purchase one of two different OmniTRACS service plans. The Basic Plan costs $35 per month and includes one automatic position poll per hour. CP 185. An automatic position poll is where the truck's location is calculated using one of two methods and transmitted from the Mobile Communications Terminal to the Network

[2] The customer typically purchases landline communication service between the customer's dispatch center and the Network Management Facility separately. CP 188 ¶ 3.9.

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

Management Facility and from there to the customer's dispatch center. CP 88, 185, 242. The Enhanced Plan costs $50 per month and includes the Basic Plan plus 180 regular messages and 18,000 characters per month. CP 185. If a Basic Plan customer sends a regular message, the customer is charged $0.05 per message plus $0.002 per character.[4] If an Enhanced Plan customer exceeds the monthly message allowance, incremental message charges are incurred at the same rate as Basic Plan customers. CP 185.[5]

A. Automatic Position Reporting

The Mobile Communications Terminal generates and transmits information about the truck's location using one of two methods - Qualcomm's proprietary system called the Qualcomm Automatic Satellite Position Reporting (QASPR) system or the public Global Positioning System (GPS). CP 243.

In Qualcomm's proprietary system, the Mobile Communications Terminal measures the signals it receives from two different Qualcomm satellites and performs calculations on the signal measurements to

[4] Customers can also send Emergency, Priority, and Group Messages, which are priced differently. CP 185.

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

generate the raw position data.[6] CP 30 ¶ 3, 242. The Mobile Communications Terminal then transmits this positioning information over Qualcomm's satellite communications system to the Qualcomm Network Management Facility, where it is converted into latitude and longitude coordinates. CP 30 ¶ 3, 112, 242. The latitude and longitude coordinates are then forwarded to the customer's dispatch center for use in the QTRACS software. CP 88.

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

B. Mobile Messaging

There are three main types of messages transmitted via the OmniTRACS service: Freeform, Macro, and SensorTRACS. CP 30 ¶ 5. Macro and Freeform messages allow drivers and dispatch centers to communicate with each other, by sending messages such as pick-up and delivery confirmations. Id. Macro messages are typically fill-in-the blank messages that customers create with the QTRACS software and send to the Mobile Communications Terminals for their drivers to use. CP 30 ¶ 6.

[6] Technically, Qualcomm leases transponder space on these satellites. CP 30 ¶ 3.

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

Qualcomm also offers an optional SensorTRACS system that collects information from various sensors on the vehicle and transmits it to SensorTRACS software located at the customer's dispatch center. CP 198. Speed, RPM, and other vehicle data are gathered through vehicle sensors and sent to the Mobile Communications Terminal. CP 197. The Mobile Communications Terminal then transmits this information to the SensorTRACS software located at the customer's dispatch center using the OmniTRACS system. CP 198. When a customer transmits the SensorTRACS information, it is treated and billed as a regular message. CP 196.

C. Procedural History

In 2002, the Department audited Qualcomm for the period 1998 to 2001. CP 53, 58. As a result of the audit, the Department assessed Qualcomm $900,573 for uncollected retail sales tax, retailing B&O and interest on its sales of the OmniTRACS service. CP 10. Qualcomm challenged this assessment before the Department's Appeals Division. Id. After reviewing Qualcomm's petition and again on reconsideration, the Appeals Division sustained the assessment. CP 8. Qualcomm then paid

the assessment and filed a de novo refund lawsuit under RCW 82.32.180. CP 5.

On cross-motions for summary judgment, the Superior Court granted the Department's motion and denied Qualcomm's motion, finding there were no genuine issues of material fact and that the Department was entitled to judgment as a matter of law. CP 304. Qualcomm timely appealed the Superior Court's order. CP 306.

IV. SUMMARY OF ARGUMENT

The OmniTRACS service provides data transmission for hire via a satellite communications system. Therefore, it falls within the definition of "network telephone service" under former RCW 82.04.065(2). While not all services that provide data transmission are classified as "network telephone service," when a service is used primarily as a method of communicating or transmitting data, instead of acquiring new information it is a "network telephone service."

The OmniTRACS service is primarily used by customers to communicate with their drivers and transmit data from the OmniTRACS hardware on the customers' trucks to the OmniTRACS software in their dispatch centers. While the Qualcomm's proprietary location reporting system does involve limited data processing, the primary feature of Qualcomm's proprietary system is the ability to transmit the positioning

information from the hardware on the trucks to the software at the dispatch center automatically no matter where the trucks are located. This is illustrated by the fact that OmniTRACS customers using the proprietary system do not incur additional processing charges than customers using the GPS system where the trucks location is merely transmitted from the Mobile Communications Terminal to the dispatch center.

When the text messaging and data communication aspects of the OmniTRACS service are considered, the undisputed evidence shows that the OmniTRACS service is primarily a communications and data transmission service. Therefore, the Superior Court correctly held the OmniTRACS service was a "network telephone service" and its order granting summary judgment to the Department should be affirmed.

V. ARGUMENT

A. Standard Of Review

Summary judgment orders are reviewed de novo. Western Telepage v. City of Tacoma, 140 Wn.2d 599, 607, 998 P.2d 884 (2000). Construction of a statute is a question of law that is reviewed de novo. Ford Motor Co. v. City of Seattle, 160 Wn.2d 32, 41-42, 156 P.3d 185 (2007), cert. denied, 128 S. Ct. 1224 (2008).

B. Qualcomm's Sales Of Its OmniTRACS Service Are Taxable As Sales Of "Network Telephone Service."

Former RCW 82.04.065(2) defines "network telephone service" as a service providing "telephonic, video, data or similar communications or transmission for hire, via telephone network, toll line or channel, cable, microwave, or similar communication or transmission system." Former RCW 82.04.065(2) (1997)(emphasis added).[7]

The OmniTRACS service is a "two-way Ku-band, satellite-based, mobile messaging and position reporting service." CP 188. This service is part of the OmniTRACS Mobile Communication System and allows customers to transmit text messages, sensor data, and position information between their trucks and dispatch centers. Id. Since OmniTRACS transmits data generated by the customer's equipment and software via a microwave communication system, it falls within the definition of a "network telephone service."[8]

In its brief, Qualcomm notes that the OmniTRACS service cannot be used for voice communication and has limited two-way communications capabilities. Opening Brief at 8. It also notes that the

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[7] RCW 82.04.065 was amended in 2002 and 2007. The 2002 amendment implements the provisions of the federal Mobile Telephone Sourcing Act, Pub. L. No. 106-252 (2000) and is not relevant to this case. Laws of 2002, ch. 67, § 2. The 2008 amendments replaced the term "network telephone service" with "telecommunications service" and are discussed below. See Laws of 2007, ch. 6, § 1002(8); Infra, at 13-14.

[8] Voice & Data Communications Handbook (1995), at 588 (Satellite communication systems use microwaves to transmit data), Appendix A.

messages are stored at Qualcomm's Network Management Center before they are forwarded to the customer's dispatch center. Id. However, the definition of "network telephone service" includes services providing one-way data transmission. Western Telepage v. City of Tacoma, 140 Wn.2d 599, 610-11, 998 P.2d 884 (2000).

In Western Telepage, the Washington Supreme Court found that a one-way paging service fell within the definition of "network telephone service." Western Telepage, 140 Wn.2d at 612. In that case, Western Telepage provided a paging service that transmitted numeric and alpha-numeric messages to customers over the company's paging terminal. These messages were prompted by either a call to the customer's paging number or via direct access by a modem, Internet e-mail, or dictation to a live operator.

The company argued that the service did not fall within the definition of "network telephone service" because the pager did not allow two-way communication. Western Telepage, 140 Wn.2d at 608. In response the Court stated "[n]owhere does the statute say only two-way communications are subject to RCW 82.04.065." Western Telepage, 140 Wn.2d at 610. Similarly, the statute does not state that the communications must be made in real-time or that data transmission cannot occur on a "store and forward" basis. The statute only states that

"network telephone service" includes "telephonic, video, data or similar communications or transmission for hire, via telephone network, toll line or channel, cable, microwave, or similar communication or transmission system." Former RCW 82.04.065(2) (1997)(emphasis added).

Because Qualcomm transmits the data from the Mobile Communications Terminal on the truck to its Network Management Center and forwards that information to the customer's dispatch center, it is providing data transmission for hire via a microwave communication system. CP 88. Nothing in the statute states that the service must allow two-way or real-time communications, or that the transmission cannot be made on a "store and forward" basis. Thus, these facts are irrelevant to the analysis in this case.

1. A service is classified as a "network telephone service" if it is used primarily as a means of transmitting information.

In determinations addressing the difference between "information services" and "network telephone services," the Department has stated:

> In carving out an exception for [network] telephone service from the definition of information services [WAC 458-20-155], the Department has drawn a distinction between those persons who are engaged in the business of furnishing a particular medium over which data is transmitted and those furnishing the data or information services being transmitted. Those engaged in the business of providing the means by which data is communicated are treated as

> making a [retail] sale, while those furnishing the data or processing it are providing a personal service.

Det. No. 90-128, 9 WTD 280-1 (1990) at 4, Appendix B (emphasis added).[9]

A similar distinction is used in the definition of "telecommunications services" contained in the Streamlined Sales and Use Tax Agreement (Streamline Agreement), Laws of 2007, ch. 6. The definition of "telecommunications service" in the 2007 act essentially replaced the term "network telephone service" in the prior version of the statute. RCW 82.04.065(8). As Qualcomm points out in its Opening Brief, the legislative history of the Streamline Agreement indicates that the changes in terminology were not intended to change the law regarding taxability. Opening Brief at 16. Therefore, the distinction between "telecommunications services" and information services in the Streamline Agreement is relevant to the analysis in this case.

Under the Streamline Agreement, the term "telecommunications service" means:

> the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points.

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[9] A reviewing court gives "considerable deference" to the construction of a statute by the officials charged with its enforcement. Ford Motor Co., 160 Wn.2d at 42; see also Inland Empire Distrib. Sys., Inc. v. Utils. & Transp. Comm'n, 112 Wn.2d 278, 282, 770 P.2d 624 (1989) (Court gives deference to an agency's interpretation of the law where the agency has specialized expertise in a certain subject area.)

> 'Telecommunications service' includes such transmission, conveyance, or routing in which computer processing applications are used to act on the form, code, or protocol of the content for purposes of transmission, conveyance, or routing without regard to whether such service is referred to as voice over internet protocol services or is classified by the federal communications commission as enhanced or value added.

RCW 82.04.065(8). However, "telecommunications service" does not include:

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

RCW 82.04.065(8)(a) (emphasis added).

Under this definition, a service that processes data or adds information is not automatically excluded. Such a service is excluded from the definition only when the primary purpose of the transaction is to obtain new information or processed data, such as purchasing Westlaw or a payroll processing service.

Therefore, under both the Department's longstanding interpretation of "network telephone service" and the definition of "telecommunications service" in the Streamline Agreement, the key distinction is whether the company is selling the data being transmitted or instead is selling a method for transmitting the data.

2. "Network telephone service" is not limited to pure transmission services.

Qualcomm argues that the definition of "network telephone service" is limited to pure transmission services. Opening Brief at 14-17. This position conflicts with both the Department's longstanding interpretation and the recent amendments to the definitions in RCW 82.04.065. As shown above, the question is whether the service is purchased primarily to provide a means of transmission or communication, or is purchased primarily to acquire new information or processed data. Thus, a service that contains both a transmission component and a data processing component that changes the content of the transmission is not automatically classified as a "network telephone service" or an "information service."

Qualcomm's reliance on a Federal Communications Commission (FCC) decision is misplaced. Opening Brief at 10. Nowhere in the definition of "network telephone service" or the Department's administration of the statute, are FCC definitions or decisions incorporated. The intent to define "network telephone service" without reference to FCC decisions is clarified by the amendments in the Streamline Agreement, which both the Department and Qualcomm agree do not change the law regarding the taxability of services. Opening Brief

at 16. The Streamline Agreement expressly defines "telecommunications service" "without regard to whether such service is ... classified by the federal communications commission as enhanced or value added." RCW 82.04.065(8). Therefore, referencing FCC decisions is inappropriate to determine the scope of the "network telephone service" and "telecommunications service" definitions.

Qualcomm's citation to Community Telecable of Seattle, Inc. v. City of Seattle, 164 Wn.2d 35, 186 P.3d 1032 (2008), is also misplaced. "Internet service" is expressly excluded from the definition of "network telephone service." Former RCW 82.04.065(2) (1997).[10] In Community Telecable, the Washington Supreme Court found that the City of Seattle could not separately tax the data transmission component of Comcast's cable internet service where "internet service" is excluded from the definition of "network telephone service." Community Telecable, 164 Wn.2d at 44, 45 ("The transmission component of Internet service cannot be separated from the actual service.")

In Community Telecable, the City of Seattle argued that since another company, At Home Corporation, provided certain Internet service

[10] "'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 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." Former RCW 82.04.065(2) (1997) (emphasis added).

components and received 35% of the Internet service revenue, Comcast could be taxed on the data transmission component of its cable Internet service. Community Telecable, 164 Wn.2d at 40, 44. The Court disagreed, holding that Comcast provided the Internet service and that the data transmission component could not be broken out.[11] Id. at 44. The Court noted also that Comcast provided data manipulation that was an integral part of providing its cable Internet service. Id. Thus, the holding in Community Telecable only states that where a company provides "internet service," its provision of the underlying data transmission component is excluded as part of the "internet service." Because the OmniTRACS service is not an "internet service," the Community Telecable decision is not relevant.

Despite Qualcomm's statement that "network telephone service" only includes pure transmission, both Qualcomm and the Department seem to agree that where a company is primarily providing a method for transmitting information, it is selling a "network telephone service." See Opening Br. at 12 (definition of "network telephone service" focuses on transmission, not generating or processing content of transmission). Qualcomm's main argument seems to rests on its assertion that the

[11] The Court distinguished the situation described in the Department's Excise Tax Advisory 2029.04.245 where a company sells data transmission to an Internet Service Provider (ISP) so the ISP can provide Internet service. Community Telecable, 164 Wn.2d at 44 n.2.

primary purpose of the OmniTRACS service is to provide information or processed data. See Opening Brief at 17-22. But Qualcomm's assertion should be rejected because it is not supported by the facts of this case.

C. The OmniTRACS Service Is Not An "Information Service" Because Customers Do Not Primarily Purchase The Service To Acquire New Information Or Processed Data.

Qualcomm argues that even though the OmniTRACS service transmits data between its customers' equipment on their trucks and the software at the customers' dispatch centers, the OmniTRACS service is an information service, not network telephone service. Opening Brief at 10-21. Qualcomm's argument is not supported by the facts in the record and improperly combines the functions of the OmniTRACS Mobile Communications System as a whole with the functions of service at issue here, the OmniTRACS service.

1. The true object test applies only when there is not a reasonable basis to bifurcate the charges.

Qualcomm states that the "true object" of its service is to provide information. Opening Brief at 21. However, Qualcomm misapplies the "true object test" and conflates the customer's use of the OmniTRACS Mobile Communications System as a whole with the use of the OmniTRACS service component.

Contrary to Qualcomm's assertions, the "true object test" only applies to sales of goods and services that cannot reasonably be bifurcated or where one service is merely incidental to the provision of another service. Det. No. 97-111ER, 19 WTD 116 (2000) at 118, Appendix C.[12] The general rule under Washington's excise tax laws is that a taxpayer is taxable on each of its separate activities. See RCW 82.04.440(1) ("Every person engaged in activities which are within the purview of the provisions of two or more sections [imposing Washington B&O taxes] shall be taxable under each paragraph applicable to the activities engaged in."). Sometimes two or more separately identifiable business activities are conducted under a single integrated contract or are provided as part of a bundled transaction.

In these situations, the Department's longstanding policy is that an integrated or bundled contract will be segregated into separate parts for state excise tax purposes only when there is a reasonable basis on which to do so. See Det. No. 97-111ER, 19 WTD 116 (2000) at 118-19, Appendix C (if the secondary activities are more than "incidental," or if the taxpayer bills its customer separately for the secondary services, then the Department will bifurcate the contract and tax according to each

[12] This determination was later withdrawn because the Department learned that critical facts were inaccurate. ETA 2011.32, Appendix D. It was not a retraction of the bifurcation statements.

business activity); Det. No. 89-433A, 11 WTD 313(1992) at 4-5, Appendix E; Det. No. 93-158, 13 WTD 302 (1994) at 12, Appendix F.[13] A reasonable basis will normally exist if the parts of the transaction are separately stated on the bill provided to the customer or on a price list or similar pricing schedule. Det. No. 89-433A, 11 WTD 313(1992) at 4-5, Appendix E. In cases where there is no reasonable basis to bifurcate the transaction, the transaction is taxed according to its "true object," i.e., the primary or predominant nature. Det. No. 00-159E, 20 WTD 372 (2001) at 380, Appendix G.

2. The OmniTRACS service is composed of two distinct and identifiable services, mobile messaging and automatic position reporting.

The OmniTRACS service has two identifiable features, (1) the ability to send text and data messages between the truck and the dispatch center, and (2) the ability to relay the truck's location. These are two distinct activities. Qualcomm charges for these services in different ways. CP 185. Customers can purchase a block of messages and characters as part of their Enhanced Plan or they can pay per message and

[13] Qualcomm cites Det. No 98-202, 19 WTD 771 (2000), for the proposition that the provision of telecommunications service can be classified as an information service. However, that determination is distinguishable from this case because there the telecommunications service was incidental to the provision of the travel agency's information service similar to a piece of paper containing the work product of a lawyer or architect. Here, the messaging service provides its own features and benefits similar to the provision of telephone service bundled with internet service.

character. Id. When customers pay per message, they are billed separately from the automatic location reporting service. Id. If a customer purchases an Enhanced Plan bundling messaging and position reporting for $50 per month, the only additional feature they get over the Basic Plan, costing $35 per month, is the ability to send 180 regular messages and/or 18,000 characters. Id. Thus, the $15 difference between the Basic and Enhanced Plans is attributable solely to mobile messaging.

Given Qualcomm's billing practices, there is a reasonable basis for bifurcating the charges between messaging and position reporting. Where customers purchase an Enhanced Plan, they are purchasing the Basic Plan for $35 plus 180 regular messages and/or 18,000 characters for an additional $15. Where customers incur incremental messaging charges, they are separately itemized and can easily be identified. Therefore, there is a reasonable basis to bifurcate the charges.

Since the OmniTRACS service charges are subject to bifurcation, the taxability of each of the component parts must be analyzed separately. RCW 82.04.440(1).

3. The messaging component of the OmniTRACS service is taxable as a "network telephone service" because it primarily involves the transmission of data over a satellite communications system.

"OmniTRACS is a two-way mobile satellite communications system that allows dispatchers and drivers to exchange text messages. It also provides vehicle location and performance data." CP 240. The messaging component includes Freeform, Macro, and SensorTRACS messages. CP 30 ¶ 5. The drivers use the Mobile Communications Terminal to transmit messages between the dispatch center via the Qualcomm's Data satellite and its Network Management Facility. CP 243.

Nothing in the record shows that the message data is converted or processed in any manner. Thus, it is analogous to the paging service at issue in Western Telepage, because it is used to transmit data over a microwave communications system. Consequently, the messaging feature is taxable as a "network telephone service." Even if there were some processing, the primary purpose of this component is to allow communication between the driver and the dispatcher via Qualcomm's satellite communications system. CP 86, 88.

In its Opening Brief, Qualcomm does not seem to address the taxability of the messaging portion of the OmniTRACS service. Instead,

it merely asserts that the primary function of the OmniTRACS service is the automatic location reporting feature and that component is taxable as an information service. As explained below, that feature is taxable as "network telephone service," but even if it were not, the messaging component is subject to bifurcation and therefore must be analyzed on its own. The record clearly shows the mobile messaging component is primarily used as a means of communication. Therefore, it is taxable as a "network telephone service."

4. The automatic position reporting component of the OmniTRACS service is taxable as a network telephone service because customers primarily purchase it to transmit location information from the equipment on the truck to the software at the dispatch center.

Qualcomm argues that the automatic position reporting portion of the OmniTRACS service is an information service. Opening Brief at 17. In analyzing the automatic position reporting component of the OmniTRACS service, it is important to distinguish the functionality of the OmniTRACS Mobile Communication System from the functionality of the OmniTRACS service.

The key distinction between the OmniTRACS Mobile Communication System and the OmniTRACS service is that the OmniTRACS Mobile Communication System includes hardware and software located on the trucks and the customer's dispatch center that

creates and processes almost all of the information. See CP 88, 242-244. The OmniTRACS service is the transmission component of the OmniTRACS Mobile Communication System that primarily transmits the information between the OmniTRACS hardware on the trucks and the OmniTRACS software at the customer's dispatch center. CP 188 ¶ 3.1, 242-244.

Qualcomm seems to argue that it is tracking the location of the trucks and reporting that information back to the customers. However, Qualcomm fails to distinguish between the operation of the OmniTRACS Mobile Communication System and the OmniTRACS service. Just as the functions of a cell phone are not relevant to the analysis of a wireless telephone service neither is the information generated or processed by the QTRACS software or Mobile Communications Terminal.

Additionally, Qualcomm only processes the position information transmitted by the Mobile Telecommunications Terminal when customers use Qualcomm's proprietary position system. CP 243. Qualcomm does not process the location information transmitted from the truck for customers using GPS receivers:

> The MCT receives the positioning data from the either the GPS receiver which is mounted on the roof of the vehicle, or via the integrated GPS (IGPS) receiver (integrated or "housed" inside the ODU [Outdoor Unit]). The data is then "packaged" for satellite transmission to the customer

> dispatch center via the Data satellite and the NMC [Network Management Center].

CP 246. Thus, the customers using GPS receivers are plainly purchasing the position reporting component of OmniTRACS service only to transmit the location information from their trucks to their dispatch centers via Qualcomm's satellite communications system.

Furthermore, even in Qualcomm's proprietary position system, the customer's hardware on the truck measures the signals from the satellites and generates the positioning information, which it then transmits back to Qualcomm's Network Management Facility using the OmniTRACS satellite communications system. CP 242. There, the information from the truck is converted into latitude and longitude coordinates and is forwarded to the customer's dispatch center. Id. Thus, Qualcomm's proprietary position system is used to both transmit the location information and process it.

The critical question then becomes what is the customer's primary motivation for subscribing to the OmniTRACS service. In the case of customer's using the GPS system to calculate the trucks position, it is plainly to obtain a method for transmitting the location information between the truck and the dispatch center. The transmission component is

also the primary or predominant aspect of Qualcomm's proprietary position system.

If customers merely wanted to know the location of their trucks, they could equip the trucks with commercially available GPS receivers and have the drivers call in the location coordinates. Qualcomm's system is superior because it allows the location information from the truck to be automatically transmitted to the customer's dispatch center without distracting the driver and regardless of whether or not the truck is in cell phone range. Thus, the transmission component of the OmniTRACS service seems to be the primary benefit, as customers are looking for a way to automatically transmit location information from the truck to the dispatch center regardless of where the truck is located.

Furthermore, the fact that customers using the GPS system subscribe to the same service as customers using Qualcomm's proprietary position system shows that the processing aspect of Qualcomm's proprietary position system is not the primary aspect of the service. CP 246. Otherwise, customers using Qualcomm's proprietary position system would be incurring additional data processing charges to obtain the processed data.

The relative cost of the various components of the OmniTRACS Mobile Communications System also shows that the customers are

primarily purchasing a medium to transmit data, not acquiring new or processed data. The QTRACS software costs $15,000 per license and the Mobile Communications Terminal costs $2,950 to $4,000 per unit, whereas the Basic Plan costs $35 per month for each truck. CP 185, 193. This does not include the optional SensorTRACS equipment or the installation costs. Using the low end of just the Mobile Communications Terminal cost, $2,950, it would take seven years for the monthly charges to equal the cost of the Mobile Communications Terminal, let alone the QTRACS software costs. This shows the OmniTRACS service is a small component of the OmniTRACS Mobile Communications System and is primarily a way to transmit data generated by the customer's equipment and software rather than a method of acquiring location information.

The Department does not dispute that Qualcomm's customers use the entire OmniTRACS Mobile Communications System to generate useful information about the operation of their trucks. However, when the OmniTRACS service portion of the OmniTRACS Mobile Communications System is viewed on its own, the evidence establishes that the OmniTRACS service is used primarily as a method of transmitting information between the Mobile Communications Terminal on the truck and the QTRACS software located at the dispatch center.

5. If the OmniTRACS service components are viewed on a combined basis, and not bifurcated, the transmission aspect further outweighs the data processing aspect.

If the mobile messaging and position reporting components of the OmniTRACS service are viewed on a combined basis, it is even more evident that the service is taxable as a "network telephone service." If they are combined, the pure transmission aspect of the mobile messaging component further minimizes the data processing component of the position reporting component. Therefore, viewing the components on a combined basis further supports the conclusion that the OmniTRACS service is primarily a method for transmitting data and not a way to acquire new or processed information.

As such, Qualcomm failed to meet its burden of proving that its customers purchase the OmniTRACS service to acquire new information or processed data. The Superior Court therefore properly granted summary judgment to the Department.

D. The Qualcomm Inc. v. Chumley Decision Is Not A Persuasive Precedent Because It Was Decided On Materially Different Facts And It Appears To Conflate The Functionality Of The OmniTRACS System With The OmniTRACS Service.

In its Opening Brief, Qualcomm cites an unpublished Tennessee Court of Appeals decision involving the taxation of the OmniTRACS system. Opening Brief at 21-22. There the court concluded that the

OmniTRACS service was an information service. In reaching that conclusion, the court relied heavily on the fact that the Tennessee Commissioner of Revenue admitted in the trial court that the primary purpose of the service was to "determine the location and load status of the customer vehicles that is, to collect data and then make it available to Qualcomm's customers." Qualcomm Inc. v. Chumley, 2007 WL 2827513 at *8 (Tenn. Ct. App. Sep. 26, 2007). The Department disagrees with that factual admission as it improperly conflates the functionality of the OmniTRACS Mobile Communications System with the function of the OmniTRACS service.

The agreed fact the Tennessee Court of Appeals relied on may be a correct description of the overall OmniTRACS Mobile Communications System, but it is the taxability of the OmniTRACS service that is at issue in this case. Here, the Department disputes that the primary purpose of the OmniTRACS service is to provide information to Qualcomm's customers. Nor does the record support such a conclusion. Because the Tennessee Court of Appeals relied on an admission that is not present in the current case, it is not persuasive.

In addition, the Tennessee Court of Appeals seems to have adopted a more restrictive interpretation of the term "telecommunications" than the Washington Supreme Court. In response to the Commissioner's argument

on appeal that the purpose of OmniTRACS was merely to transfer messages created by customers, the Tennessee Court of Appeals noted that OmniTRACS does not serve as a replacement for the driver's cell phone. Chumley, 2007 WL 2827513 at *8. The court also noted "OmniTRACS was never primarily used as a means for free-flowing conversations between a customer and its driver." Id.

The Washington Supreme Court's decision in Western Telepage illustrates that the term "network telephone service" in former RCW 82.04.065 includes wireless messaging services and is not limited to services that allow free-flowing real time communication. Western Telepage, 140 Wn.2d at 610-11, 612. Thus, the Chumley decision appears to conflict with Washington case law and should not be followed.

VI. CONCLUSION

Qualcomm has failed to meet is burden of proving that its customers purchased the OmniTRACS service to obtain new information or processed data. Instead, the record shows that the OmniTRACS service is used primarily to transmit information between the OmniTRACS equipment and the OmniTRACS software purchased by customers and installed on their trucks and at their dispatch centers. Because the OmniTRACS service is used primarily to transmit information it is taxable as a "network telephone service." Therefore, the Superior Court correctly

granted summary judgment to the Department, and this Court should affirm the summary judgment order.

RESPECTFULLY SUBMITTED this 13th day of October, 2008.

ROBERT M. MCKENNA
Attorney General

BRETT S. DURBIN, WSBA No. 35781
Assistant Attorney General
CAMERON G. COMFORT
Sr. Assistant Attorney General, WSBA #15188
Attorneys for Respondent

APPENDIX A

Satellite

Satellite uses a microwave transmission system, with radio connectivity being the primary means of broadcast. This technique has long been considered useful in very long-distance communications. Satellite transmissions were initially begun in the early 1960s, but several enhancements have been made over the years.

Typically, an earth station (uplink and downlink) is used to broadcast information between receivers. Current technology uses a geosynchronous orbiting satellite. *Geosynchronous orbit* means that a satellite is launched into an orbit above the equator at 22,300 miles. This orbit means that the satellite is orbiting the earth as fast as the earth is rotating. Therefore, it appears to earth stations that the satellite is stationary, thus making communications more reliable and predictable—and earth stations less expensive, because they can use fixed antennas.

This communications technique uses a frequency (uplink) broadcast up to the satellite, where a transponder receives the signal, orchestrates a conversion to a different frequency (downlink) and transmits back to the earth. As the communications is transmitted from the satellite toward the earth, a 17° beam is used. This produces a pattern of reception known as a *footprint*. The footprint is shown in Figure 26.1, with the entire U.S. covered by a single satellite. There are obviously many more than just three satellites in orbit, circling the earth, but only three are needed to provide global coverage. The satellites used for commercial applications are in what is called a *geosynchronous orbit*.

Frequencies

Satellite frequencies currently being used are categorized in bands. These bands are divided into the RF frequency spectrum that allow for different capacities and reception variations. The frequency bands are divided into two separate capacities, called *uplinks* and *downlinks*. The service provides for full-duplex operation, so a pair of frequencies is used. The uplink is used for transmission, the downlink is used for receiving (Table 26.1).

Satellites are good for broadcast communications; one to many locations. They are also termed distance insensitive, because once the signal is traveling up (22,300 mi) and back down (22,300 mi), the position of the receiver doesn't matter on a land line basis. We do not rent or lease the channel based on distance, but on the capacity of the channel. If two sites are using a satellite to communicate, the price is the same whether they are 10 miles or 3000 miles apart. The round trip from earth to the "bird" and back is essentially the same distance.

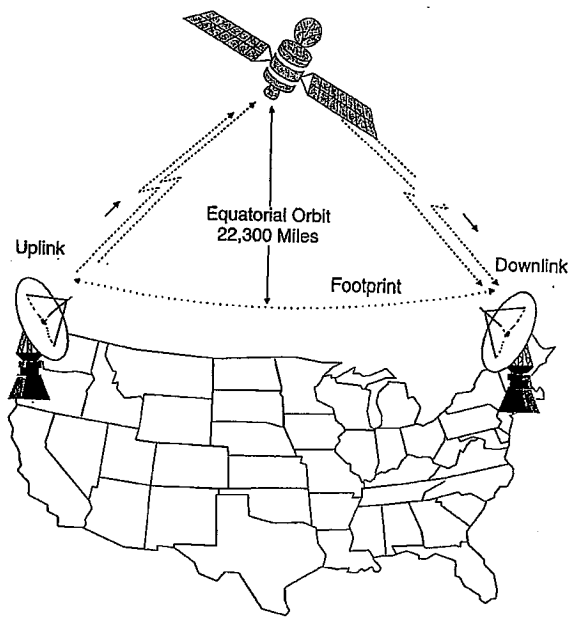

Figure 26.1 The satellite footprint covers ⅓ of the earth.

TABLE 26.1 Summary of the Frequency Bands Used for Satellite Transmission

Band	Uplink frequency	Downlink frequency
C	5.925–6.425 GHz	3.700–4.200 GHz
Ku	14.0–14.5 GHz	11.7–12.2 GHz
Ka	27.5–31.0 GHz	17.7–21.2 GHz

Advantages of satellites

Obviously, there are some distinct advantages to the use of satellite, or else no one would want to use the capacity. These advantages include some of the following:

- *Distance insensitive* As stated, the distance between the two end points is not a consideration in the pricing.
- *Single hop* With just a single shot up and back from the satellite, most communications coverage should be easily addressed. There is only one

APPENDIX B

Cite as 9 WTD 280-1

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

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

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

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

TAXPAYER REPRESENTED BY: . . .

DATE OF TELEPHONE CONFERENCE: . . .

NATURE OF ACTION:

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

FACTS AND ISSUES:

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

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

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

TAXPAYER'S EXCEPTIONS:

---

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

The taxpayer argues that providing dedicated telephone lines to its customers constitutes the furnishing of "network telephone service" as that term is defined in RCW 82.04.065 and WAC 458-20-245. According to the taxpayer, it purchases eight dedicated lines from . . . and in turn leases the lines for a flat fee to customers in fifty locations. The taxpayer asserts that this "network telephone service" is a separate product from the furnishing of computer services which is not used by all of its customers. Because those customers using the "product" are the consumers of the telephone service, the taxpayer concludes that the fees charged for the service is retailing income and taxable as such.

DISCUSSION:

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

> Persons rendering information or computer services and persons who manufacture, develop, process, or sell information or computer programs are subject to business and occupation taxes and retail sales or use taxes as explained in this rule.
>
> . . .
>
> The term "information services" means every business activity, process, or function by which a person transfers, transmits, or conveys data, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium. The term does not include transfers of tangible personal property such as computer hardware or standard prewritten software programs. Neither does the term include telephone service defined under RCW 82.04.065 and WAC 458-20-245.
> The term "computer services" means every method of providing information services through the use of computer hardware and/or software. (Emphasis supplied.)

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

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

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

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

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

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

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

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

Here, it is clear that the furnishing of the telephone lines is not the object of the transaction, but merely incidental to the personal services being rendered. The representative form of agreement used by the taxpayer which was submitted in support of the petition is instructive in this regard. The agreement repeatedly refers to "services" or "data processing services" in describing the taxpayer's obligations to the customer. Several pages of the agreement are devoted exclusively to a detailed description of the types of data processing services to be rendered and the manner in which these services are to be performed. The only reference to the telephone lines is contained in the provision dealing with the customer's obligation to bear the cost of the same in connection with the "on-line availability" of the data processing services.

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

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

We cannot accept the taxpayer's argument that because less than all customers contract for on-line services, the telephone lines are a separately furnished product. This argument misses the point. The relevant inquiry is whether the transactions which include the Network Charge are sales or

services. The fact that certain customers choose not to contract for on-line service has no bearing on this issue. By focusing on the real objective sought by the taxpayer's customers, we have concluded that the taxpayer's Network Charges should be taxed under the Service classification.
For purposes of the retail sales tax, the taxpayer is the consumer of the telephone service and as such is obligated to pay the tax on its purchases. Since the taxpayer has previously collected retail sales tax on the fees charged for telephone service, it is entitled to a credit to the extent these taxes have been refunded to customers.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED the 27th day of March 1990.

APPENDIX C

THIS WTD IS WITHDRAWN EFFECTIVE 02/14/2003 AND IS NO LONGER IN EFFECT. SEE ETA 2011-1S.32.

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Ruling of	EXECUTIVE LEVEL DETERMINATION
	No. 97-111ER
. . .	Registration No. . . .

[1] RULE 17001; RCW 82.04.050(2)(b); RCW 82.04.190(6): GOVERNMENT CONTRACTING – CONTRACTORS DEEMED TO BE CONSUMERS – PRIMARY NATURE OF CONTRACTS. Taxpayer engaged in the business activity of "government contracting" is subject to B&O tax under that classification even though it believes the primary nature of its contract with the government is "retailing."

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

NATURE OF ACTION:

A corporate taxpayer seeks reconsideration of Det. No. 97-111, in which the Appeals Division affirmed a decision by the Department of Revenue's (Department's) Audit Division that the corporation was a government contractor liable for use tax on the value of the computer hardware and software sold to, and installed for, the United States Department of Defense (DOD).[1]

FACTS:

Gray, A.L.J. – The taxpayer sought and obtained executive-level reconsideration of Det. No. 97-111. WAC 458-20-100(5) and (6). The taxpayer does not allege any factual errors in Det. No.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

97-111. Rather, the taxpayer challenges our conclusion based on a "primary nature" test that government contracting was the correct tax classification for its contract receipts.

The taxpayer originally requested the Department's Taxpayer Information & Education (TI&E) Section to confirm the contract with DOD for the sale and installation of computer software and hardware was a retail sale. Usually, TI&E issues rulings of prior determination of tax liability (ruling). However, in this instance TI&E referred the matter to the Audit Division because that division was auditing the taxpayer.[2] The Audit Division concluded the taxpayer should be taxed as a government contractor. The taxpayer then appealed the Audit Division's ruling, arguing that it should be classified as a retailer.

In Det. No. 97-111, we agreed with the Audit Division with respect to the taxpayer's contract. In doing so, we reaffirmed the Department's position regarding the primary nature test. We said the measure of the tax is the full contract price, even though there may be receipts generated by secondary activities included under the contract, the performance of which by themselves might be separately taxable under a different B&O tax classification. We said that if the secondary activities are more than "incidental," or if the taxpayer bills its customer separately for the secondary services, then the Department will bifurcate the contract and tax according to each business activity.

Thus, in our original determination, we found the taxpayer's separate activity of installing the computers sold to the U.S. government was more than "incidental" to the contract for sale of the computers. We found the contract the taxpayer had with the government was for the sale of the computers (both hardware and software) as well as the custom-design of a computer system and the installation of that system on government property (. . .).

The taxpayer argues that because the determination affirms the Audit Division's conclusion that installing "LAN drops" constituted labor used to improve real property under RCW 82.04.050, it forces the entire contract into the government contracting classification. The taxpayer states this result creates a sales and use tax burden that it neither budgeted for, nor is capable of recouping from the federal government. Further, the taxpayer objects to the determination because it claims its contract is primarily a retail transaction that also includes some incidental services that would otherwise be included in the retail classification but for the fact that we based our decision on whether the secondary activity was essential or nonessential to the performance of the contract. Basing the decision on whether the secondary activity is "essential" or "nonessential" taxpayer says, is a meaningless test. The taxpayer relies on Det. No. 89-433A, 11 WTD 313 (1991); Det. No. 90-154, 9 WTD 286-29 (1990); Det. No. 92-183ER, 13 WTD 96 (1993); Det. No. 90-034, 9 WTD 71 (1990); WAC 458-20-17001; and ETA[3] 544.04/08.245.

[2] This determination does not include any appeal of a tax assessment. Its scope is limited to the appeal of the ruling.
[3] The Department cancelled all Excise Tax Bulletins effective July 1, 1998 and replaced them with Excise Tax Advisories (ETAs). We will refer to ETAs in this determination.

In its petition for reconsideration, the taxpayer argued "[Det. No. 97-111] puts into turmoil the predictability of properly classifying contracts that call for a mixture of activities that are differently classified for B&O tax purposes."

The taxpayer argued the Department erred in Det. No. 97-111 when it concluded the LAN drops were essential and therefore the amounts received on the entire contract should have been classified as "government contracting." It argues there is no evidence to support a conclusion that the government required the taxpayer to install the computer system, and further argues the "test," to determine "essential" or "incidental" functions, has not been the test used by the Department in the past.

ISSUES:

Was the taxpayer's contract with DOD subject to B&O tax under the government contracting classification?

DISCUSSION:

The taxpayer says our original determination incorrectly applied the primary nature test. The "primary nature" test is not statutorily derived, but is a concept applied by the Department to determine a taxpayer's liability when a contract may have several activities, separately taxable under different B&O tax classifications. It is used when the other activities may be incidental to the primary function or purpose of the contract. We explained this concept in Det. No. 92-183ER, supra:

> The B&O tax is imposed for the privilege of engaging in business activities. RCW 82.04.220. The tax rate or rates applicable to a particular taxpayer depends upon the type of activity or activities in which it engages, e.g., manufacturing, wholesaling, or retailing. Generally, if a taxpayer engages in activities which are within the purview of two or more tax classifications, it will be taxable under each applicable classification. See RCW 82.04.440; Group Health Coop. v. Department of Rev., 106 Wn.2d 391 (1986).
>
> However, where a taxpayer agrees to perform an activity taxable primarily under a particular classification and only incidentally engages in other activities in furtherance of that activity, the taxpayer will be taxed according to its primary activity. In Final Det. No. 89-433A, 11 WTD 313 (1992), we stated:
>
> > [B]ifurcation of a contract for taxation will be the unusual case. In most cases income from a performance contract will be taxed according to the primary nature of the activity.
>
> See, e.g., [ETA] 544.04\08.245; [ETA] 85.08.107; Det. No. 91-163, 11 WTD 203 (1991).

> In short, taxpayer's income from its contracts should be taxed according to the primary nature of the work performed under the contracts.[4]

In Det. No. 97-111, we affirmed the letter ruling from the Audit Division in which it concluded the taxpayer's gross receipts were subject to government contracting B&O tax and the taxpayer was liable for use tax on the value of the property.[5] We reached this decision based on the following facts, gleaned from documents the taxpayer submitted to the Department. We think a recap of those facts, as explained in greater detail in the original determination, is helpful:

> The taxpayer designs computer software. It sells its software and compatible hardware to the public. The software is "modular" in nature; i.e., the buyer can purchase pieces of the software at different times as the need arises, and the additional software and hardware will function correctly as the pieces are added.
>
> In this case, the software, known as the [program], is designed for . . ., creating and managing an "integrated . . . database." There are eight [program] modules that run on computer hardware: . . . . This software improves access to complete . . . and administrative information. [Businesses] use this information to gain efficiencies in . . . .
>
> Unless a single module is used on a stand-alone computer, the software and hardware must run in a network environment. This means hardware connections are required.
>
> The installation of LAN drops[6] is accomplished by running cable behind the walls and through the ceiling. Then, the cable is connected to a wall plate in a designated area or office.
>
> DOD bought this system under an umbrella procurement contract (. . .) for its military bases throughout the world. Pursuant to this contract, the petitioner sold software, hardware, and some services to DOD.
>
> The statement of work, found in the February 28, 1991 Order for Supplies or Services (DOD Form 1155), describes the contractor's duties as follows:

---

[4]Simply separating an activity into component activities and entering into a separate contract for each component activity is insufficient to overcome the requirement that the taxpayer be taxed according to its "primary" activity; there must be substance to the charges for individual activities. See, e.g., ETA 373.08.172\135. [footnote in the original].

[5] The Audit Division's result regarding Phase 5 of the taxpayer's project was stated in the alternative. Income from sales to the U.S. government of custom disk (software) upgrades and installation labor were subject to selected business services B&O tax if contracted for and custom upgrading was performed outside the equipment installation contract. Otherwise, it was subject to government contracting B&O tax and the taxpayer was liable for use tax on the value of the standard or canned software and on the value of materials used to provide custom software.

[6] LAN means "local area network." It is a communications network that serves users within a confined geographical area. It is made up of servers, work stations, a network operating system, and a communications link. A LAN "drop" refers to the wire or cable that is typically "dropped" from a ceiling or wall to connect an individual computer terminal to the server.

> The Contractor shall provide materials, services and personnel required to install a system sufficient to support the operation of [program] at . . . Washington. The system will be a replacement of the . . . currently being provided by the . . . system at . . . . The hardware suite to be installed shall be the minimum configuration necessary to accommodate initial file and table build activities, initial training, and operation of the system.

Based on these contract terms, we found the total receipts from taxpayer's contract with the DOD was derived from the sale and installation of a computer system, including hardware and software, and was, therefore, subject to this state's government contracting B&O tax classification. As a result of this classification, we also found the taxpayer was liable for use tax on the tangible personal property installed on U.S. government property. In our original decision we said the primary nature of the taxpayer's activities under the contract was government contracting because the installation of the network computer system was an essential part of the contracted for services. On reconsideration, we reach the same result, but for different reasons.

In Det. No. 97-111, we said that contractors (prime or subcontractors) who install or attach any article of tangible personal property to federal buildings are the consumers as defined in RCW 82.04.190(6). We also said that a retail sale includes constructing or repairing new or existing buildings of or for consumers, whether or not such personal property becomes a part of the realty. RCW 82.04.050(2)(b). We applied these statutory definitions to the facts of the taxpayer's contract and concluded the taxpayer was subject to tax under the government contracting classification of the B&O tax and owed use tax on the materials. WAC 458-20-17001(5) says:

> The retail sales tax does not apply to the gross contract price, or any part thereof, for any business activities taxable under the government contracting classification. Prime and subcontractors who perform such activities are themselves included within the statutory definition of "consumer" under RCW 82.04.190 and are required to pay retail sales tax upon all purchases of materials, including prefabricated and precast items, equipment, and other tangible personal property which is installed, applied, attached, or otherwise incorporated in their government contracting work. This applies for all such purchases of tangible personal property for installation, etc., even though the full purchase price of such property will be reimbursed by the government or housing authority in the gross contract price. It also applies notwithstanding that the contract may contain an immediate title vesting clause which provides that the title to the property vests in the government or housing authority immediately upon its acquisition by the contractor.

As was discussed in Det. No. 97-111, it is unnecessary for the installed or attached items to become fixtures in order for the contractor to be a consumer and the contract to constitute a retail sale. RCW 82.04.190(6) is quite explicit on that point: "whether or not such personal property becomes a part of the realty by virtue of installation." The fact the taxpayer was required to install or attach the cables for the computer system inside the walls and ceiling is critical here, because

it satisfies the statutory criteria for the contractor to be a consumer and for the contract to constitute a retail sale.

Viewing the taxpayer's contract as a whole, we find this type of contract falls under the statutory and administrative classification of government contracting, and the gross receipts from that contract should be taxed under the government contracting B&O tax classification. The taxpayer's duties and the scope of the contract involved more than simply the retail sale of tangible personal property. It required the taxpayer to design the computer system, and install both the computers and the system. That work is properly classified as government contracting.

If the taxpayer had not been the actual installer of the computer system, it would not be liable for use tax on the value of the cable and other materials so long as the actual installer had paid the use tax. In this particular case, however, the taxpayer was also the actual installer.

We conclude that the taxpayer's business activity in its DOD contract was properly classified as government contracting.

DECISION AND DISPOSITION:

Det. No. 97-111 and the ruling from the Audit Division are affirmed, except to the extent that the reasoning in Det. No. 97-111 is inconsistent with this determination. Because this is not an appeal that arose under RCW 82.32.160 or 82.32.170, there is no further appeal.

The reporting instructions in this Determination constitute "specific written instructions" within the meaning of RCW 82.32.090. Failure to follow the instructions would subject the taxpayer to the additional ten percent penalty mandated by that statutory section.

Dated this 21st day of April 1999.

APPENDIX D

State of Washington
Department of Revenue

REVENUE

Excise Tax Advisory

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

Number: 2011-1S.32 Issue Date: February 14, 2003

Withdrawal of published determinations

Excise Tax Advisory 2011.32 (ETA 2011) explains that the Department of Revenue (Department) publishes certain written opinions issued by its Appeals Division. These determinations, called Washington Tax Decisions or WTDs, are published in accordance with RCW 82.32.410 and are available on the Department's Internet website.

This advisory is the first supplement to ETA 2011 and announces the withdrawal of an additional WTD. Readers should refer to ETA 2011 for an explanation of when the Department will announce the withdrawal of a WTD through an ETA or ETA supplement.

ETA 2011 and its supplements should not be discarded as these documents provide a history of all WTDs withdrawn by the Department through an ETA or ETA supplement.

The following WTD is withdrawn effective February 14, 2003:

Det. 97-111ER, 19 WTD 116. The Department has learned that the critical facts described in this determination are inaccurate. Therefore, the Department does not believe this determination provides helpful guidance.

Advisories numbered as 2 plus three digits (e.g. 2002.16.179) are advisories issued on or after July 2, 1998. **To inquire about the availability of receiving this document in an alternate format for the visually impaired or assistance in language other than English, please call (360) 486-2342. Teletype (TTY) users please call 1-800-451-7985.**	Please direct comments to: Department of Revenue Legislation & Policy Division P O Box 47467 Olympia, Washington 98504-7467 eta@DOR.wa.gov

APPENDIX E

Cite as Det. No. 89-433A, 11 WTD 313 (1992).

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	F I N A L D E T E R M I N A T I O N
	)	
. . .	)	No. 89-433A
	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] FIXED PRICE CONTRACT TO PERFORM VARIETY OF ACTIVITIES -- TAXATION OF. A fixed price contract to perform retailing, service, and government contracting activities treated as a contract to perform a variety of activities, each of which is taxable according to its corresponding B&O tax category, where the values assigned to the various activities were negotiated by the contracting parties prior to performance of the contract.

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

TAXPAYER REPRESENTED BY: . . .
. . .

DATE OF CONFERENCE: January 9, 1991

NATURE OF ACTION:

At issue is whether 100% of the income earned by the taxpayer under its contract with the military (Contract B) is taxable at the Service rate rather than at the rates applicable to the various activities performed pursuant to the contract.

FACTS AND ISSUES:

Roys, Sr. A.L.J. -- The taxpayer is a prime contractor for the United States [military]. At issue is the income from its contract for providing services at the . . . (Contract B). The taxpayer contends the Determination erred in concluding it received a fixed price for the contract which was paid regardless of performance and in concluding that the contract was overwhelming a service contract.

The taxpayer submitted an affidavit from its vice president of finance which explained the nature and structure of its contracts with . . . (contract A) and . . . . According to the taxpayer, "contract A" was one for operation of base morale services such as the Officer's Club and other recreational facilities. The taxpayer received a commission on its sales for those services.

The taxpayer explained "Contract B" as follows:

> The contract at the . . . facility is one for operation and maintenance of the physical plant and assets at that facility. The contractor reviews the requirements for performance of the contract which are specified in the Annexes to the contract, and makes a fixed price bid for the performance of the activities specified. Assuming the contractor is otherwise qualified to perform the contract, the contract is awarded to the contractor making the lowest bid.
>
> The contractor awarded the contract prepares a Schedule of Deductions, which assigns values to the activities described in the Annexes. The total of the values assigned to the activities equals the fixed price bid. The values assigned to the various activities are negotiated with [military] personnel, as these values form the basis for non-payment by the [military] in the event the contractor does not perform an activity.
>
> Payment of an amount listed in the Schedule of Deductions is contingent upon performance of the activity. If [taxpayer] does not perform a particular activity, the value assigned to the activity in the Schedule of Deductions is not paid. The [military] has an extensive quality assurance program, and [taxpayer] is required to submit detailed reports, such that performance of the activities required under

> the contract is closely monitored. In a few instances, [taxpayer] has not been paid amounts listed in the Schedule of Deductions, and thus, did not receive the entire fixed price for the fiscal year, as a result of claims by the [military] that certain activities were not performed by [taxpayer].

The taxpayer also provided portions of Contract B. Section B6 of the contract explained the Schedule of Deductions. The Schedule was to be prepared and submitted for approval within 15 calendar days after the date of the confirmation of the tentative award of the contract. No work was to begin until the Schedule of Deductions was approved.

The issue on appeal is whether Contract B should be treated as a contract to perform a variety of activities, each of which should be taxed under the corresponding B&O tax category, or as one for general services subject to Service B&O tax.

In the alternative, if the income from Contract B is to be taxed under the same B&O tax category, the taxpayer argued it should not be the service category. According to the taxpayer's calculations, less that 50% of the income from the activities is classified as a service activity. For example, for 1987, the percent of the total contract price was allocated as follows:

Service taxable -------	41.9383%
Government contracting --	26.5728
Retail - ----------	16.4251
Warehousing----------	15.0638
total	100%

DISCUSSION:

The taxpayer relies on RCW 82.04.220 through 290, 82.04.440; Fidelity Title Co. v. Department of Rev., 49 Wn.App.662 (1987); ETB 49.04.171; Pan Am World Airways, Inc. v. State, (Thurston Cty. Superior Ct. No. 82-2-00358-9 1983); and WAC 458-20-224 (Rule 224) for its position that income should be taxed according to the type of activity performed. We agree that those authorities and others support the general proposition that a given business may involve more than one classifiable activity.

Clearly the Department recognizes that proposition. Assessments of businesses routinely include more than one B&O tax classification. For example, a business might perform accounting functions for affiliates, make retail sales, print forms for internal use, etc. and it would be subject to the applicable B&O tax on those activities. See, e.g., Group Health Cooperative of Puget Sound v. Department of Rev., 106 Wn.2d 391 (1986)(B&O tax upheld on Group Health's carpentry and print activities). Also, a personal service business would be subject to retailing B&O and retail sales tax on any income received from sales of tangible personal property apart from the rendition of personal services. WAC 458-20-148.

We also agree with the taxpayer that the fact it was required to submit a fixed price bid for performing all of the activities should not require all of the income for the contract to be subject to the same tax classification. The Department has allowed taxpayers to report income from lump sum contracts under more than one tax classification. ETB 49.04.171 summarizes a 1966 decision by the former Washington Tax Commission. At issue was whether the construction of publicly owned roads as part of a construction contract for a large housing project was taxable as a retail sale where the contract or contractor's records only showed a lump sum

amount. The Commission held that the taxpayer's records only needed to prove that such work was performed and that the value as reported was reasonable to be taxable under "Public Road Construction" rather than "Retailing."

If a person sold a going business, the total price might be allocated between the real property, personal property, and goodwill. Assuming the allocated amounts were reasonable, the Department would assess real estate excise tax on the value of the real property transferred and retail sales or use tax on the value of the personal property sold. Similarly, we believe that some contracts to perform various business activities could be bifurcated between the various activities to be performed.

We do believe that bifurcation of a contract for taxation will be the unusual case. In most cases income from a performance contract will be taxed according to the primary nature of the activity. For example, income from processing for hire is taxed at the processing for hire rate even though some storage or other services are also involved. Rule 136, subsection 11, states that persons processing for hire are taxable under the processing for hire classification "upon the total charges made

therefor." The total charges could include unloading and loading which would be subject to tax at the stevedoring rate if they had been separate charges and not in conjunction with any processing activities.

In the present case, however, we agree Contract "B" should be treated as a contract to perform a variety of activities, each of which should be taxed under the corresponding B&O tax category. In reaching this conclusion we have relied on the fact that the contract required the taxpayer to perform a variety of different business activities with different B&O tax classifications and the Schedule of Deductions provides a reasonable basis for determining the value of the various activities performed. The Schedule of Deductions was required by the contract and was negotiated with the [military] before the work was performed and the values form the basis for non-payment in the event the taxpayer does not perform an activity.

Clearly, if the [military] had contracted with different businesses to perform the different activities, the Department would tax the amounts according to the nature of the activity performed. For example, if the [military] had hired one business to do its data entry services and another to do maintenance and repairs, the income from each contract would be taxed differently. We believe the result should be the same with a fixed price contract to perform a variety of activities where values are assigned to the various activities to be performed by the parties to the contract and the assigned values are reasonable.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. The matter will be remanded back to the Audit Division for a revised assessment. Unless Audit has evidence that the Schedule of Deductions was not a reasonable allocation of the lump-sum amount, those amounts shall provide a basis for classifying the income for B&O tax purposes.

DATED this 4th day of December 1991.

APPENDIX F

Cite as Det. No. 93-158, 13 WTD 302 (1994).

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

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 93-158
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .

[1] RULE 155: RETAIL SALE -- USE/DEFERRED SALES TAX -- CANNED VERSUS CUSTOM SOFTWARE -- CUSTOMIZED -- INCIDENTAL MODIFICATION. "Canned" software does not become "custom" software, as that term is used in Rule 155, simply because it is adapted to meet a customer's needs.

[2] RULES 107, 138, 155, AND 257; RCW 82.32.070: RETAIL SALE -- USE/DEFERRED SALES TAX -- CANNED SOFTWARE -- COMPUTER TELEPHONE SUPPORT SERVICES -- COMPUTER TRAINING -- WARRANTY -- MAINTENANCE -- MIXED AGREEMENTS -- SEGREGATION OF CHARGES. Payments to a vendor of canned software for the training of employees are not subject to sales tax if separately stated from the charges for software maintenance. However, charges for maintenance of canned software are subject to use/deferred sales tax. Where payments are not adequately segregated, the combined charge will be subject to use/deferred sales tax.

[3] MISCELLANEOUS -- USE/DEFERRED SALES TAX -- ESTOPPEL -- MANIFEST INJUSTICE -- INCONSISTENT ACTION. Estoppel will only prevent the state from collecting public revenues when all of the elements are present and applying the doctrine is necessary to prevent a manifest injustice. Requiring this taxpayer to pay its fair share of use/deferred sales tax does not constitute a manifest injustice. Estoppel does not apply against the Department where its subsequent action is not inconsistent with its prior action. The Department is not estopped from assessing use/deferred sales tax on taxpayer's purchase of software support

services where taxpayer received no information from the Department that is inconsistent with the tax asserted.

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

. . .

NATURE OF ACTION:

Title insurance company contests assessment of use/deferred sales tax on its use of software support services.

FACTS:

Eggen, A.L.J. -- Taxpayer was audited for the period January 1, 1988 through September 30, 1991. As a result of this audit, use/deferred sales tax [and interest] were assessed. Taxpayer protests . . . the assessment, plus interest.

Specifically, taxpayer protests the assessment of use/deferred sales tax on its use of "software maintenance" and "system support" services. The auditor classified these services as retail sales because they include replacement software, modifications, and updates. Because taxpayer had not paid sales tax, the auditor assessed use/deferred sales tax.

Taxpayer contends the services do not involve retail sales but instead involve professional services that are subject to neither sales nor use tax. Taxpayer contends the services primarily involve telephone consultation, technical assistance with program application, and problem solving. Taxpayer notes that these services "could be equated to remote training necessary to enable an operator to define and correct operator induced problems or errors."

Taxpayer contracted with four companies to provide the services at issue. Although the services relate to software owned by or licensed to taxpayer, taxpayer notes that the services were purchased separate from the underlying software. Taxpayer states that most of the services are provided over the telephone.

Under the first agreement, . . ., Provider A "agrees to support the program product ("Software") listed below in accordance with its then current user documentation and the provisions of this Agreement." . . .

Under the agreement between Provider A and taxpayer, Provider A agrees to:

1. provide two hours of telephone assistance per month;

2. maintain a copy of system software similar to taxpayer's;

3. make available an emergency password to access system source code in the event Provider A defaults on the agreement;

4. investigate any errors in system software where there is a departure from original or updated system specifications supported by Provider A;

5. correct any errors in system software where there is a departure from original or updated system specifications supported by Provider A during the first six months from installation of a program, enhancement, or modification;

6. maintain an up-to-date version of programming code and specifications incorporating "Programming Requests" enacted after initial programming;

7. propose a programming solution and price estimate to taxpayer's written Programming Request for any customization or modification, any file expansion or error correction, and any addition to software;

8. provide taxpayer with information on new systems and existing system enhancements that may benefit taxpayer and offer system upgrades or enhancements at least annually; and

9. provide installation of programming requests required by outside organizations, including government agencies.

Pursuant to this agreement, Provider A has helped taxpayer work out "bugs" in its programs over the telephone.

If taxpayer requests installation of programming solutions developed in response to its "Programming Requests" or if it requests the enhancements or upgrades described in item eight, it is separately charged. The tax consequences of these additional charges are not at issue.

The agreement between taxpayer and Provider S . . . provides:

> [Provider S] may, at its option, with no additional charge to [taxpayer], make modifications to improve the operation and/or reliability of the products being serviced under this Agreement.

> . . .
> Warranty provided hereunder for software and documentation services shall be limited to providing the software support and documentation services selected by [taxpayer].

This agreement specifically excludes the provision of training. Taxpayer states that it primarily received assistance in solving operator problems under this agreement.

Taxpayer's agreement with Provider T . . . divides the responsibilities of Provider T into two categories, and the charges for these two categories are separately stated.
The first category is Software Maintenance. Software Maintenance includes:

> 1. Extended warranty of installed software. Software releases will be issued annually. These releases are intended for bug fixes and program modifications not affecting the actual structure of [program]. . . .
>
> 2. Changes handled on an as-needed basis: New user codes and security records; new county codes, formats, and county dependent tables; changes in county procedures which prevent existing county dependent tables from being used.
>
> 3. Written documentation on the changes made, including installation instructions.
>
> 4. [Brand Name] Software support. System software upgrades will be tested and distributed as they are received by [Provider T].

The second category of services is Customer Support, which includes:

> 1. Telephone consultation for the purpose of problem solving; assistance in communicating with hardware vendors . . . ; assistance in resolving problems resulting from equipment failure, operator error, or data errors.
>
> 2. Opportunity to purchase additional [brand name] hardware from [Provider T] at a discount of five (5) percent from the published list price.
>
> 3. One annual . . . on-site visit by a [Provider T] Customer Support Representative. . . . The purpose of the visit can include but is not limited to: Additional operator or user training; hardware relocation; major . . . software upgrades.

Pursuant to this agreement, taxpayer has received information to fix "crashes" and to correct bugs, errors, names, and access codes.

The fourth agreement appears to relate to a specific brand name software program. It is entitled "[Brand Name] Software Maintenance Agreement." The agreement appears to be a standard form agreement, with the brand name included as part of the form. The agreement between taxpayer and Provider V states:

> [Provider V] and the LICENSEE who is currently licensed to use the [Brand Name] software (the PRODUCT) agree on the following:
> 1. Provider shall:
>
> Supply LICENSEE with updates to the PRODUCT and documentation
>
> Provide Technical Support by mail, phone, fax or dial-in
>
> Maintain compatibility of the PRODUCT with the . . . operating system

In its petition, taxpayer conceded that the software that is subject to the four support agreements is canned software. However, at the hearing, taxpayer asserted that the software is custom. Taxpayer further urges that we should not look to the type of program that is subject to the support agreements. Instead, we should look to the "true object" of the agreements. If the true object is to acquire professional services, we should not tax it, even if some tangible personal property is provided.

Nonetheless, taxpayer provided the following information in support of its argument that the software is custom.

Provider A provides software exclusively to the escrow and title industry. According to taxpayer, Provider A states:

> [B]ecause each of its customers operate [sic] their [sic] businesses differently, the customers have different software requirements. Also, each [Provider A] installation requires an in-depth study of how the customer does business, and this study determines the customization required to meet the customer's needs.

Provider A received input from taxpayer in compiling taxpayer's program. Taxpayer further states:

> When [Provider A] sold the Escrow Management System to [taxpayer] . . . data base screens had to be designed, calculations defined and documents created based on specifications provided to [Provider A] by [taxpayer]. These specifications differ from one customer to another and for each location, so that no two customers have completely interchangeable programs.

Taxpayer is prohibited from sharing its program with others, and the only copies of this program are the copy taxpayer uses and taxpayer's back-up copy.

Taxpayer concedes that Provider A uses a "core program" to begin the design of a customer program. However, taxpayer notes:

> [M]any of the specific fields, documents and reports are altered for each new customer [sic] [Provider A] installs. This is because every company does business in its own unique fashion. [Provider A] states that it prides itself on the ability to identify those unique qualities and customize its products accordingly.

Taxpayer concedes that the program serviced by Provider T that is referred to by brand name in the agreement is a canned program. However, there are apparently other Provider T programs that taxpayer contends are custom. Taxpayer urges that one program is "essentially a 'custom' software package developed for [three counties] exclusively" because the software was designed to match the recording practices of those counties. While taxpayer argues that this software could not be used for any other counties in any other state, taxpayer does not argue that the software could not be used by any other customer. Taxpayer's license agreement with Provider T prohibits taxpayer from copying the program for others. Taxpayer contends it was "actively involved in providing the specific county posting and searching requirements" for this program.

Taxpayer further contends that one of the programs was "developed for the exclusive use and enjoyment" of taxpayer. However, the support agreement refers to a "user group" for this program and an annual meeting for persons using this program.

Taxpayer notes that no canned programs were used in creating the Provider T programs.

Taxpayer provided no specific information regarding the custom nature of the Provider S or Provider V software.

Finally, taxpayer argues that the Department is estopped from asserting use/deferred sales tax. In support of its argument,

taxpayer provided a letter it received from Provider A, which states:

> [Provider A] does not charge sales tax on support invoices as this is a service to our clients that is performed from our office.
>
> If we visited your office and performed the support services there, then we would charge sales tax.
>
> We have confirmed this several times with the Washington State Revenue Department.

Taxpayer also provided a letter that Provider A received from Taxpayer Information and Education. This letter states that income from servicing canned software is subject to retailing B&O tax, and sales tax must be collected. The letter also provides that income from servicing custom software and consultations is subject to the service classification, and sales tax need not be collected. In providing a copy of this letter to taxpayer, Provider A stated:

> As we employ programmers on our staff and customize the software to the client's needs, we do not need to charge retail sales tax on this item.

Taxpayer also provided a letter it received from Provider S. This letter states that no sales tax is due on system support, but sales tax is due on equipment maintenance. Provider S provided taxpayer with the name of the person in Taxpayer Information and Education consulted in reaching these conclusions but did not provide anything in writing from the Department.

Taxpayer contends Provider T also provided a memorandum regarding the taxation of its agreements. However, taxpayer did not provide a copy of this memorandum.

ISSUES:

1. Whether the software that is subject to the agreements is canned or custom software.

2. Whether taxpayer's agreements with its software support providers involve warranty, maintenance, or personal services, and whether the charges for each type of service are adequately segregated.

3. Whether the Department is estopped from assessing use/deferred sales tax against taxpayer based on the letters the software support providers received.

DISCUSSION:

The assessment of use/deferred sales tax on taxpayer's purchase of software support services will be sustained if these services are classified as retail sales of property or services. RCW 82.08.020; 82.12.020.

If the services are either warranty or professional services, they are not subject to sales or use tax. If, on the other hand, the services are maintenance services, they are subject to sales or use tax. To be considered warranty or maintenance services, the services must relate to tangible personal property. Thus, we will first address whether the software that is subject to the agreements is canned (tangible personal property) or custom software (intangible personal property).

[1] WAC 458-20-155 (Rule 155) provides:

> The term "custom program" means software which is developed and produced by a provider exclusively for a specific user, and which is of an original, one-of-a-kind nature.
> The term "standard, prewritten program," sometimes referred to as "canned" or "off-the-shelf" software, means software which is not originally developed and produced for the user.

Rule 155 further provides that a custom program is one "written to meet a particular customer's specific needs," while a program will be considered canned "irrespective of any incidental modifications to the program medium or its environment (e.g., adaptation to computer room configuration) to meet a particular customer's needs."

The sale of custom software is the sale of a professional service, which is not subject to sales or use tax. In contrast, the sale of canned software is the sale of tangible personal property, which is subject to sales or use tax. Rule 155.

Taxpayer urges that we should not look to the type of software that is subject to the support agreements. Instead, we should look to the "true object" of the agreements. If the true object of the agreements is to acquire professional services, we should not tax them, even if some tangible personal property is provided. Neither the courts in Washington nor the Department have adopted such a test as it relates to computer software, and we decline to do so here.
. . . According to taxpayer, Provider A studies each of its customers and provides software suited to its needs. Taxpayer notes that it provided input to Provider A to assist Provider A in designing taxpayer's software and that Provider A had to

"alter" specific fields, documents, and reports for taxpayer's use. However, taxpayer conceded that Provider A used a "core program" to begin the design of taxpayer's software. In addition, taxpayer is prohibited from sharing this program with others.

In Det. No. 92-15, 12 WTD 57 (1992), we explained that where standard, prewritten software is combined with other standard, prewritten software and some original programming, it does not become custom software just because it may be unique or one-of-a-kind. Similar to taxpayer's argument here, the taxpayer in that determination argued that each software program was unique since it was custom tailored to each machine that used the software. We disagreed. We reasoned:

> Rule 155 requires that in order for a program to be considered a "custom program" it must be both "developed and produced by a provider exclusively for a specific user, . . ." and also "be an original, one-of-a-kind nature." In this case, the bulk of the generic program has not been developed and produced by the provider exclusively for the taxpayer. . . . Rule 155 clearly states that sales of standard, prewritten software are fully subject to the retail sales/use tax, notwithstanding some incidental modifications. Therefore, we conclude that even though a particular program may be unique to a particular machine, these modifications do not convert what was otherwise several standard, prewritten software programs into one unique custom program. To the extent that some original programming, instructions, translations, or parameters needed to be written for an individual machine, these acts constitute "incidental modifications to the program medium or its environment . . . to meet a particular customer's needs" within the meaning of Rule 155.

In Det. No. 87-359, 4 WTD 327 (1987), we stated that canned software does not become custom software, even if it is adapted at considerable expense to meet a customer's specific needs. Rather, we explained custom software as "developed from scratch" or "uniquely designed and custom tailored to meet the customer's specific requirements."

Taxpayer conceded that the program it acquired from Provider A was created using a "core program." Further, taxpayer presented no evidence that would support our finding that the modifications were anything more than "incidental modifications." Thus, we find that the software taxpayer acquired from Provider A is canned software.

Similarly, taxpayer has failed to prove that the software it acquired from Provider T is custom software. While taxpayer argued that one of the software programs was developed for [three counties] exclusively, taxpayer presented no evidence to support our finding that it was created for taxpayer exclusively. Further, while taxpayer contends that one of the programs was "developed for the exclusive use and enjoyment" of taxpayer, we found that the support agreement refers to a "user group" for this program and an annual meeting for persons using this program. These facts contradict taxpayer's claim that the program was designed exclusively for its use. Therefore, we find that the software taxpayer acquired from Provider T is canned software.

Finally, because taxpayer presented no evidence relating to the custom nature of the software provided by Provider S and Provider V, we conclude that this software is canned.

[2] Because we have concluded that all of the software that is subject to the support agreements is canned software, we must next determine whether the agreements are for warranty, maintenance, or professional services. Effective June 2, 1990, WAC 458-20-257 (Rule 257)[1] provides:

> (a) Warranties . . . are agreements which call for the replacement or repair of tangible personal property with no additional charge for parts or labor, or both, based upon the happening of some unforeseen occurrence, e.g., the property needs repair within the warranty period.
>
> . . .
>
> (c) Maintenance agreements . . . sometimes referred to as service contracts, are agreements which require the specific performance of repairing, cleaning, altering, or improving of tangible personal property on a regular or irregular basis to ensure its continued satisfactory operation.

Similarly, Rule 155 provides:

> The retail sales tax also applies to all charges to users for the repair, maintenance, alteration, or modification of

---

[1]Prior to June 2, 1990, WAC 458-20-107 (Rule 107) governed warranties and maintenance agreements. To the extent relevant here, the provisions of Rule 107 are essentially the same as those contained in Rule 257.

> hardware, equipment, and/or standard, prewritten software or materials.

Rule 257 further provides that nonmanufacturer's warranties and manufacturer's warranties not included in the retail selling price of the article being sold are not subject to sales or use tax. In contrast, maintenance agreements are subject to sales or use tax under all circumstances. If an agreement contains both warranty and maintenance provisions, the agreement is subject to sales or use tax.

In Det. No. 88-257, 6 WTD 137 (1988), we explained that if an agreement does not require that preventive maintenance be performed, the agreement is a warranty. In contrast, if services are required that are not contingent upon breakdown, the agreement is a maintenance agreement. Det. No. 87-375, 4 WTD 393 (1987).

For an agreement to constitute a maintenance agreement, taxpayer argues that Rules 107 and 257 require "specific performance" of activities that involve actual physical "touching" of the software by the service providers. However, Rule 155 and 4 WTD 327 provide
that maintenance of canned software is subject to sales tax. Whether the services involve "touching" is not controlling.

In 4 WTD 327, the taxpayer received maintenance services at no additional charge at the time it purchased the software. Taxpayer seeks to distinguish that determination because taxpayer entered the software support agreements after it purchased the underlying software. Thus, taxpayer argues, its agreements do not involve additions or improvements to software purchased at the time of acquisition of the software. However, modifications to canned software are subject to sales or use tax, even where the modifications are performed by a third party after the initial acquisition of the software. Det. No. 89-43, 7 WTD 130-1 (1989), affirmed 89-43A, 8 WTD 5 (1989).

In contrast, personal or professional services are not considered retail sales and, therefore, are not subject to sales or use tax. See RCW 82.04.040, .050; WAC 458-20-138 (Rule 138); WAC 458-20-224 (Rule 224). Thus, payments to a vendor of canned software for training are not subject to sales or use tax when separately negotiated and severable from the purchase of the canned program. Det. No. 89-43, 7 WTD 130-1 (1989), affirmed, Det. No. 89-43A, 8 WTD 5 (1989). Taxpayer argues that its support agreements, like training, involve professional services. Taxpayer emphasizes that the primary service offered to taxpayer is telephone consultation.

However, in order for professional services to be excluded from sales tax, the charges for those services must be stated separately from the charges for maintenance. In 8 WTD 5, which related to modifications to a canned program as well as the writing of a new, custom program, we stated:

> It is important to note here that the work at issue was not performed pursuant to a single contract for a single, lump sum billing. Rather, the work constituted a combination of activities classifiable as either retailing or service activities. Taxpayer now claims to have documented the various activities. Accordingly, subject to confirmation of the claimed segregation of activities and charges, the taxpayer is entitled to the appropriate tax classification for each. See RCW 82.04.440.

The Department does not generally allow a single contract to be segregated unless there is a reasonable basis on which to do so. As we stated in Det. No. 89-433A, 11 WTD 313 (1992):

> We do believe that bifurcation of a contract for taxation will be the unusual case. In most cases income from a performance contract will be taxed according to the primary nature of the activity. For example, income from processing for hire is taxed at the processing for hire rate even though some storage or other services are also involved.

In that case, segregation was allowed because the taxpayer's contract, which was negotiated before the work was performed, provided a reasonable basis for determining the value of the various activities performed. See also, Det. No. 90-35A, 9 WTD 289 (1990)("the Department does not favor bifurcation"); Det. No. 91-163, 11 WTD 203 (1991)("We must determine the predominant nature of the contract to determine the business and occupation tax classification of the receipts received under its terms. We must also determine if it is a separate service, severable from the contract."); ETB 44.08.138; ETB 85.08.107.

The burden of segregating taxable income from exempt income rests upon the taxpayer. Tidewater Terminal Co. v. State, 60 Wn.2d 155, 372 P.2d 674 (1962). Taxpayers are required to keep books and records sufficient to determine their tax liabilities. RCW 82.32.070.

Under taxpayer's agreement with Provider A, Provider A provides two separately billed services: "system support" and "user support." Taxpayer states that these services are primarily provided over the telephone. Although these amounts are separately stated, the services provided under the two classifications are not separately itemized. Instead, the

services under both categories can include telephone assistance, maintenance of system software, provision of emergency password, investigation of software errors, correction of errors in system software, maintenance of programming code, provision of information on new systems, and installation of programming requests required by outside organizations. Taxpayer conceded that Provider A helped it work out "bugs" over the telephone. While some of these services may involve warranty or professional services, because the charges for maintenance services are not adequately segregated, we sustain the auditor's assessment of use/deferred sales tax on the entire agreement.

Under taxpayer's agreement with Provider S, Provider S "may, at its option, with no additional charge to [taxpayer], make modifications to improve the operation and/or reliability of the products being serviced under this Agreement." This agreement specifically excludes the provision of training. Taxpayer states that it primarily received assistance in solving operator problems under this agreement. Although this agreement refers to the "Warranty provided hereunder," we find that the services include maintenance services because the agreement calls for the provision of modifications to canned software. Because the charges were not separately stated, we sustain the auditor's assessment of use/deferred sales tax.

Taxpayer's agreement with Provider T . . . divides the responsibilities of Provider T into two categories, and the charges for these two categories are separately stated.

The first category of Provider T services is Software Maintenance. Software Maintenance includes "extended warranty" of installed software; annual software releases to fix "bugs"; new codes, security records, and tables; written documentation on the changes made, including installation instructions; and testing and distribution of system software upgrades. These services include both warranty and maintenance services. Under Rules 107 and 257, mixed agreements are taxed as maintenance agreements, subject to sales or use tax. The auditor's assessment of use/deferred sales tax on this portion of the agreement is therefore sustained.

The second category of Provider T services is Customer Support, which includes: telephone consultation for the purpose of problem solving; assistance in communicating with hardware vendors; assistance in resolving problems resulting from equipment failure, operator error, or data errors; opportunity to purchase additional hardware at a discount; one annual on-site visit by Provider T for training, hardware relocation, or major software upgrades. This category of services includes both professional services and maintenance. Because the charges were not separately stated, use/deferred sales tax on this portion of the agreement is also sustained.

Taxpayer's agreement with Provider V provides that provider V will supply product updates and documentation, technical support, and maintain compatibility of the product with the operating system. These services include maintenance and, perhaps, professional services. However, because the charges for the services are not segregated, we sustain the auditor's assessment of use/deferred sales tax on the entire agreement.

[3] Finally, taxpayer argues that the Department is estopped from asserting use/deferred sales tax, citing Harbor Air Serv., Inc. v. Board of Tax Appeals, 85 Wn.2d 359, 560 P.2d 1145 (1977). In support of its argument, taxpayer provided a letter it received from Provider A, which states that Provider A does not charge sales tax on services that are performed from Provider A's office. Provider A states that it "confirmed this several times with the Washington State Revenue Department." In support of its statement, Provider A supplied taxpayer with a letter Provider A received from Taxpayer Information and Education, which states that income from servicing canned software is subject to sales tax but that income from consultations and servicing custom software is not.

Taxpayer also provided a letter it received from Provider S, which states that no sales tax is due on system support, but sales tax is due on equipment maintenance. Provider S provided taxpayer with the name of the person in Taxpayer Information and Education consulted in reaching these conclusions but did not provide anything in writing from the Department.

Taxpayer contends Provider T also provided a memorandum regarding the taxation of the agreements. However, taxpayer did not provide us a copy of this memorandum.

In Det. No. 92-15, 12 WTD 57 (1992), we stated:

> As the Washington State Supreme Court stated in Kitsap-Mason Dairymen's Association v. Tax Commission, 77 Wn.2d 812, 818 (1970), "The doctrine of estoppel will not be lightly invoked against the state to deprive it of the power to collect taxes." It has further held that estoppel will only prevent the state from collecting public revenues when all of the elements are present and applying the doctrine is necessary to prevent a manifest injustice. Harbor Air v. Board of Tax Appeals, 88 Wn.2d 359 (1977). In the taxpayer's case, even assuming that all of the elements are present, we do not believe that the application of the estoppel doctrine is required to prevent a manifest injustice. This is not a case where a taxpayer has relied on [prior written instructions] and failed to collect retail

> sales tax from its customers. Nor is this a case where a taxpayer has relocated a repair facility in reliance on a prior ruling. On the contrary, the tax involved here is use tax, upon which the primary liability falls squarely upon the taxpayer as a consumer. . . . We do not believe that requiring this taxpayer to pay its fair share of taxes constitutes a manifest injustice.

(Footnote omitted.)

This reasoning applies equally here. Further, we note that to create an estoppel, three elements must be present: (1) an admission, statement, or act inconsistent with the claim afterwards asserted; (2) action by the other party on the faith of such admission, statement, or act; and (3) injury to such other party resulting from allowing the first party to contradict or repudiate such admission, statement, or act. Harbor Air Serv., Inc. v. Board of Tax Appeals, 88 Wn.2d at 366-67. The support providers appear to have received very general information from the Department. None of the communications indicates that any specific facts were given. In each instance, the Department's advice was correct; the Department simply was not addressing the fact situation presently before us. Taxpayer's petition on this issue is denied.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 27th day of May 1993.

APPENDIX G

Cite as Det. No. 00-159E, 20 WTD 372 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	FINAL DETERMINATION
	)	No. 00-159E
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
	)	Docket No. . . .

[1] RULE 245; RCW 82.04.065: RETAILING B&O AND RETAIL SALES TAX -- NETWORK TELEPHONE SERVICE -- DEFINITION -- TRUE OBJECT. Where Taxpayer's network provided a computer data protocol conversion service in addition to transmitting data and information over its network to another computer, the true object of the service was found to be the transmission of data and information.

[2] RULE 245; RCW 82.04.065, RCW 82.04.297: SERVICE B&O TAX OR RETAIL SALES TAX -- NETWORK TELEPHONE SERVICE -- INFORMATION SERVICE -- INTERNET SERVICE. The term "internet service" was held to not include a protocol conversion and transmission service that acted upon only the protocols of the transmitted data or information.

. . .

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

DEPARTMENT OF REVENUE: Janis P. Bianchi, Policy & Operations Manager
Randolph E. Okimoto, Administrative Law Judge

NATURE OF ACTION:

A shared wide-area network computer service provider protests its re-designation to a network telephone service provider that is taxed under retailing and retail sales tax classifications.[1]

FACTS:

. . . (Taxpayer)[2] operates a shared wide area network (WAN) headquartered [outside Washington]. Taxpayer's books and records were examined by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1989 through December 31, 1993. This examination resulted in additional taxes and interest being assessed of $. . . . Document No. . . . was issued in that amount on July 20, 1995. Taxpayer protested the entire amount, and it remains due.

During the audit period Taxpayer operated two separate, shared wide area computer networks,[3] one utilizing the X.25[4] technology and another utilizing frame relay[5] technology. Each computer system on each WAN was linked by data transmission facilities utilizing either leased lines or packet-switched networks. In contrast to regular WANs, shared WANs share data transmission resources and may also share computer processing resources. Shared WANs are made up of logically separated[6] and subordinate WANs. Both shared WANs and regular WANs can be expanded to include systems on other WANs, through WAN-to-WAN interconnections called "gateways." Taxpayer gives the following explanation in its brief:

> To illustrate, the petitioner's customers, A and B, will each have at least one system on their premises (e.g., a host computer or router) comprising the edge of their proprietary networks and usually linked on a full-time basis to the petitioner's shared WAN.[7] A's remote users may form a temporary link with the network through remote (dial-up) access to A's host computer.[8] Users of A's host computer are typically denied access to

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] Nonprecedential portions of this determination have been deleted.
[3] A computer network is a set of interoperable (i.e. each computer can communicate with each other computer) computer-related systems.
[4] X.25 was the first worldwide accepted standard defining the interface between end-user equipment and a packet-switched network. It was first introduced in 1976. Enterprises generally stopped building X.25 WANs around 1990 and most have shifted to newer technologies such as frame relay.
[5] The frame relay standard was approved in 1991. The frame relay WAN first produced revenue for the petitioner in . . . 1991.
[6] The logical separations between proprietary WANs are achieved through access controls (log-in routines and password protection), network management systems or separate facilities.
[7] The full-time link generally consists of leased line services purchased by the shared WAN provider (e.g., Taxpayer) from a local telephone company, together with associated facilities.
[8] The temporary link consists of dial-up services purchased by the remote users from their local telephone companies which temporarily connect them to the WAN's shared remote access centers. Taxpayer does not provide this service. Remote (dial-up) access is a feature of X.25 and IP networks, but is not feasible for frame relay or

B's host computer, and vice versa. In this way, individual proprietary subscriber networks are logically carved out of the shared WAN. The addition of a gateway may allow A's users to interoperate with B's host computer, and the addition of another gateway may allow A's host computer to interoperate with a third party's computer on another shared WAN.

TAXPAYER'S CONTENTIONS AND ARGUMENTS:

Schedule 2 – Unreported Service Income

In Schedule 2, Audit assessed tax under the service and other activities business and occupation (B&O) tax classification on income that the auditor believed had not been reported on Taxpayer's monthly B&O tax returns. The auditor examined a listing of sales for one month and based on that listing, estimated that an additional 25% of Taxpayer's reported income had not been properly reported under the service tax classification. The auditor made this estimate because Taxpayer did not provide Audit with the actual invoices. On the other hand, Taxpayer contends that it reported 100% of its Washington income under the retailing B&O tax classification and that no income was unreported on its tax return. Although Taxpayer concedes that a portion of that income should have been reported under the service or selected business services[9] tax classification, Taxpayer states that the actual percentage is significantly more than the 25% assessed by Audit. In fact, Taxpayer argues that all of its income should be taxed under the service and other business activities tax classification or the selected business services tax classification, because it is providing computer networking services or internet services.

Schedule 3 – Disallowed Sales Tax Deductions

In Schedule 3, Audit assessed retail sales tax on disallowed deductions taken from the retail sales tax classification, because Taxpayer could not substantiate or document a valid reason for the deduction.

Recurring Charges - Dedicated Access Facilities Charges and Network Usage Fees:

Included in the disallowed deductions were charges for "rental/maintenance." At the hearing Taxpayer presented sample invoice #. . . from October 93 and its accompanying "recurring charge summary" which broke down all charges under this heading. The "recurring charge summary" identified all recurring charges associated with a particular equipment location. It indicated that Taxpayer charged the sample customer $174 for DAF Dial Backup, $783 for

ATM networks. However, remote (dial-up) access can be provided through an internetwork, e.g., an X.25 network with a gateway to a frame relay network.

[9] Effective July 1, 1993, RCW 82.04.290 was amended to create the selected business services tax classification. Chapter 25, Laws of 1993, 1st Special Session. The legislature repealed the selected business services tax classification in 1997 effective, June 30, 1998. Chapter 7, Laws of 1997.

Dedicated Access, and $87 for ". . . ."[10] Taxpayer concedes that portions of these charges were for the rental of equipment and properly subject to retailing B&O and retail sales tax. Taxpayer states that it has properly remitted retail sales tax on those amounts. Taxpayer contends, however, that the majority of these recurring charges were actually for "Dedicated Access Facilities" (DAF). Taxpayer contends that these charges were received for data information services and not for the use of tangible personal property or network telephone services. Taxpayer further explained in its May 17, 1996 memo that the DAF charges on its X-25 network were primarily for protocol processing services performed by one of [Taxpayer's] "black box" specialized computers through its X-25 network.[11] Taxpayer did acknowledge, however, that the DAF service charges included the costs of a dedicated telephone line between the customer's computer and [the] black box. Taxpayer further clarified that the term "permanent network connection point" referred to the physical slot on [the] "black box" protocol processor.

The remaining charges on the sample invoice were network usage fees. These fees were charged to customers for utilizing Taxpayer's shared WAN and were computed based on the number of units processed. Taxpayer also argues that these charges were for information services, computer networking services or internet services and not network telephone services.

True Object:

Taxpayer makes several alternative arguments to support its contention that its shared wide area network services (DAF charges & network usage fees) do not constitute network telephone services within the meaning of RCW 82.04.065 and Rule 245. First, Taxpayer argues that the true object of its customer on the X-25 network, is to acquire protocol conversion services that allow a customer's originating computer to communicate with a host or other on-line computers. Taxpayer explains in its petition that:

> [Taxpayer]'s customers know there is widespread incompatibility between the protocols of the computers and terminal devices with which they may wish to provide for the exchange of information. The binary data generated by one device frequently is not in a protocol that is recognizable by another device. The data may be in an incompatible format, it may employ an incompatible binary code, and it may be in an incompatible protocol. They know that protocol conversion will be required in order for the devices to interoperate. Processing of the format, code and protocol, is generically referred to as "protocol processing." In the usual case where the protocol processing results in a net change in the binary form between the sending and receiving devices, that change is referred to as "protocol conversion."

Taxpayer further explains in its petition that:

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[10] We presume that this is a hardware charge, since Taxpayer billed and collected retail sales tax on this amount.

[11] Since Taxpayer does not provide protocol conversion services through its frame relay network, Taxpayer acknowledges that DAF charges on the frame-relay network could not have been for protocol conversion services.

> The required protocol changes are accomplished by special purpose protocol processors placed between (interfacing) the devices and the telephone lines. The sending device's protocol is stripped off at the first processing node and replaced with a binary form known as X.25. At the terminating node, the X.25 protocol is removed and replaced with the contractually pre-defined protocol recognized by the customer's host device.

Taxpayer further explains in its brief:

> WAN's like the petitioner's X.25 WAN filled a key need by offering services that reduced line costs through sharing of data transmission facilities, but more importantly offered customers a compelling value proposition in offering protocol conversion capabilities that made it much easier to connect cheaper ASCII terminals and PC's emulating these devices (e.g. Digital's VT-100) to IBM FE's (front ends) and by extension to applications resident on mainframes. These new protocol conversion capabilities offered over both shared WAN's and through dedicated protocol conversion hardware enabled corporations to extend the reach of their applications to new classes of users. For example, services based on protocol conversion made it practical to provide direct access to mainframe applications such as order entry and tracking to field sales personnel.

Taxpayer relies on WAC 458-20-245 (Rule 245) and Det. No. 90-128, 9 WTD 280-1 (1990) in support of its position.

Legislative Intent:

Next, Taxpayer points out that when the Washington State Legislature originally removed the telephone business from the public utility tax classification in 1983,[12] computer networking services were not considered part of the telephone business. Therefore, computer networking services were not subject to public utility tax but instead were taxed under the service and other business activities tax classification. Taxpayer argues that the Legislature intended that only the existing regulated telephone business (that was formerly subject to public utility tax classification) should be included under the newly defined "network telephone services" definition of a retail sale. Taxpayer argues that the Legislature did not intend to place any existing non-regulated businesses into the new definition and argues that all non-regulated existing businesses should remain in their respective B&O tax classifications.

Internet Service:

[12] Laws of 1983, 2nd Ex. Sess., ch. 3.

In the alternative, Taxpayer argues that its shared wide area networking services constitute "internet service" within the meaning of RCW 82.04.297[13] and, therefore, [are] specifically excluded from the definition of network telephone service. Taxpayer points to the definition of "internet service" contained in RCW 82.04.297 and states that it closely resembles the Federal Communications Commission's (FCC) definition of "enhanced services" that is codified in 47 C.F.R. § 64.702(a). Taxpayer states that the FCC treats enhanced services as a non-regulated activity.

Based on the definition of "internet service" contained in RCW 82.04.297, Taxpayer argues that its shared WANs (. . .) are part of the Internet and, therefore, when it allows its customers access to [its shared WANs], it is also allowing them access to the "Internet." Since providing access to the Internet is specifically included within the definition of "internet service," Taxpayer argues that its activities should be taxed as an internet service under either the service and other or selected business activities tax classifications.

Taxpayer also argues that even if [its shared WANs are] not actually the "Internet," its network is sufficiently similar so that its activities should be treated as internet services for taxation purposes. Taxpayer points out that:

> Computer networking has roughly five major facets. These include: (1) network interaction; (2) network reliability; (3) network security; (4) network services, and; (5) network connection methods. The . . . the Internet, [Taxpayer's shared WANs], and all other networking solutions implicate all five facets, albeit in slightly different ways.

. . .

Taxpayer also asks that extension interest be waived.

ISSUES:

1) Do Taxpayer's dedicated access facilities charges and network usage fees for its shared WAN services fall within the definition of network telephone services?

2) Are Taxpayer's shared WAN services "internet services" and, therefore, excluded from the definition of network telephone services?

. . .

DISCUSSION:

[13]The Washington State Legislature specifically excluded "internet service" from the definition of network telephone services in 1997. Laws of 1997, ch. 304. Although RCW 82.04.297 was enacted in 1997, it was intended to be a clarification of existing law, and, therefore, we apply it retroactively. *See*, Det. No. 98-193, 18 WTD 338 (1999).

Schedule 2 – Unreported Service Income

This issue involves whether Taxpayer has reported all of its taxable Washington income on its state and local combined state excise tax returns. The verification of gross income and the computation of tax for various tax classifications is primarily an issue of fact. The Audit Division is better suited to perform this task. Taxpayer is directed to provide all billing invoices to the Audit Division for the period October 1993 within 90 days of the issuance of this determination. Accordingly, this issue is remanded to the Audit Division. If Taxpayer fails to provide such invoices within 90 days or such longer period as the Audit Division may, in its discretion grant, the assessment shall be deemed upheld.

Schedule 3 – Disallowed Sales Tax Deductions
Recurring Charges - Dedicated Access Facilities Charges & Network Usage Fees:

RCW 82.04.050(5) defines a retail sale as including "the providing of telephone service, as defined in RCW 82.04.065, to consumers." RCW 82.04.065 defines "telephone service" as "competitive telephone service or network telephone service, or both." It further states:

> "Network telephone service" means the providing by any person . . . 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.

In interpreting the above statute the term "network telephone service" is broadly defined. If Taxpayer's services fall within any one of the statutorily defined activities then it is taxable as a network telephone service provider and subject to retailing B&O and retail sales tax on its charges. If not, WAC 458-20-245 (Rule 245) and RCW 82.04.290 provide that Taxpayer's computer and data processing activities are taxable under the service and other activities or selected business services B&O tax classifications.

True Object:

Under RCW 82.04.065 "network telephone service" means "the providing of telephonic, video, data, or similar communication or transmission for hire, via a local telephone network, toll line or channel, cable, microwave, or similar communication or transmission system." (Emphasis ours.)

We believe that Taxpayer's shared WAN services fall within this broad statutory definition of network telephone services.

First, Taxpayer clearly transmits data or information for hire. Taxpayer's customer supplies the data or information, and Taxpayer's shared WAN transmits that data from a computer in one location to a different computer in another location. The fact that Taxpayer may contract with an underlying telecommunications carrier for the telephone lines that actually transmit the data is not

determinative. What is determinative, however, is that the customer holds Taxpayer responsible for the eventual transmission of the computer data or information to its final destination. If the computer data is not received, the customer would look to Taxpayer for restitution and/or compensation and not the underlying carrier. Instead, we believe that Taxpayer purchases basic network telephone transmission services from an underlying telecommunications carrier and, for the X-25 network, Taxpayer further enhances the transmission by adding protocol conversion services. For the X-25 network the taxpayer sells the protocol conversion services and transmission services to customers under one fee. For the frame relay network the fee is for transmission services only.

Although Taxpayer cites Det. No. 90-128, 9 WTD 280-1 (1990) in support of its contention that the true object of Taxpayer's shared WAN services is to provide protocol conversion services or computer interoperability, not transmission of data for hire, Taxpayer's reliance is misplaced. Det. No. 90-128 involved a data processing service that performed data processing services for customers via computer terminals connected with its own data processing computers. In addition, the agreement between the data service provider and its customer only required the customer to "bear the cost of the same [leased lines] in connection with the 'on line availability' of the data processing services." Id at 280-4. The determination also noted that the contractual agreement repeatedly referred to "services" or "data processing services" when describing that taxpayer's obligations to its customer. The determination also emphasized that several pages of the agreement were "devoted exclusively to a detailed description of the types of data processing services to be rendered and the manner in which these services are to be performed." Id at 280-4. Under these circumstances, the determination found that the true object of the purchaser in the transaction was to acquire data processing services and that the billing for leased lines was essentially a recovery of one cost of providing that service.

In contrast, Taxpayer's marketing flyer . . . describes the services offered by Taxpayer to be primarily data transmission services . . . .

. . .

[Similarly], the options and customer support features [listed in the flyer] primarily emphasize the quality or quantity of the data transmission services that Taxpayer provides to customers and not protocol conversion services.

We further note that Taxpayer does not separately invoice or itemize a charge for its protocol conversion services performed through its X-25 network. Instead, these charges are included with and billed as part of Taxpayer's entire charge for transmitting the customer's data or information to, from and through its X-25 shared WAN. Protocol conversion services are simply included in its DAF charges. In addition, Taxpayer has presented no evidence that it charges differently for transmission services provided through its X-25 network than for those provided through its frame relay network, even though protocol conversion services are provided only through its X-25 network. This omission reinforces our conclusion that the true object of Taxpayer's shared WAN services is data transmission.

In general, the Department does not allow a single billing or contract to be segregated or bifurcated unless there is a reasonable basis on which to do so. Det. No. 98-012, 17 WTD 247 (1998). As we stated in Det. No. 89-433A, 11 WTD 313 (1992):

> We do believe that bifurcation of a contract for taxation will be the unusual case. In most cases income from a performance contract will be taxed according to the primary nature of the activity. For example, income from processing for hire is taxed at the processing for hire rate even though some storage or other services are also involved.

In that case, we allowed bifurcation because the taxpayer's contract, which was negotiated before the work was performed, provided a reasonable basis for determining the value of the various activities performed. Generally, if a taxpayer engages in activities that are within the purview of two or more tax classifications, it will be taxable under each applicable classification. RCW 82.04.440. However, bifurcation is not allowed as a matter of law if the activity is essentially a single activity, even if the contract may provide a basis for determining the value of the various activities performed under the contract. If the services are functionally integrated, then the entire contract price is subject to tax at a single rate. *See Chicago Bridge and Iron v. Department of Rev.*, 98 Wn.2d 814, 659 P.2d 463, *appeal dismissed*, 464 U.S. 1013 (1983).[14]

In this case, Taxpayer's protocol conversion services are additional services that allow the customer's transmitted data or information to interact with the receiving computer. It is functionally integrated with the transmission activities performed by Taxpayer's shared wide-area computer network. As such, it is an integral part of the transmission activity and cannot be bifurcated from what is essentially a single activity. This is true, even though the contract may or may not provide a basis for determining the value of the protocol conversion activity alone.

Based on these facts, we conclude that the true object of Taxpayer's shared WAN business activities is to transmit computer data or information for hire. Although protocol conversion is important, it is not the true object of the services being provided.

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[14] In *Chicago Bridge*, the taxpayer sought a refund of a portion [of] the B & O taxes paid on the gross receipts from the sales of goods designed, manufactured, and installed for customers in Washington, but contracted for outside the state. It contended the tax was unconstitutional as a violation of due process (U.S. Const. amend. 14, § 1 and Const. art. 1, § 3) and the commerce clause (U.S. Const. art. 1, § 8, cl. 3). The contracts at issue bifurcated the design and manufacturing of three products from their installation. Hence, the taxpayer argued that the 3 contracts covering only the design and manufacturing phase had no nexus to Washington. The Washington Supreme Court did not recognize the bifurcation, stating:

> CBI generally performs all aspects of design, manufacture, delivery and installation of its products, and customers negotiate a single, lump-sum price for a finished, installed product. CBI's engineering, manufacturing, and installation operations are functionally integrated and coordinated from the first proposal to a customer through each phase of the design, manufacturing and installation process.

98 Wn.2d at 818. Accordingly, the design and engineering services were subject to B&O tax because the contracts were "functionally integrated."

Legislative Intent:

Next, Taxpayer contends that the 1983 Washington State Legislature only intended to place the existing telephone business that was formerly taxed as a public utility into the new network telephone service definition. We believe, however, that the legislature intended to complete what it had begun in 1981, i.e. the deregulation of the telephone business and the equalization of tax burdens on all businesses engaging in the telephone business without regard to whether the business was regulated or non-regulated. *See Western Telepage, Inc. dba AT&T Wireless Services v. Tacoma*, 140 Wn. 2d 599, 998 P.2d 884 (2000). To accomplish this purpose, the Legislature drafted a broad definition of network telephone services and excluded from that definition those existing businesses, i.e. cable, broadcast services by radio or television that the legislature wanted to continue to tax under a separate tax classification. Taxpayer's activities, because they are primarily focused on the transmission of information for hire, fall within the broad definition of network telephone services, not the excluded services.

Internet Service:

RCW 82.04.065(2) clarifies that certain services, even though they include some data or information transmission services, are not within the statutory definition of network telephone services. It states in pertinent part:

> . . . "Network telephone service" 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. "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.

Taxpayer contends that its protocol conversion services in its X-25 network are "internet services" which are taxed as information services under RCW 82.04.055. We cannot agree.

RCW 82.04.290(1) imposes a B&O tax upon "every person engaging within this state in the business of providing selected business services." RCW 82.04.055 defined "selected business services" as including "information services." It further stated:

> (d) Information services, including but not limited to electronic data retrieval or research that entails furnishing financial or legal information, data or research, internet service as defined in RCW 82.04.297, general or specialized news, or current information unless such news or current information is furnished to a newspaper publisher or to a radio or television station licensed by the federal communications commission.

RCW 82.04.297(3) defines "internet service" and states:

> "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.

We first note that the legislature has included "internet service" within the broader term "information service" contained in RCW 82.04.055 and not within the term "data processing services." Information service implies that new information or data is obtained, whereas data processing service implies that existing data is merely manipulated. *See* RCW 82.04.055. In addition, RCW 82.04.297 states that the internet service provider must provide that information service through the use of computer processing applications that either 1) provide the user with additional or restructured information [through the internet or a proprietary subscriber network], or 2) permit the user to interact with stored information through the internet or a proprietary subscriber network.

Although Taxpayer's protocol conversion services include computer processing applications, the applications do not meet the second part of the statutory test for internet service. They do not provide the user with restructured data or information. Taxpayer's protocol conversion services only act on or change the protocols accompanying the data or information being sent and do not restructure the transmitted data or information itself. The data or information remains substantially the same as when it was originally received. The Model Telecommunications Act and the Federal Communications Commission's (FCC) definitions exclude from telephone services certain enhanced services. The FCC defines enhanced services to specifically include computer applications that:

> ... act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information, or provide the subscriber with additional, different, or restructured information, or involve subscriber interaction with stored information. 47 CFR § 64.702(a). (Underlining added.)

We find it noteworthy that the Washington State Legislature, when it enacted internet legislation in 1997, chose not to utilize this portion of the FCC definition. By not including in its definition of internet services the FCC language dealing with computer applications acting solely on format, content, code, protocol, the legislature must be presumed to have not included such applications within the definition of internet service. *Cf. Bird-Johnson Corporation, v. Dana Corporation* 119 Wn.2d 423, 833 P.2d 375 (1992). This conclusion is further supported by the fact that "internet service" is defined as an information service and not a data processing service.

Neither do Taxpayer's shared WAN services meet the second alternate type of internet service by permitting the ". . . user to interact with stored information through the internet or a proprietary subscriber network . . . ." RCW 82.04.297(2) contains the following definition of the "Internet":

> "Internet" means the international computer network of both federal and nonfederal interoperable packet switched data networks, including the graphical subnetwork called the world wide web.

Taxpayer's shared wide area network was a closed network limited to only Taxpayer's shared WAN users. Taxpayer has not presented evidence that gateways either existed or were utilized that permitted Taxpayer's user to interact with stored information through the Internet during the audit period. For these reasons, we find that Taxpayer has not established that [Taxpayer's shared WAN] was part of the Internet during the period in question.

We also do not believe that [Taxpayer's shared WAN] was a proprietary subscriber network within the meaning of RCW 82.04.297. In Taxpayer's supplemental brief, dated November 20, 1997, Taxpayer speculates:

> The Legislature was probably using the phrase "proprietary subscriber network" in the same sense in which that phrase was used by the Interactive Services Association (ISA) in its January 28, 1997 white paper entitled "*Logging On to Cyberspace Tax Policy White Paper.*" There, the ISA defined a "proprietary subscriber network" in terms contiguous with the business operations of a typical Online Service Provider (OSP), e.g.; . . ., . . ., or . . ., in which proprietary information data bases, e-mail, chat and other services are made available only to their subscribers in exchange for a usage-based or fixed monthly fee. The ISA explained:
>
> > '[A]n OSP is a business providing access to and content available on a proprietary subscriber network." "Content is made available to the public by OSPs.... It consists of information and services delivered to the public electronically via ... proprietary subscriber networks.'

This identification of "proprietary subscriber networks" with OSPs is further supported by the House Bill Report filed by the House Committee on Energy & Utilities of the Washington State Legislature, regarding the passage of Substitute Senate Bill 5763 in 1997. Although Taxpayer states that its shared WANs currently provide e-mail services, and allow hosting of some other financial and medical information or data like other on-line service providers, it has not established that these services were offered during the audit period in question.[15] Therefore, we find that Taxpayer's shared WANs were not proprietary subscriber networks during the audit period.

. . .

. . .

[15] In Taxpayer's supplemental letter submitted March 30, 2000, Taxpayer indicated that the Product Identification Codes for [Taxpayer's shared WAN]'s e-mail, e-commerce and medical and financial information services previously described in its brief, did not show up during the audit sample month, October of 1993. Consequently, Taxpayer is not certain that these services were offered during the audit period.

DECISION AND DISPOSITION:

Taxpayer's petition is conditionally granted in part, remanded in part and denied in part.

Dated this 12th day of February, 2001.

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DIVISION II

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STATE OF WASHINGTON
BY
DEPUTY

NO. 37718-7-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

QUALCOMM, INCORPORATED,

Appellant,

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Respondent.

DECLARATION OF SERVICE

I, Carrie A. Parker, state and declare as follows:

I am a citizen of the United States of America and over 18 years of age and not a party to this action. On October 13, 2008, I provided a true and correct copy of BRIEF OF RESPONDENT and this DECLARATION OF SERVICE to be served via U.S. mail (through Consolidated Mail Services), with proper postage affixed to:

Michele Radosevich
Davis Wright Tremaine
1201 Third Avenue, Ste 2200
Seattle, WA 98101-3045

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

Executed this 13th day of October, 2008, in Olympia, Washington.

Carrie A. Parker

Carrie A. Parker, Legal Assistant