STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
SPRINT INTERNATIONAL COMMUNICATIONS CORPORATION	:	DECISION DTA No. 808985
for Redetermination of Deficiencies or for Refund of Corporation Tax under Article 9 of the Tax Law for the Years 1983 through 1987.	:	

Petitioner Sprint International Communications Corporation, 2330 Shawnee Mission Parkway, Westwood, Kansas 66205 (hereinafter "Sprint") and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on March 17, 1994. Petitioner appeared by Richard N. Wiley and Mark V. Beshears, Esqs. The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

Each party filed a brief in support of their exception and in opposition to the other party's exception. Each party also filed a reply brief. Oral argument, at the request of both parties, was heard on February 15, 1995 and began the six-month period for the issuance of this decision.

Commissioner DeWitt delivered the decision of the Tax Appeals Tribunal. Commissioners Dugan and Koenig concur.

ISSUES

I. Whether Sprint International Communications Corporation is subject to tax under Tax Law §§ 183, 183-a, 184 and 184-a as a business whose activities constituted telephony or telegraphy or the conduct of a transportation or transmission business.

II. Whether Sprint International Communications Corporation is subject to tax under Tax Law §§ 186-a and 186-c as a business whose activities constituted the sale of telephony or telegraphy.

III. Whether Sprint International Communications Corporation's gross earnings computed for the purposes of Tax Law §§ 184 and 184-a may be reduced by a deduction for the proportionate cost of nationwide telephone company costs and charges acquired and resold and apportioned to New York.

IV. Whether the attempt by the Division of Taxation to assess Sprint International Communications Corporation pursuant to Tax Law § 186-a is unconstitutional selective enforcement.

V. Whether the attempt by the Division of Taxation to assess Sprint International Communications Corporation lacks a rational basis and/or violates the equal protection clauses and/or the due process clauses of both the United States and New York State Constitutions.

VI. Whether petitioner has shown that its failure to comply with the Tax Law, if so determined, was due to reasonable cause and was not due to willful neglect.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

STIPULATED FACTS

Pursuant to 20 NYCRR 3000.7, the parties stipulated and agreed that the following facts may be taken as true, subject to the rights of the parties to introduce other and further evidence not inconsistent with these stipulated facts.

Petitioner, Sprint International Communications Corporation ("Sprint"), is a corporation organized under the laws of the State of Delaware and has its principal offices in Reston, Virginia.

In or about June 1987, the New York State Department of Taxation and Finance ("Division")[1] audited petitioner's operations. By letter dated June 14, 1989, the Division notified petitioner that it considered petitioner to be principally engaged in the conduct of a transmission business subject to franchise taxation under Article 9, sections 183, 184 and 186-a[2] of the Tax Law. As such, the Division treated petitioner as a utility as defined in section 186-a(2) of the Tax Law.

By cover letter dated June 19, 1989, the Division forwarded copies of audit workpapers computing the amount of tax it claimed petitioner owed under Article 9, sections 183, 184 and 186-a of the Tax Law.

The Division's letters of June 14, 1989 and June 19, 1989, and the audit workpapers, reflect the Division's intent to treat petitioner as a utility, as defined in section 186-a(2) of the Tax Law, retroactively to the year 1983.

The Division issued 29 notices of deficiency (the "notices") to petitioner, dated September 7, 1990. The basis for the notices were the computations set forth in the audit workpapers. The notices set forth the amount of tax, interest and penalty the Division claimed petitioner owed under Article 9, sections 183, 183-a, 184, 184-a, 186-a[3] and 186-c of the Tax Law for the years 1983 through 1987.

The Division's proposed assessments under Article 9, sections 183 and 183-a, together with the amount of penalty and interest accrued through the date of the notices, are as follows:

Year Ended	Tax Law Section	Assessment Number	Tax	Penalty	Interest	Total
31-Dec-87	183	C900907120F	$4,106.00	$1,164.00	$ 616.00	$ 5,886.00
31-Dec-87	183-a	C900907121S	434.00	123.00	65.00	622.00
31-Dec-86	183	C900907122F	2,575.00	990.00	541.00	4,106.00
31-Dec-86	183-a	C900907123S	16.00	6.00	3.00	25.00

[1]For purposes of clarity, the term "Division" was substituted for the term "Department," which appeared in the original Stipulation of Facts.

[2]References to sections 183, 184 and/or 186-a will also include sections 183-a, 184-a and/or 186-c.

[3]Section 186-a was omitted from the original Stipulation of Facts.

31-Dec-85	183	C900907124F	105.00	55.00	26.00	186.00
31-Dec-85	183-a	C900907125S	15.00	8.00	4.00	27.00
31-Dec-84	183	C900907126F	107.00	76.00	27.00	210.00
31-Dec-84	183-a	C900907127S	12.00	9.00	3.00	24.00
31-Dec-83	183	C900907128F	83.00	75.00	21.00	179.00
Total			$7,453.00	$2,506.00	$1,306.00	$11,265.00

The Division's proposed assessments under Article 9, sections 184 and 184-a, together with the amount of penalty and interest accrued through the date of the notices, are as follows:

Year Ended	Tax Law Section	Assessment Number	Tax	Penalty	Interest	Total
31-Dec-87	184	C900907110F	$ 16,984.00	$ 4,816.00	$ 4,246.00	$ 26,046.00
31-Dec-87	184-a	C900907111S	8,788.00	2,492.00	2,197.00	13,477.00
31-Dec-86	184	C900907112F	15,116.00	5,810.00	4,686.00	25,612.00
31-Dec-86	184-a	C900907113S	6,498.00	2,497.00	2,015.00	11,010.00
31-Dec-85	184	C900907114F	20,521.00	10,692.00	7,182.00	38,395.00
31-Dec-85	184-a	C900907115S	7,480.00	3,897.00	2,618.00	13,995.00
31-Dec-84	184	C900907116F	68,504.00	48,629.00	23,976.00	141,109.00
31-Dec-84	184-a	C900907117S	9,674.00	6,867.00	3,386.00	19,927.00
31-Dec-83	184	C900907118F	43,554.00	39,602.00	15,244.00	98,400.00
31-Dec-83	184-a	C900907119S	5,704.00	5,186.00	1,996.00	12,886.00
Total			$202,823.00	$130,488.00	$67,546.00	$400,857.00

The Division's proposed assessments under Article 9, sections 186-a and 186-c, together with the amount of penalty and interest accrued through the dates of the notices, are as follows:

Year Ended	Tax Law Section	Assessment Number	Tax	Penalty	Interest	Total
31-Dec-87	186-a	C900907100F	$ 339,500.00	$ 96,275.00	$ 84,875.00	$ 520,650.00
31-Dec-87	186-c	C900907101S	44,584.00	12,643.00	11,146.00	68,373.00
31-Dec-86	186-a	C900907102F	228,802.00	87,936.00	70,928.00	387,666.00
31-Dec-86	186-c	C900907103S	30,416.00	11,690.00	9,429.00	51,535.00
31-Dec-85	186-a	C900907104F	291,412.00	151,831.00	101,994.00	545,237.00
31-Dec-85	186-c	C900907105S	34,448.00	17,948.00	12,057.00	64,453.00
31-Dec-84	186-a	C900907106F	294,131.00	208,793.00	102,946.00	605,870.00
31-Dec-84	186-c	C900907107S	41,385.00	29,378.00	14,485.00	85,248.00
31-Dec-83	186-a	C900907108F	193,351.00	175,809.00	67,673.00	436,833.00
31-Dec-83	186-c	C900907109F	25,551.00	23,233.00	8,943.00	57,727.00
Total			$1,523,580.00	$815,536.00	$484,476.00	$2,823,592.00

The Division's total proposed assessments, penalty and interest under Article 9, sections 183, 183-a, 184, 184-a, 186-a and 186-c equals $3,235,714.00 as of the date of the notices. The totals per Tax Law section are as follows:

Tax Law Section	Tax	Penalty	Interest	Total
183 & 183-a	$ 7,453.00	$ 2,506.00	$ 1,306.00	$ 11,265.00
184 & 184-a	202,823.00	130,488.00	67,546.00	400,857.00
186-a & 186-c	1,523,580.00	815,536.00	484,476.00	2,823,592.00
Total	$1,733,856.00	$948,530.00	$553,328.00	$3,235,714.00

Petitioner has throughout the years 1983 through 1987 provided services for a fee using regular telephone lines and packet-switching technology, as described below. Petitioner's services involve the transmission of data.

Petitioner's customers utilize petitioner's service by dialing the telephone number of petitioner's access center. This call is made via the telephone lines of the user's ordinary local exchange carrier ("LEC") or interexchange carrier ("IXC"). The user is billed by the LEC or IXC for the telephone call including all applicable State and local taxes.

At petitioner's access center, the call is inputted into a packet assembler/disassembler ("PAD") and is converted into the X.25 packet protocol. This information is then transmitted by the appropriate IXC, via telephone lines which petitioner leases from the IXC, to petitioner's access center which is closest to the location of the computer which is to receive the information.

Petitioner pays the IXC a fee for transmitting this information between petitioner's access centers, including all applicable taxes.

At petitioner's receiving access center, the information is converted back from the X.25 packet protocol into the original protocol used by petitioner's customer. The information is then transmitted from petitioner's access center to the recipient host computer via the telephone lines of the appropriate LEC or IXC.

Petitioner pays the LEC or IXC a fee for transmitting the message from petitioner's access center to the recipient host computer, including all applicable taxes.

Petitioner's customers pay petitioner the fees, including sales and other taxes, petitioner pays to the LEC or IXC. The customers pay petitioner a fee for the services petitioner provides to the customers. Petitioner submits a bill to the customer which does not itemize petitioner's costs.

Petitioner provided customers with a nationwide electronic mail service throughout the years 1985 through 1987. This service utilized packet-switching equipment and software and leased phone lines and provided a store-and-forward function. The percentage of petitioner's revenue derived from the electronic mail service and its applications for the years 1983 through 1987 is as follows:

1983	1984	1985	1986	1987
0.0%	0.0%	8.8%	7.5%	17.9%

The subscriber of the electronic mail service who wishes to send an electronic message to another subscriber accesses this service in the same manner as described in paragraphs 11-14 above. The message undergoes protocol conversion into the X.25 packet protocol. However, instead of the message being sent to the recipient host computer, the information is deposited in a computer "mailbox" to which only the addressee of the message has access.

These mailboxes are contained in a computer located at petitioner's Reston, Virginia facility. The message is then stored in the mailbox until the addressee accesses the mailbox.

In order to access the mailbox, the addressee must access petitioner's service in the same manner as the sender of the message. The message received by the addressee is identical in content, and possibly, but not necessarily, identical in format, to the message inputted into the system by the sender. At no time is there an interactive session between the originator of the message and the addressee.

Fees to the LEC or IXC are paid by the same parties as described above.

Petitioner, throughout the years 1983 through 1987, sold hardware (i.e., computers, switches and the like), computer software and related services to its customers to enable them to operate their own systems. The percentage of petitioner's revenue derived from sales of hardware, computer software and related services for the years 1983 through 1987 is as follows:

1983	1984	1985	1986	1987
32.9%	35.5%	33.1%	24.4%	27.9%

In 1941, the New York State Legislature issued a Declaration of Legislative Intent (L 1941, ch 137) which provided that:

> "[Section 186-a] defined a utility, for the purposes of the tax, as including every person subject to the supervision of the department of public service and every other person furnishing utility services. It was intended to include persons and corporations which were directly in competition with ordinary utilities, such as, landlords and submeterers, who buy their services from other utilities and, in turn, resell such services." (L 1941, ch 137, § 1.)

Petitioner is one of several competitors providing the services described above.

Petitioner does not stand in a monopolistic relationship to its customers or have monopoly control over its customers.

Petitioner is not, and never has been, a publicly regulated entity or utility, or otherwise subject to the supervision of, or regulation by, the New York State Department of Public Service, under the Public Service Law, chapter 48 of the Consolidated Laws of the State of New York.

The State has not granted petitioner any special franchises or privileges.

The State has not granted petitioner any rights to provide exclusive service to any part of the State.

The State has not granted petitioner any public service contracts.

The State has not granted petitioner any protection from competition or other monopolistic privileges.

The State has not granted petitioner any rights to use public roadways, easements or other public facilities or property.

Petitioner has classified its services as "enhanced services" for purposes of Federal Communications Commission ("FCC") regulation (FCC Regulation § 64.702), and no objection to this classification has been asserted by the FCC.

Illinois has determined that "in providing [its] services, [petitioner] is not engaged in the business of transmitting messages and, therefore, is not subject to the Illinois Telecommunications Excise Tax Act" (Ill Rev Stat, ch 120, ¶ 2001). This was confirmed by letters, dated February 23, 1989 and March 21, 1989, issued by the Illinois Department of Revenue to petitioner.

Rhode Island has determined that petitioner's services are not telecommunications services and therefore petitioner is not subject to Rhode Island's gross earnings tax (RI Gen Laws § 44-13-1, et. seq.). This was confirmed in correspondence dated June 22, 1988 and issued by the Rhode Island Department of Administration, Division of Taxation.

Connecticut has determined that petitioner's services are not telecommunications services and therefore petitioner is not subject to Connecticut's Telecommunications Service Company Tax Act (Conn Gen Stat, § 12-255b). This position was confirmed in correspondence dated October 12, 1989 and issued by the Connecticut Department of Revenue Services.

On October 14, 1988, the Division's Taxpayer Services Division issued a memorandum addressing the applicability of Article 9, sections 183, 184 and 186-a of the Tax Law to petitioner. The Division stated that:

> "[T]he major factor to be considered when distinguishing between corporations providing information services, which would be subject to tax under article 9A, and those which furnish a utility service for purposes of section 186-a, is whether or not the data for transmission is manipulated or altered by the taxpayer.
>
> "GTE Telenet [petitioner] provides its customers with access to various existing data bases such as FINET, MINET and etc. via lines which it leases from AT&T.
>
> "GTE [petitioner] contends that it is more than a mere conduit and that it provides value added services, mainly, packet-switching.

> "The purpose of packet-switching is to derive more efficient use from transmission facilities. While packet-switching modifies the method of transmission and provides for store-and-forward functions for existing data bases no data manipulation occurs.
>
> "Based on the above it is our opinion that GTE Telenet [petitioner] falls within the meaning of a 'utility' and accordingly would be subject to the tax imposed under section 184-a.
>
> "GTE [petitioner] maintains that the Tax Commission has never attempted to subject companies which are not regulated utilities to tax under sections 183 and 184. This is not the case, we presently apply these sections to companies such as interstate phone companies and coin operated phone companies which are no longer subject to the supervision of the Public Service Commission."

Since 1975, petitioner has been engaged in the business of selling services and other products relying on packet-switching equipment and software, as described above, in New York.

Since 1975, petitioner has filed annual franchise tax returns as a general business corporation under Article 9-A of the Tax Law.

The Division has not objected to petitioner's filing of reports or returns under Article 9-A of the Tax Law prior to 1987 until it commenced its first audit of petitioner.

For purposes of the proposed assessments herein under dispute, in determining "gross operating income" subject to tax under Article 9, section 186-a of the Tax Law, the Division included petitioner's receipts from the sale of hardware and computer software, gains from the sale of capital assets and refunds from suppliers. The Division on audit requested details concerning the sale of hardware, but petitioner did not provide this information.

For purposes of the proposed assessments herein under dispute, in determining "gross operating income" subject to tax under Article 9, section 186-a of the Tax Law, the Division included the cost to petitioner of telephone services it purchased from telephone companies (i.e., LECs and IXCs) subject to taxation under Article 9 of the Tax Law.

Additional Facts

Petitioner is headquartered in Reston, Virginia. Its initial corporate name was GTE Telenet Communications Corporation, when it was a subsidiary of GTE Telenet Holding Corporation. On July 1, 1986, petitioner's name became Telenet Communications Corporation and its parent became Telenet Holding Corporation. Presently, petitioner's corporate name is Sprint International Communications Corporation and it files as part of the consolidated return of Telenet, Inc., which is owned by US Sprint.[4] During the years at issue, petitioner was a subsidiary of GTE Corporation.

Petitioner's Federal tax returns list the SIC code, which is the Internal Revenue Service's code that identifies the type of industry the particular taxpayer is involved in, for telecommunication companies (4825). Petitioner filed under Article 9-A for all years under audit.

Petitioner operates a nationwide data communications network utilizing "packet-switching" technology. It also offers "Telemail", an electronic mail service, and MINET and FINET, medical and financial database information services. The network operated by petitioner is linked to approximately 400 cities, making the network within local dialing distance of virtually all major urban areas.

Petitioner rents the necessary terminal equipment to its customers (certain of petitioner's larger customers purchase the equipment). The customer gains access to the public data network by dialing a local access number, using the rented terminal and modem. The network itself consists of "long lines" leased by petitioner from AT&T, or some other long-distance telephone company, as well as the packet-switching technology. Petitioner charges the customer for use of the network on a total time-used basis at its cost for such time plus a set markup.

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[4]US Sprint is a partnership owned by GTE Corp. and US Telecom.

A small percentage of petitioner's receipts are derived from the electronic mail and database services, which require use of a personal computer, or terminal, and modem. The database services, entitled MINET and FINET, provide doctors and financial institutions, respectively, with access to the appropriate database in order to obtain certain relevant information. The databases are maintained by Sprint with information obtained from appropriate medical and financial sources.

Petitioner's standard service contract is entitled "Master Agreement for Data Communications Service". In conjunction with the execution of the Master Agreement, an "Order for Data Communication Service" form is completed, which delineates the specific products and services to be provided by petitioner.

Petitioner's principal business during the years in issue was the transmission of data via packet-switching technology. Packet switching is a means of digital data transmission by which a large number of users may transmit data over common transmission lines more efficiently than by circuit switching, the conventional voice message system. The data/message is delivered to a network which breaks it up into discrete packets for transmission over the network. The packet-switching system takes the message from the sender and delivers it to the recipient.

Packet switching is used to transmit data between computers. The unique characteristic of package switching is that data is transmitted in packets. Data coming from an end-point device are collected in a buffer (area of memory) by packet assembly software ("PAD"). Each packet contains header information (a delivery address and other control information) plus the substantive message. Because each packet contains self-identification information, it is not necessary to transmit the packets at the same time via the same path or in any particular order. Thus, each packet may be routed on a best-path basis toward the destination. The packets may be stored; however, the storing is typically transient in nature and is generally on the order of tens or hundreds of milliseconds. The key benefit of packet switching is that it avoids the need for an open dedicated line between computers for the purpose of data transmission. That is, economies

of scale in the use of transmission lines is achieved because the lines are used only when data is sent.

Because data is transmitted in packets, a certain level of cooperation is required between the communication network and the attached stations. The agreed rules and procedures for the orderly transfer of data between digital devices that are interconnected by communication facilities are called protocols.

All aspects of data communication are covered by protocols. Such aspects as the electrical connection between a modem and a data terminal, the acknowledgement by the terminal that it is ready to receive data, and the switching of the data along the network must all be specified in the protocol.

To establish some order to the many standards and interfaces encountered in data communication, the International Organization for Standardization ("IOS") has created a model for open-systems interconnection, consisting of several levels. Three of the layers (physical, link and packet) are concerned with the routing of data from one piece of equipment to another. The standards (protocols) for these three layers are set forth in the X.25 protocol.

The X.25 protocol is the universally used standard for the routing of data via packet switching. The standard specifies how an interface between a host system and a packet-switching network will occur.

An optional component of petitioner's transmission system is protocol conversion. Protocol conversion is basically a translation between protocols. A crude analogy to protocol conversion would be translating French to English.[5] Protocol conversion permits communication between disparate terminals and networks. Even if a protocol conversion is used, the substance of the message is unchanged. Thus, for example, if a computer is transmitting the information that a bank account should be credited for $1,000.00, the recipient computer will make the credit

[5]The analogy is inexact in that it is possible that the French word may not have an exact equivalent in the English language. No such element of imprecision exists as to protocol conversion.

to the appropriate bank account for $1,000.00, regardless of whether protocol conversion is employed.

Petitioner's packet-switching communication system has several features in common with other transmission systems. Its system has the capacity to place multiple signals on a single line (multiplexing). Multiplexing is a common feature of modern communication systems. Petitioner's system is capable of checking messages for errors in transmission. Petitioner's transmission system has security features. Petitioner's line is of a high quality. Voice and data communication customers may purchaser higher quality lines from transmission companies.

As the data moves through the packet-switching network, petitioner acts upon the data in many ways, by speeding it up or slowing it down, by concentrating the data for many different users across a single access line, by performing translation or protocol conversion, by checking data for accuracy and correcting it if necessary, by measuring the volume of data and by securing it. The actions of petitioner performed upon the data in the packet-switching network is done to overcome the limitations of basic transmission services ("BTS"). A BTS is one which enables information to flow from one location to another. There is no manipulation of the data, no value-added capabilities; it is just a conduit for the information. The limitations of BTS, which the packet-switching technology was created to address, are as follows:

(a) BTS is error prone with no way to detect an error or to recover from an error because the network just transmits pure information.

(b) BTS is inflexible:

(i) Both sides of the computer must be virtually identical, with the same speed of terminal and computer in order to communicate.

(ii) The same code is required (in order to communicate). It is a fundamental incompatibility to try to mix different codes in a BTS without the implementation of a transmission protocol, which exists apart from the BTS.

(c) BTS is inefficient for IBM. The IBM protocol for data transmission requires that the host computer "poll" the terminals for queries, which clogs the data communications network and is considered inefficient.

(d) BTS calls are subject to disconnection. A failure at any point of the leased line will put the circuit entirely out of operation. In addition, the host computer itself could fail, and the BTS network has no way to rectify the situation.

(e) BTS suffers from a lack of accounting information.

(f) BTS has no network security.

As previously mentioned, the packet-switching technology was created to address the problems caused by the limitations of BTS. The benefits of packet-switching technology and the distinctions between petitioner's technology and BTS are as follows:

(a) The packet-switching network corrects the error-prone limitation of a BTS by storing information and checking and correcting it.

(b) Sprint's network terminal devices, as well as the host computer can be any speed, which addresses the inflexible nature of a BTS which requires the same speed, code and protocol for both ends of the system.

(c) Sprint's host computer corrects the BTS limitations of inefficiency for IBM by intercepting the polling at the nearest nodes (the local connection to the host computer). Polling still occurs, but now no poll transverses the long-distance network.

(d) Sprint's packet-switching technology detects failure on the links and reroutes the packets in other directions, thereby addressing the BTS limitation of its network being subject to disconnection.

(e) Packet switching, via network management systems or NMS, will count the packets pertaining to each call, thereby informing the network users of how much data is being sent and addressing the BTS problem of a lack of accounting information.

(f) Sprint's network corrects the BTS limitation of no network security by going beyond even the initial security of packet switching with a feature called TAMS (Telenet Access Management Security), which interprets calls and asks for passwords and names.

(g) Sprint's network has cost economies -- it saves many dollars per hour of usage by the use of packet switching as opposed to BTS.

The main reason why customers hire petitioner is to insure that their data transfers are protected from the faults inherent in telephone company end-to-end circuits (BTS). Petitioner's customers desire to insure that their transfers of data over telephone company circuits are managed, so that their data will be secure during its transfer, will maintain its integrity from beginning to end (i.e., the data sent will be the same as the data received), and will be reliable (i.e., the security and integrity of the data transfers will be maintained on a consistent basis). Another ability of packet-switching technology is it can provide its customers with the capability of exchanging data among computers that employ dissimilar "protocols."

The Division computed Article 9 taxes for the years at issue based upon information furnished by petitioner. Gross receipts were taken from petitioner's Federal corporation income tax returns. Allocation percentages were provided by petitioner. The auditor asked for but did not receive revenue figures for petitioner's non-telecommunication services.

During the course of the audit, the auditor asked petitioner's representative for the names of petitioner's competitors. This information was requested in order to assist the auditor to understand petitioner's business and to insure that the competitors had filed Article 9 tax returns or were assessed Article 9 tax. At least one competitor (Uninet) was audited.[6]

Petitioner is a value-added common carrier ("VACC") operating a value-added network ("VAN") and regulated by the FCC. It was also regulated by the FCC as an International Record

[6]The results of this audit could not be disclosed because petitioner, which has been merged with Uninet, would not waive the secrecy provisions.

Carrier ("IRC") and is a Vendor of Dedicated Data Networks to customers who wish to purchase a private network.

Additional Stipulated Facts

Pursuant to 20 NYCRR 3000.7, the parties, following the hearing, stipulated and agreed that the following facts may be taken as true.

The nationwide network telephone company costs and charges incurred by petitioner for the tax years 1983 through 1987 are as follows:

TELENET INCORPORATED
NETWORK TELCO CHARGES[7]
1983 - 1987

Year	Amount
1983	$17,499,572.00
1984	20,930,432.00
1985	24,892,944.00
1986	41,653,737.00
1987	59,147,011.00

All amounts are from the company's financial statements for the applicable years.

The same percentage of revenue allocable to New York State as determined on audit and shown on the audit workpapers entitled "Sec 186-a Tax on Gross Income" (Exhibit B of Exhibit "II"; Exhibit "U") shall be used to arrive at the appropriate deductions from gross revenue for telephone company costs for the tax years 1983 through 1987 in computing tax due under Tax Law § 186-a for the years at issue.

OPINION

Section 186-a imposes a tax on every "utility" doing business in the State, whether or not it is regulated by the Department of Public Service, based upon "gross operating income" (Tax Law § 186-a[1]). Section 186-c provides for a surcharge on such "utilities," also based upon gross operating income as apportioned to the metropolitan commuter transportation district. The

[7]Consist of costs for network lines, dial ports and dedicated access facilities.

Administrative Law Judge determined that Sprint was a utility furnishing telegraphic service. For the reasons that follow, we reverse the determination of the Administrative Law Judge on this point.

The term "utility" includes every person:

> "who sells . . . telephony or telegraphy, delivered through . . . wires, or furnishes gas, electric, steam, water, refrigerator, telephone or telegraph service, by means of mains . . . or wires . . . ." (Tax Law § 186-a[2]).

Section 186-a does not define the terms "telegraphy" or "telegraph service."

Petitioner, in its brief on exception, argues that in Quotron Systems v. Gallman (39 NY2d 428, 384 NYS2d 147), the Court of Appeals set up four "tests" for determining whether a person was providing a telegraph service. Petitioner argues that the Administrative Law Judge failed to consider the threshold "test," i.e., "that the service in question be generally recognized as a telegraph service by the common understanding of man" (Petitioner's brief on exception, p. 2). Further, petitioner argues that the two "tests" used by the Administrative Law Judge (the "mere conduit" test and the "in competition with ordinary utilities" test) were misapplied. Petitioner argues that the Administrative Law Judge also ignored the rule of construction strongly favoring taxpayers in interpreting statutes imposing taxes.

The Division argues, in response, that because petitioner transmits data without any change in its content, such activity constitutes either a telephone or telegraph service and petitioner is, therefore, subject to tax under sections 186-a and 186-c. The Division also argues that petitioner has raised a new issue on exception, i.e., whether or not the Administrative Law Judge correctly determined that petitioner provided a telegraph service. Further, the Division argues that the E-mail service provided by petitioner is subject to taxation under Article 9 because petitioner has not furnished sufficient details as to the actual operations of and billings for this service.

The Court of Appeals, in Quotron Systems v. Gallman (supra), considered whether a company was engaged in the sale of telegraphy or furnishing a telegraph service. Quotron contracted with the major stock and commodity exchanges in order to receive data concerning every transaction made. Such data was then stored by Quotron in its computers. Quotron also extracted information from various publications and other sources, again storing this material in its computers. This information, once compiled by Quotron, was transmitted upon request of its customers. Quotron not only stored and transmitted data but it also made available information concerning the past performance of each security as well as other relevant information taken from financial publications. The customer's request for information and the information requested were transmitted over telegraph and telephone lines leased from Western Union and AT & T.

Prior case law had held that: telegraphy was defined as the "transmission of communications" (Matter of New York Quotation Co. v. Bragalini, 7 AD2d 586, 184 NYS2d 924, lv denied 7 NY2d 706, 193 NYS2d 1027); a "telegraph service" consists essentially of "the mere transmission of communications, the service of the telegraph company being completed when the message has been transmitted" (Holmes Elec. Protective Co. v. McGoldrick, 262 App Div 514, 30 NYS2d 589, 593, affd 288 NY 635; Matter of New York Quotation Co. v. Bragalini, supra); "[t]elegraph service in the ordinary sense envisions a sender, a transmitter, and a receiver, with the sender delivering a message to the transmitter for transmission" (Matter of New York Quotation Co. v. Bragalini, supra, 184 NYS2d 924, 927); and "[i]n enacting the sales tax and the excise utility tax, we think the legislative intent was to tax telegraphic services as such are ordinarily understood" (Holmes Elec. Protective Co. v. McGoldrick, supra, 30 NYS2d 589, 595).

The Court in Quotron decided that:

> "[i]n the absence of such statutory definition, the meaning ascribed to a word or phrase by the lexicographers may serve as a useful guidepost (McKinney's Cons Laws of N.Y., Book 1, Statutes § 234). Webster's New World Dictionary, for example, defines 'telegraphy' as the 'transmission of messages by telegraph.' Equally

> instructive in this case is the Legislature's own declaration of its intent . . . . In re-enacting [Tax Law § 186-a] in 1941, the following statement was included in the portion of the enactment entitled 'Declaration of legislative intent':
>
> > '[Section 186-a] defined a utility, for the purposes of the tax, as including every person subject to the supervision of the department of public service and every other person furnishing utility services. It was intended to include persons and corporations which were directly in competition with ordinary utilities, such as, landlords and submeterers, who buy their services from other utilities and, in turn, resell such services' (L 1941, ch 137, § 1)" (Quotron Systems v. Gallman, supra, 384 NYS2d 147, 148).

The Court found that Quotron did not sell telegraphy or furnish telegraphic services using the following analysis:

> "[i]n light of the dictionary definition, which focuses on 'transmission,' the declaration of legislative intent, which is concerned with 'competition with ordinary utilities,' and the well-established rule of construction that ambiguities in tax statutes are to be construed most strongly in favor of the taxpayer and against the government [citations omitted], we conclude that Quotron neither sells telegraphy nor furnishes telegraphic services within the meaning of section 186-a of the Tax Law" (Quotron Systems v. Gallman, supra, 384 NYS2d 147, 148-149).

The Court of Appeals compared the activities of Quotron with those of the taxpayers in Matter of New York Quotation Co. v. Bragalini (supra) and Matter of Teleregister Corp. v. Beame (18 AD2d 631, 235 NYS2d 107, affd, 13 NY2d 834, 242 NYS2d 355). In each of those cases, the taxpayers had been found to be engaged in furnishing a telegraphic service.

In New York Quotation, stock market information was sent to the petitioner's ticker transmitting plant through pneumatic tubes and the petitioner's employees changed the information on a typewriter keyboard to electric impulses. These were sent through a transmitter to a terminal plant from which they were then sent out over wires to customers who subscribed to the petitioner's services. The wires themselves were leased by the petitioner. In Teleregister, the taxpayer received stock quotation information, edited it and sent it, in the form of electrical impulses over telephone and telegraph wires, to its customer's offices.

In comparing these cases, the Court in Quotron stated:

> "[i]n a sense Teleregister did act as both the originator and transmitter of data, as does Quotron. However, its [Teleregister's] operation bore a greater degree of similarity to that of New York Quotation than to Quotron's in at least one very important regard, namely, that it merely stored and transmitted raw market data. Quotron, on the other hand, not only stores and transmits such data, but it also makes available information concerning the past performance of each security as well as other relevant information culled from financial publications" (Quotron Systems v. Gallman, supra, 384 NYS2d 147, 150).

It is important to note that section 186-a classifies a corporation as a "utility" if it sells telegraphy or furnishes telegraphic service "regardless of whether such activities are the main business of such person or are only incidental thereto" (Tax Law § 186-a[2]). The Court in Quotron clearly acknowledged that while a portion of the taxpayer's activities consisted of the storage and transmission of raw market data in the same manner as did the New York Quotation and Teleregister taxpayers, its transmission activities were not those of an ordinary telegraph company. The Court stated:

> "[w]hile transmission of information is certainly an integral aspect of Quotron's business, its transmissions cannot be likened to those made by an ordinary telegraph company. It is common knowledge that a telegraph company normally functions as a mere conduit, transmitting to third-party recipients messages given it by various originators. Here Quotron is more than a mere conduit" (Quotron Systems v. Gallman, supra, 384 NYS2d 147, 149).

The Court concluded that: "Nevertheless, if there remains a conflict between these cases [New York Quotation, Teleregister and Quotron], we prefer the analysis in this case" (Quotron Systems v. Gallman, supra, 384 NYS2d 147, 150).

Applying the Quotron analysis to Sprint, we look to whether the services Sprint provided can be considered those of an ordinary telegraph company. Sprint's packet switching services clearly involve the transmission of data. The packet-switching technology manipulates data received from its customers by converting it into discrete "packets," storing them, if necessary, and sending them at intervals and by different routes to their ultimate destination. Sprint's

technology provides protocol conversion, checks the data for accuracy on receipt and varies the speed of its transmission as needed. All of Sprint's services are rendered to ensure the accurate transmission and receipt of data. However, Sprint does not actually transmit the data itself. The transmission is accomplished by the BTS (Basic Transmission Service) "which enables information to flow from one location to another" (Determination, finding of fact "46"). It was stipulated that a BTS is "just a conduit for the information" (Determination, finding of fact "46"). The testimony of Sprint's witness clearly established that its services were designed to overcome certain limitations inherent in the BTS. As a result, Sprint cannot be considered to be a "mere conduit" for the data, as is the BTS. Nor does Sprint provide the "mere transmission of communications." Therefore, as in Quotron, it must be concluded that, while transmission of information is certainly an integral aspect of Sprint's business, "its transmissions cannot be likened to those made by an ordinary telegraph company" (Quotron Systems v. Gallman, supra, 384 NYS2d 147, 149).

Additionally, Sprint's witness identified certain of its competitors (Tr., p. 203) as Uninet, Tymnet and Packnet. There is no evidence that any of these entities or any other competitors of Sprint are "ordinary utilities" as contemplated by the Legislature in enacting Chapter 137 of the Laws of 1941.

Finally, Sprint, having filed a petition to contest the assessment of tax by the Division pursuant to Article 9 of the Tax Law, has the burden of proof to demonstrate that the assessment is improper (Matter of Levin v. Gallman, 42 NY2d 32, 396 NYS2d 623; 20 NYCRR 3000.10[d][4]). However, "[a] statute which levies a tax is to be construed most strongly against the government and in favor of the citizen. The government takes nothing except what is given by the clear import of the words used, and a well-founded doubt as to the meaning of the act defeats the tax" (Matter of Grace v. New York State Tax Commn., 37 NY2d 193, 371 NYS2d 715, 718, lv denied 37 NY2d 708, 375 NYS2d 1027).

As the Court concluded in Holmes Elec. Protective Co. v. McGoldrick (supra, 30 NYS2d 589, 594), quoting from the decision of the Public Service Commission in Matter of Browne v. National Dist. Tel. Co. (24 St. Dept. Rep. 101, 110): "[t]he Commission is of the opinion that the telegraph and telephone companies over which it has been given power of regulation are those generally recognized as such by the common understanding of man and that it would be a violent interpretation of such understanding to hold that this company is generally recognized as either a telegraph or telephone company." To find that Sprint is a utility furnishing telegraphic services would likewise be a violent interpretation of the common understanding of what constitutes a telegraph company. Therefore, we conclude that Sprint has met its burden of proof to demonstrate that it does not sell telegraphy nor does it furnish telegraphic service. As a result, Sprint is not a utility subject to tax pursuant to the provisions of sections 186-a and 186-c.

We disagree with the Division's argument that petitioner has raised a new issue on exception of whether or not it furnished telegraph services. In paragraph 13 of the petition, petitioner alleged that it was an error for the Department to determine that it was a company formed for or principally engaged in the conduct of a "telegraph" business, among others. In paragraph 14 of its petition, petitioner alleged that its business does not consist of providing "telegraphic" or "transmission" services, among others. Petitioner restates and realleges these paragraphs four times in its petition. In the Division's Answer, at paragraph 15, it affirmatively states that section 186-a(1) of the Tax Law defines a utility as every person who "sells telegraph or telephone service by means of mains, pipes or wires." In paragraph 16 of its Answer, the Division affirmatively stated that petitioner is a utility subject to tax under Tax Law § 186-a, citing Matter of New York Quotation Co. v. Bragalini (supra), in which the taxpayer was found to be a telegraph company. Therefore, it appears that the issue of whether or not petitioner furnished telegraph services as a telegraph company was before the Division of Tax Appeals and is properly raised before the Tax Appeals Tribunal.

The Division, however, asks us to consider on exception whether petitioner is taxable as a utility because it sells telephony or furnishes telephone services. We have consistently held that new legal issues may be raised on exception (Matter of Chuckrow, Tax Appeals Tribunal, July 1, 1993). However, while petitioner took exception to the Administrative Law Judge's conclusion of law that it was a utility furnishing telegraph services, the Division took exception to only so much of the determination of the Administrative Law Judge as concerned the abatement of penalties which had been assessed pursuant to sections 1085(a)(3) and 1085(k) of the Tax Law. The Division did not take exception to that portion of the Administrative Law Judge's determination which concluded that Sprint was a utility furnishing telegraph services, nor did it request additional findings of fact or conclusions of law regarding the furnishing of telephone service. Therefore, the Division may not, through its brief in opposition to petitioner's exception, attempt to modify the Administrative Law Judge's determination with the conclusion that Sprint is a utility which furnished telephone services instead of telegraph services or that Sprint is a utility which furnishes both telephone and telegraph services.

The Administrative Law Judge determined that petitioner's Telemail service, a nationwide electronic mail service, was subject to tax under the sections of the Tax Law at issue herein. The Administrative Law Judge made no determination as to the taxability of the MINET or FINET database information services provided by petitioner. We reverse the determination of the Administrative Law Judge on the taxability of the Telemail service and, additionally, determine that neither the FINET or MINET services are telegraph services taxable under sections 186-a or 186-c.

Electronic mail consists essentially of access to a mailbox, or file, stored on petitioner's mainframe computer located at Reston, Virginia, while the database services involve the use of computer applications to distill and store medical and financial information. The E-mail service "utilized packet-switching equipment and software and leased phone lines and provided a store-and-forward function" (Determination, finding of fact "17"). A subscriber accesses the service to

send a message in the same manner as it would to transmit data via petitioner's packet-switching network. However, "instead of the message being sent to the recipient host computer, the information is deposited in a computer 'mailbox' to which only the addressee of the message has access" (Determination, finding of fact "18"). Thus, the E-mail is only received at the option of the addressee and may never be received at all. In order to access the mailbox, "the addressee must access petitioner's service in the same manner as the sender of the message. . . . At no time is there an interactive session between the originator of the message and the addressee" (Determination, finding of fact "20").

As discussed above, Sprint's packet-switching services are rendered to ensure the accurate transmission of data. Sprint does not actually transmit the data that it manipulates. This is accomplished by the Basic Transmission Service (BTS). Likewise, Sprint does not actually transmit the E-mail messages of its customers. The messages are actually transmitted over telephone lines leased from the BTS.

Sprint's E-mail service is even more distinguishable from an ordinary telegraph service than its data communications services. As the Court concluded in Holmes Elec. Protective Co. v. McGoldrick (supra, 30 NYS2d 589, 593), "telegraph service" consists essentially of "the mere transmission of communications, the service of the telegraph company being completed when the message has been transmitted." Here, the service is not completed when the message has been transmitted from the sender. The message is stored until accessed by the addressee. There is no definition of "telegraph service" which includes a message storage function of unspecified duration, an essential component of the E-mail service. Sprint's E-mail service is not a "mere conduit" for the transmission of data nor does it provide the "mere transmission of communications," two indicia of a telegraph service. Therefore, it must be concluded that Sprint's E-mail service is not a telegraph service.

The FINET and MINET database services also appear to be more than "mere conduits" for data, just as providing stock market information beyond instantaneous market transaction data was in Quotron. In that case, because Quotron not only stored and transmitted raw data but made "available information concerning the past performance of each security as well as other relevant information culled from financial publications," it was found not to be a telegraph service. Here, "[t]he database services, entitled MINET and FINET, provide doctors and financial institutions, respectively, with access to the appropriate database in order to obtain certain relevant information. The databases are maintained by Sprint with information obtained from appropriate medical and financial sources" (Determination, finding of fact "43"). There is nothing in the record to distinguish the nature of these services from those in Quotron and we find the Court's conclusion that such services are not telegraph services to be controlling.

We next consider whether Sprint has met its burden of proof to show that it is not subject to tax under Tax Law §§ 183, 183-a, 184 and 184-a.

Section 183(1)(b) imposes a franchise tax on certain corporations:

> "principally engaged in the conduct of . . . telegraph [or] telephone . . . business . . . or formed for or principally engaged in the conduct of two or more of such businesses . . . or . . . principally engaged in the conduct of a . . . transmission business. . . ."

This tax, and the temporary metropolitan transportation business tax surcharge provided by section 183-a, are based upon the corporation's capital stock within New York.

Section 184 imposes an additional franchise tax on certain corporations:

> "formed for or principally engaged in the conduct of . . . telegraph, [or] telephone . . . business . . . or formed for or principally engaged in the conduct of two or more of such businesses . . . or principally engaged in the conduct of a . . . transmission business. . . ."

This tax, and the temporary metropolitan business tax surcharge provided by section 184-a, are based on the taxpayer's "gross earnings from all sources within the state."

The Administrative Law Judge determined that Sprint was a corporation principally engaged in the conduct of a transmission business. For the reasons that follow, we reverse the determination of the Administrative Law Judge on this point.

Petitioner argues that it "offers and its customers purchase packet switching interface services for computer communications which add value well beyond the BTS that actually transmits the manipulated data from one location to another. Since petitioner does not provide the BTS, it is not subject to taxation under sections 183, 183-a, 184 or 184-a" (Petitioner's brief in support, p. 18). Petitioner relies on Matter of McAllister Bros. v. Bates (272 App Div 511, 72 NYS2d 532, lv denied 272 App Div 979, 73 NYS2d 485) and Matter of RVA Trucking v. New York State Tax Commn. (135 AD2d 938, 522 NYS2d 689) for the proposition that control over the physical transmission facilities is an essential feature of a transmission company not otherwise identified in the statute.

The Division argues that the basic definition of transmission service is "whether the business transmits communications without adding new information or altering the substance of the message" (Division's brief in opposition, p. 12). Further, the Division argues that petitioner held itself out as selling a "transmission service." Since petitioner holds itself out as a communication/transmission company and is perceived by its customers as a transmission company, it is a transmission company.

Since we have concluded that petitioner is not engaged in a telegraph business, if petitioner is taxable under Tax Law §§ 183 and 184, it must be because it is "principally engaged in the conduct of . . . a transmission business," a phrase not defined in statute or regulation.

As the Administrative Law Judge determined:

> "[c]lassifications for corporation tax purposes are to be determined by the nature of the taxpayer's business and not by the words in its certificate of incorporation, nor by focusing on one aspect of its business operation. The business must be viewed in its entirety and from the perspective of its customers -- what they buy and pay for (Matter of Capitol Cablevision Systems, Tax Appeals Tribunal, June 9, 1988; see also, Quotron Systems v.

> Gallman, supra; Holmes Elec. Protective Co. v. McGoldrick, supra; Matter of McAllister Bros. v. Bates, 272 App Div 511, 72 NYS2d 532, lv denied 272 App Div 979, 73 NYS2d 485)" (Determination, conclusion of law "D").

The Administrative Law Judge concluded that:

> "'[c]ustomers hire Sprint . . . to insure that their data transfers are protected from the faults inherent in telephone company end-to-end circuits. Sprint customers want to ensure that their transfers of data over telephone company circuits are managed to insure that their data will be secure during its transfer, that their data will maintain its integrity from start to finish (i.e., the data sent will be the same as the data received), and that their data transfers will be reliable (i.e., the security and integrity of the data transfers will be maintained on a consistent basis)' [footnote omitted]. An additional attraction of Sprint is its ability to provide its customers with the capability of exchanging data among computers that employ dissimilar protocols. Sprint may eliminate errors in transmission through its packet-switching network, it may provide flexibility through its network terminal devices which may operate with different speeds, codes and protocols, it may provide accounting information through its NMS technology, and it may offer security through its TAMS technology" (Determination, conclusion of law "B").

By reviewing relevant portions of the Findings of Fact (Nos. 10-15, repeated below), which are based on the stipulation of the parties, it is also apparent that, while Sprint is involved with the transmission of data, it does not actually transmit such data itself:

> "10. Petitioner has throughout the years 1983 through 1987 provided services for a fee using regular telephone lines and packet-switching technology, as described below. Petitioner's services involve the transmission of data.
>
> "11. Petitioner's customers utilize petitioner's service by dialing the telephone number of petitioner's access center. This call is made via the telephone lines of the user's ordinary local exchange carrier ("LEC") or interexchange carrier ("IXC"). The user is billed by the LEC or IXC for the telephone call, including all applicable State and local taxes.
>
> "12. At petitioner's access center, the call is inputted into a packet assembler/disassembler ("PAD") and is converted into the X.25 packet protocol. This information is then transmitted by the appropriate IXC, via telephone lines which petitioner leases from the IXC, to petitioner's access center which is closest to the location of the computer which is to receive the information.

"13. Petitioner pays the IXC a fee for transmitting this information between petitioner's access centers, including all applicable taxes.

"14. At petitioner's receiving access center, the information is converted back from the X.25 packet protocol into the original protocol used by petitioner's customer. The information is then transmitted from petitioner's access center to the recipient host computer via the telephone lines of the appropriate LEC or IXC.

"15. Petitioner pays the LEC or IXC a fee for transmitting the message from petitioner's access center to the recipient host computer, including all applicable taxes" (Determination, Findings of Fact "10" through "15," emphasis added.)

Petitioner's witness stated:

"Q You also used in your testimony the word 'nodes,' I believe; is that correct?

"A Yes, it is.

"Q And is it correct that Telenet owns the nodes?

"A The nodes themselves, which consist of a physical facility to house packet switches. We, of course, lease these facilities from some real estate entity; we own the packet switches and the PADS that are within the node, but the transmission facilities that interconnect the nodes are not owned by Telenet. In fact, Telenet owns no transmission facilities whatever.

"Q Telenet leases the transmission facilities from other entities, the telephone company and other entities; is that correct?

"A That is correct.

"Q Do you know whether those entities pay utility taxes?

"A I wouldn't know" (Tr., p. 193).

The witness also stated:

"I think that it's very clear that Telenet has very little in common with a basic transmission service except for the fact that information coming into one end of the network does exit to the other end of the network. The facilities that makes that possible are leased from the telephone company, from transmission providers. Telenet owns no transmission facilities and has been classified for, I think, virtually its entire existence by the FCC as an enhanced service provider for the reasons I've described. I,

> therefore, feel that it's very improper and inaccurate particularly to classify Telenet as a basic transmission service" (Tr., pp. 196-197).

Although factually distinguishable, we think that our reasoning in Matter of Capitol Cablevision Systems (supra) is equally applicable to the instant situation. There, the Tax Appeals Tribunal concluded that even though the petitioner actually transmitted its broadcast products to its customers via cable installed for that purpose, the petitioner was not principally engaged in the conduct of a transmission business. Rather, the petitioner in Capitol Cablevision was in the business of selling television entertainment to its subscribers. As the Tribunal concluded:

> "[t]ransmission is merely the means by which the petitioner conveys its product to its customers, it is not the petitioner's business.
>
> "We are further compelled to find for the petitioner because of the vagueness of the statute itself. There is no statutory or regulatory definition of '. . . principally engaged in the conduct of a . . . transmission business . . .' and, application of the normal tools of statutory construction and interpretation such as the words of the act, legislative history and precedent shed little light on the meaning of the phrase. Therefore, any doubt as to its meaning must be resolved in favor of the taxpayer" (Matter of Capitol Cablevision Systems, supra).

Here, while Sprint's services involve transmission, it does not provide the actual transmission. It acts on the customer's data external to the transmission network. The business of Sprint is more concerned with data protection and integrity than with transmission. Therefore, as in Capitol Cablevision, we conclude that Sprint is not principally engaged in the conduct of a transmission business.

Finally, since the Division's exception related only to the abatement of penalty, our disposition of the taxation issues renders the penalty issue moot.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Sprint International Communications Corporation is granted;

2. The exception of the Division of Taxation is denied;

3. The determination of the Administrative Law Judge is modified in accordance with paragraph "1" above;

4. The petition of Sprint International Communications Corporation is granted; and

5. The notices of deficiency dated September 7, 1990 are cancelled.

DATED: Troy, New York
July 27, 1995

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Donald C. DeWitt
Donald C. DeWitt
Commissioner