11-3394 & 11-3395
TAX TYPE: SALES TAX
TAX YEARS: 11-1-2005 through 9-30-2010
DATE SIGNED: 8-27-2013
COMMISSIONERS: B. JOHNSON, D. DIXON, M. CRAGUN, R. PERO
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER-1 & TAXPAYER-2, Petitioners, v. TAXPAYER SERVICES DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING ORDER** Appeal Nos. 11-3394 11-3395 Tax Type: Sales Tax Tax Period: 11/1/2005 – 9/30/2010 Judge: Phan

Presiding:
Jane Phan, Administrative Judge

Appearances:
For Petitioner: REPRESENTATIVE FOR TAXPAYERS-1 & 2, Attorney at Law
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT-1, Assistant Director Taxpayer Services Division
RESPONDENT-2, from Taxpayer Services
RESPONDENT-3, From Taxpayer Services

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing in accordance with Utah Code §59-1-502.5, on March 25, 2013. Petitioners TAXPAYER-1 and TAXPAYER-2 were affiliates of TAXPAYER-3 (collectively all three entities will be referred to as "Taxpayers"). TAXPAYER-3 had submitted a refund request in the amount of $$$$$ for sales tax and municipal telecommunications tax that the two affiliates had collected from Utah customers on various wireless services providing Internet access during the period from November 1, 2005 through September 30, 2010. TAXPAYER-3 is seeking refunds in numerous states following the settlement of a class action brought by TAXPAYER-3 customers contending that TAXPAYER-3 improperly collected taxes on Internet access. Respondent ("Division") issued a Statutory Notice on November 21, 2011, denying the refund request and the Taxpayers timely appealed. For the hearing, Taxpayers no longer contested the Division's action

regarding the refund request for the period from November 1, 2005 through September 30, 2007, conceding that the refund for this period would be barred by the statute of limitations. Further, there was a statutory revision effective January 1, 2009, which specifically excluded Internet access from telecommunications taxes, so the period after the revision was not at issue. For the Initial Hearing the parties had limited the issues to be addressed to cover the refund request for the period from October 1, 2007 to December 31, 2008. TAXPAYER-3 had submitted a Prehearing Brief dated March 21, 2013, and a Post Hearing Brief dated April 15, 2013. The Division had submitted a Prehearing Brief dated March 22, 2013, and a Post Hearing Brief dated April 30, 2012. The issue before the Commission during the hearing pertains to taxes Taxpayers charged to customers and remitted to the Tax Commission for wireless Internet access services.

APPLICABLE LAW

Utah law provided for taxation of "telephone service" at Utah Code § 59-12-103(1) (2007) as follows:

> A tax is imposed on the purchaser as provided in this part for amounts paid or charged for the following transactions: . . . (b) amounts paid: (i) to a: (A) telephone services provided regardless of whether the telephone service provider is municipally or privately owned; . . . (ii) for . . . (B) mobile telecommunications service that originates and terminates within the boundaries of one state only to the extent permitted by the Mobile Telecommunications Sourcing Act, 4 U.S.C. Sec. 116 et seq . . .

"Telephone Service" is defined at Utah Code § 59-12-102(104) (2007) as follows:

> (a) "Telephone service" means a two-way transmission: (i) by: (A) wire; (B) radio; (C) lightwave; or (D) other electromagnetic means; and (ii) of one or more of the following: (A) a sign; (B) a signal; (c) writing; (D) an image; (E) sound; (F) a message; (G) data; or (h) other information of any nature.
> (b) "Telephone service" includes: (i) mobile telecommunications service; (ii) private communication service; or (iii) automated digital telephone answering service.
> (c) "Telephone service" does not include a service or a transaction that a state or a political subdivision of a state is prohibited from taxing as of July 1, 2001, under the Internet Tax Freedom Act, Pub. L. No. 105-277.

During the period at issue the Internet Tax Freedom Act ("ITFA") at § 1101(2007) provided as follows:

> (a) Moratorium. No State or political subdivision thereof may impose any of the following taxes during the period beginning November 1, 2003, and ending November 1, 2014:
> (1) Taxes on Internet access.
> (2) Multiple or discriminatory taxes on electronic commerce.
> . . .

> (e) Additional exception to moratorium.
> (1) In general. Subsection (a) shall also not apply with respect to an Internet access provider, unless, at the time of entering into an agreement with a customer for the provision of Internet access services, such provider offers such customer (either for a fee or at no charge) screening software that is designed to permit the customer to limit access to material on the Internet that is harmful to minors.
> (2) Definitions. In this subsection:
> (A) Internet access provider. The term 'Internet access provider' means a person engaged in the business of providing a computer and communications facility through which a customer may obtain access to the Internet, but does not include a common carrier to the extent that it provides only telecommunications services.
> (B) Internet access services. The term 'Internet access services' means the provision of computer and communications services through which a customer using a computer and a mode or other communications device may obtain access to the Internet, but does not include telecommunications services provided by a common carrier.
> (C) Screening software. The term 'screening software' means software that is designed to permit a person to limit access to material on the Internet that is harmful to minors.

ITFA provides a definition of 'tax on internet access which is at ITFA at § 1105(10) and provides:

> (A) In general. The term 'tax on Internet access' means a tax on Internet access, regardless of whether such tax is imposed on a provider of Internet access or a buyer of Internet access and regardless of the terminology used to describe the tax.

Utah Code §59-1-1417 provides, "[i]n a proceeding before the commission, the burden of proof is on the petitioner…"

DISCUSSION

On November 1, 2011, the Division issued a Statutory Notice disallowing the Taxpayers' refund request for sales tax and municipal telecommunications tax that the Taxpayers collected from Utah customers and remitted to the Tax Commission. For purposes of the Initial Hearing,[1] the parties limited the argument to the issue of, "Whether the Commission may deny the portion of the Refund Claims for the period October 1, 2007 to December 31, 2008, by asserting that the Taxpayers failed to offer screening software to customers and that such purported failure justifies denial of a refund of taxes on Internet access services paid by customers."[2] At the hearing the Taxpayers argued that Internet access services were not subject to the sales tax even prior to the January 1, 2009 statutory revision. In the Post

[1] Prior to the Initial Hearing the parties had discussed an issue arising from the Utah Supreme Court's decision in *Ivory Homes v. Utah State Tax Commission*, 2011 UT 54 (2011). However, both parties were in agreement that the issue was resolved when Utah Senate Bill 27 was adopted amending Utah Code Sec. 59-1-1410(7).
[2] AT&T's Post Hearing Brief, dated April 15, 2013, pg. 1.

Hearing Brief, the Taxpayers made a second argument in the alternative, that Taxpayers had, in fact, offered screening software to customers.

The Taxpayers argue that although during the period from October 1, 2007 to December 31, 2008, Utah law specifically provided a tax for mobile telecommunications services it did not tax charges for Internet access services. The Taxpayers argue that the wireless Internet services they provided were not "telephone services" and not taxable under Utah Law. They pointed out that historically, the Utah State Tax Commission had not subjected internet access charges to tax.[3] The statute in effect from 2001 through 2008 had been adopted by the Utah Legislature in SB213, 2001. It was the Taxpayers' contention that the fiscal note with this bill showed no fiscal impact, arguing that the Legislature merely intended to continue its historic practice of not taxing Internet access services.

In addition to the legislative history, the Taxpayers argue that the law in effect during the period at issue excluded from tax a "service or transaction" that a state would be prohibited from taxing under ITFA. Utah Code Sec. 59-12-102(104)(c). The Taxpayers point to the language of ITFA §1101 and argue that it is directed to an Internet access provider. They noted that the tax imposed under Utah Code § 59-12-103(1) is on the purchaser and merely collected and remitted by the provider. The Taxpayers argue that the Division's interpretation is in error because, "the determination of whether any given Utah customer must pay telecommunications tax on its purchases of Internet access services would depend on whether the provider did or did not offer screening software to its customers." The Taxpayers go on to state, "This cannot have been the intention of the Utah legislature."[4]

It was the Taxpayers' position in its Prehearing Brief and at the hearing that the application of the ITFA language addressing screening software is not relevant because Internet access services were not subject to tax under Utah law, regardless of ITFA. For that reason they had not previously addressed the question of whether they had offered the screening software with the Internet access services which they provided to their customers. In their Post Hearing Brief the Taxpayers stated they did offer screening software to their customers as early as December 11, 2005 and provided some brochures or advertising available through Internet archives that described "parental controls" and how they were available to restrict access to mature content. However, this information had not been submitted at the hearing and it was unclear if this information had previously been given to the Division to review.

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3 Taxpayers site to Commission Advisory Opinions from 1996 and 1998, Opinions 96-141, 97-080, 99-012. As the Taxpayers acknowledge, these were issued prior to the 2001 revision of Utah Code Sec. 59-2-102(1004) that was in effect up to December 31, 2008. Additionally, the requesting companies did not appear to be mobile telephone service providers.

4 Taxpayer's Post Hearing Brief, pg. 3.

In this matter the Division argues that the wireless Internet services were subject to sales tax under Utah Code Sec. 59-12-103(1), as amounts paid to a telephone service provider for telephone services. Utah Code Sec. 59-12-102(104) specifically includes mobile telecommunications service and also provided a specific exclusion from taxation incorporating the ITFA provision. It was the Division's position that the ITFA created a moratorium on taxing Internet access that was contingent on the Internet access provider also providing screening software that filters content harmful to minors. The Division's representative argued that the Internet access the Taxpayers had provided would be subject to tax as part of the telephone service under Utah Code §§ 59-12-103 and 59-12-102(104) unless it came within the tax moratorium provided in ITFA at §Section 1101(a). Therefore, the Division argues only if the Taxpayers were able to prove that they offered screening software to their customers would the transaction be excluded from the tax. The Division noted that the ITFA provisions were incorporated in their entirety under Utah Code § 59-12-102(104). The Division argues, " . . . the determination of whether a service transaction is subject to sales tax always turns on what specific services the merchant offers in the transaction. Indeed, it is impossible to bifurcate the Internet service provider's decision not to offer filtering software to its customers from the taxability of the transaction in which that service is sold to the customer."[5]

The Commission's decision on whether the Taxpayers must prove they offered the screening software to their customers to be entitled to the refund or whether the Internet service was not subject to tax regardless of the ITFA provisions is a question of law based on the interpretation of the statutes in effect for the period of October 1, 2007 through December 31, 2008. During this period Utah Code § 59-12-103 imposed a tax on the purchaser on the amounts paid for telephone service. Utah Code § 59-12-102(104)(a) defined 'telephone service' to be a two-way transmission by wire, radio, light wave or other electromagnetic means of a sign, signal, writing, image, sound message or data. Utah Code § 59-12-102(104)(b) specifically included mobile telecommunications services. Utah Code § 59-12-102(104)(c) excluded from 'telephone services' a service or a transaction that a state or political subdivision is prohibited from taxing under the Internet Tax Freedom Act. The ITFA provides that states and political subdivisions may not impose taxes on internet access if, "at the time of entering into an agreement with a customer for the provision of Internet access services, such provider offers such customer screening software that is designed to permit the customer to limit access to material on the Internet that is harmful to minors." ITFA at § 1101(e)(1).

The Taxpayers argue that the wireless Internet access it provided to its customers was not taxable

5 Division's Post Hearing Brief, pg. 4.

as a telephone service and, therefore, not subject to tax regardless of the ITFA exclusion. However, the Taxpayer's interpretation of Utah Code Sec. 59-12-102(104) would render the provisions of Utah Code Sec. 59-12-102(104)(c) meaningless, because if wireless Internet services provided by the mobile telecommunications providers were not included in "telephone service" there would be no need for the ITFA exclusion, as the ITFA provisions deals only with Internet services. The interpretation of the statute in the manner suggested by the Division is appropriate and is consistent with a Private Letter Ruling issued by the Commission, October 12, 2007, which considered the statute in effect during the period at issue. In *Private Letter Ruling 06-024* the Commission held "Utah law provides for taxation to the extent not prohibited by the Internet Tax Freedom Act . . . For sales and use tax, the applicable Utah statutes specifically mention the Internet Tax Freedom Act."[6] Therefore, for the wireless Internet service provided by the Taxpayers to be nontaxable during the period of October 1, 2007 to December 31, 2008, the Taxpayers will have to show that they meet the Sec. 59-12-102(104)(c) exclusion by demonstrating that "at the time of entering into an agreement with a customer for the provision of Internet access services" the Taxpayers offered "such customer (whether for a fee or at no charge) screening software that is designed to permit the customer to limit access to material on the Internet that is harmful to minors." ITFA Sec. 1101(e)(1). Although the Taxpayer did submit some information to indicate that this capability had been available during the refund period at issue, this had been in a post-hearing submission. This is a factual determination that was not fully explored during the hearing and, therefore, the burden of proof on this point has not been met by the Taxpayers. The Taxpayers' appeal should be denied.

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Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission denies the Taxpayers' appeal. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a

6 Neither party had cited to Private Letter Ruling 06-024. Private Letter Rulings are available in a redacted format at tax.utah.gov/commission-office. For the Initial Hearing the parties had limited the issue narrowly, so it is unclear whether they have considered, but decided not to address other factors that were brought out in this Private Letter Ruling.

request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____day of _____, 2013.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner