STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CONCENTRIC NETWORK CORPORATION	:	DECISION DTA NO. 819533
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Years 1999 and 2000.	:	

Petitioner Concentric Network Corporation, c/o Michael O'Day, XO Communications, 11111 Sunset Hills Road, Reston, Virginia 20190, filed an exception to the determination of the Administrative Law Judge issued on January 20, 2005. Petitioner appeared by Anderson, Gulotta & Hicks, P.C. (Michael A. Gruin, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Lori P. Antolick, Esq., of counsel).

Petitioner filed a brief in support of its exception and the Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on September 27, 2005 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner's purchases of line access were telephony or telegraphy services within the meaning of Tax Law § 1105(b)(1)(B).

II. Whether, if determined to be telephony or telegraphy, such services were nevertheless exempt from tax as interstate or international services within the meaning of Tax Law §1105(b)(1)(B).

FINDINGS OF FACT

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

On February 25, 2002, the Division of Taxation ("Division") received from Concentric Network Corporation ("Concentric") an Application for Credit or Refund of Sales and Use Tax which claimed a refund in the amount of $438,960.26. The application stated that Concentric, a company wholly owned by XO Communications (Concentric was purchased by XO Communications, formerly Nextlink, Inc., in 2000), is located at various locations throughout the State of New York and is engaged in the business of providing internet service to customers located in New York. The refund claim involved sales tax paid by Concentric on tangible personal property, including equipment and dial-up access, in connection with its delivery of internet services.

The bases upon which Concentric claimed exemption from tax were: (a) that pursuant to Tax Law § 1115(a)(12) for the period prior to 2000 and pursuant to Tax Law § 1115(a)(12-a) thereafter (actually after September 1, 2000, the effective date of the enactment of paragraph 12-a), its purchase of equipment used directly to provide internet access service was exempt; and (b)

that pursuant to Tax Law § 1105(b)(1), sales for resale of telephone service are not subject to tax.[1]

On September 30, 2002, the Division denied, in full, Concentric's claim for refund of sales tax stating as follows:

> There are three issues involved in this refund denial:
>
> 1. Part of the refund is for periods beyond the time this company filed sales tax returns and paid sales tax. (The company's ownership and ID number changed in August 2000.)
>
> 2. ISP[2] equipment was not exempt from sales and use tax prior to September 2000.
>
> 3. Telephone charges are not exempt when an ISP pays them, even though they bill their customers an internet access charge.

Due to the fact that Concentric merged into XO Communications in August 2000, the claim for refund was revised from its original amount of $438,960.26 to $272,113.42 to reflect only those amounts of tax paid prior to the merger, i.e., all of the transactions at issue occurred during the years 1999 and 2000. Transactions occurring after 2000 were included in a separate claim for refund which is not at issue in this proceeding.

At the hearing, Concentric introduced into evidence a summary of all of the invoices upon which sales tax was paid by Concentric and for which the claim for refund was based. This summary listed: a reference number, the name of the vendor to whom tax was paid, the date of the invoice, a description of what was purchased (examples included: "private line," "dial

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[1] Concentric's assertion that its purchases were exempt because they were for resale was apparently withdrawn since at the hearing and in its brief and reply brief, it contended that its purchases were not subject to tax because such purchases were not properly classified by the Division as telephony or telegraphy.

[2] The abbreviation "ISP" refers to an Internet Service Provider.

access," "Colo Class III Pops," etc), invoice amount, amount paid, Federal tax, State sales tax, local sales tax and refund requested (the amount of refund was the sum of State and local sales tax paid). The summary also contained a column entitled "Comments." Under this column were listed the locations of the line access purchased by Concentric which, in all cases, were New York locations. The locations listed included: "New York," "Buffalo, New York," "New York(Hudson)," "New York City, New York " and Syracuse, N.Y."

During the period from February 1999 until June 2000, Concentric purchased channelized T-1 lines and ATM lines from MCI Worldcom, Eagle Communications and Frontier. A T-1 or Trunk Level 1 is a digital transmission link with a total signaling speed of 1.544 Mbps (1,544,000 bits per second which may be divided into up to 24 separate voice-quality channels or which may be utilized as a single two-way high speed data stream). An ATM or Asynchronous Transfer Mode is a layered networking protocol which allows for a single physical line to be used to connect multiple destinations.

The internet is the worldwide interconnected system of packet-switched computer networks that connects computers and facilitates the exchange of data and information.

An ISP or Internet Service Provider is a vendor whose primary function is to provide its customers with access to the internet and world wide web along with other secondary functions such as providing electronic mail accounts.

The Internet Backbone is the high-speed network which spans the world from one metropolitan area to another.

National Access Points or NAPs are interconnection points where the lines that form the internet backbone are linked and where local ISPs must connect in order to carry their customers' data traffic to the internet backbone.

TCP/IP Protocol stands for Transmission Control Protocol/Internet Protocol. Internet Protocol defines how information is broken down into packets and routed. Transmission Control Protocol adds reliability to the IP packets which helps the packets reach their destination in the proper fashion.

T-3 or Trunk Level 3 is a digital transmission link with a total signaling speed of 44.736 Mbps with a capacity equivalent to 28 T-1 lines.

A packet switched network allows the same computer to send and receive data packets to and from multiple sources simultaneously. It is not necessary for a direct connection to be established in order for two computers to communicate with one another over the internet. This network differs from circuit switched networks or traditional phone networks which require a continuous connection.

A POP or Point of Presence is a facility where local internet traffic is aggregated. A Super POP is a combination point of all of the aggregated traffic for delivery to the internet backbone.

During 1999 and 2000, Concentric did not provide voice products or switch traditional voice traffic of any kind.

In all cases, internet traffic on Concentric's network, originating in New York and other states, was routed through Washington D.C. or Chicago, Illinois before reaching its destination.

Any ISP could insure that all of its traffic was routed both inside and outside a particular state by locating a router and related equipment in at least two states.

Michael Scott who is employed by Access Communications and was a director of access technology at Concentric until approximately 2002 appeared at the hearing and was qualified as an expert witness in the area of internet access. He participated in the creation of the commercial entity known as the "internet." In 1993, Mr. Scott and two other individuals started Concentric, initially offering internet e-mail and then offering more interactive internet services where people could chat with each other, exchange files and use other computer systems. In 1994, they built their own internet network because it became too expensive to pay Sprint for dial-up service. In 1995, network upgrades were made to prepare for the world wide web. After April 30, 1995, the internet was privatized; previously, the National Science Foundation operated the internet backbone and controlled access to the internet. In 1996, with the passage of the Telecommunications Act, competitive local exchange carriers were created and Mr. Scott and his associates began a company called MFS Communications which was eventually acquired by World Com. MFS Communications was a pioneer in the network architecture specifically for ISPs. In 1997, MFS Communications worked with SBC Communications to launch digital subscriber line service (DSL) which is a high-speed form of internet access which was competitively priced to compete with dial-up internet service. In 1998, Concentric purchased Internex Information Services, a national entity which had pairing arrangements with 35 or 40 different ISPs across the United States, which allowed Concentric to become a Tier 1 ISP which is not dependent upon traffic with other internet service providers. In June 2000, Concentric

merged with Nextlink Communications and later that year changed its name to XO Communications.

Mr. Scott explained that when one dials into or connects to the internet, there is an engine for every computer that is connected to the internet and that can "talk to" other computers. That process is done through creating packets which are collections of data. The internet is made up of thousands of devices called routers which are responsible for taking bits of information and passing them through the communication links that make up the entire internet.

There are a collection of ISPs that make up the internet backbone. The internet categorizes ISPs as Tier 1, 2 or 3. A Tier 1 ISP is the largest and is an ISP that maintains a relationship with all of the other ISPs in the internet, i.e., it talks to everyone. After its purchase of Internex, Concentric was considered to be a Tier 1 ISP and had the network facilities to operate the internet network across the United States.

A Network Access Point is the facility at which all of the ISPs come together to exchange traffic with each other and to interconnect their networks. There were three original network access points: Pentsauken, New Jersey, Chicago, Illinois and San Francisco, California.

Mr. Scott indicated that a traditional telephone network is made up of a circuit switch technology which means that the network sets up a phone call in such a fashion that there is a reserved amount of space or bandwidth to cross that telecommunication network for the call to occupy. With packet switch networks which are utilized when computers are communicating across the internet, there is no fixed amount of band allocated for that session. The bandwidth is used as it is needed thereby making it more efficient. There is a telephone aspect of dial-up

internet access which is that portion that connects one to the telephone where calls are received and routers answer those calls.

While all of the invoices at issue were introduced into evidence at the hearing, Concentric also introduced into evidence, as a separate exhibit, a packet of selected invoices which were referenced by Mr. Scott during his testimony. For example, the invoice labeled "1710A" is an invoice from MFS Worldcom, dated November 1, 1999, which describes the item purchased by Concentric, for the sum of $756.00, as "COLO Class III Pops" which Mr. Scott indicated was the cost associated with Concentric's co-location (putting the equipment into someone else's facility) of equipment into the City of Buffalo with World Com. It must also be noted that this invoice, under the heading "BAN DESCRIPTION" states "PRIVATE LINE BUFFALO."

The invoice labeled "1768A" is an invoice from MFS Worldcom which bills Concentric for the sum of $55,354.53 for six different items. Mr. Scott indicated that the invoice was related to the ATM network connectivity that Concentric's super POP has in Hillburn, New York. Mr. Scott described the first of the six items, "BB ATM Access - MCI," as representing two circuits, one which goes to Washington, D.C. and the other to Chicago, Illinois. The next two items, "INTERNET MCI" and "INTERNET Other" could not be identified by Mr. Scott. The final three items on the invoice, "DAF installation," "DAF local loop" and "DAF infrastructure," were described by Mr. Scott as the infrastructure for the ATM network, the "port level" costs for the virtual circuits and virtual paths.

Invoice "1773E," an invoice from MFS Telecom, Inc., dated April 1, 1999, is part of a larger invoice for new charges totaling $23,602.04 (including taxes and finance charges) which

is labeled "1773B." The first two charges on invoice 1773E were described by Mr. Scott as charges associated with the DSL base internet access product, customer circuits. Invoice "1773G" and "1773H" list the customers of Concentric's internet services.

Invoice "2268C" contains charges (current charges are $822.20) billed to Concentric by Frontier, dated August 28, 1999, for channelized T1 service in Rochester, New York. These charges include fees for "VP Flat Rate T1 Link" and "VP T1 Channel Termination." This invoice indicates that the charges are for monthly service for the period August 28, 1999 through September 27, 1999. Mr. Scott indicated that these services represent channelized T1 or the telephone line portion of Concentric's internet network in Rochester, New York.

Invoice "2838A" is an invoice dated January 12, 2000 from MFS Dial Access NY (Hudson) for dial access in the amount of $12,326.26. Mr. Scott indicated that the invoice was for a facility at 60 Hudson Street in New York City and represented the dial-up portion of the internet network.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge found that petitioner was a retail customer of MCI Worldcom, Frontier and Eagle Communications and what it purchased from these vendors was apparatus which could be used "for transmission of sound, sound reproduction or coded or other signals" (20 NYCRR 527.2[d][2]) and the fact that petitioner used such lines to provide its customers with internet access rather than sound reproduction did not render the purchases nontaxable. Accordingly, it was determined that petitioner's purchases of line access were properly treated by the Division as purchases of telephony or telephone service.

The Administrative Law Judge then rejected petitioner's alternative argument that even if its purchases of line access constituted purchases of "telephony or telephone service" they were nonetheless exempt from tax because they involved "interstate and international telephony and telephone services" within the meaning of Tax Law § 1105(b)(1)(B). The determination states, "[f]or each of the purchases . . . which are at issue herein, the line access service was delivered to and consumed by [petitioner] at various locations in New York State" (Determination, conclusion of law "H").

The Administrative Law Judge also concluded that all of the purchases at issue in this case were for line access and none was for equipment as had been asserted in the original refund claim.

ARGUMENTS ON EXCEPTION

Petitioner first argues that the subject of the transactions at issue here did not come within the statutory terms "telephony and telegraphy and telephone and telegraph service of whatever nature" because petitioner's services are limited to packet switching technology and related services and do not include "transmission" of data. It relies on our decision in ***Matter of Sprint Intl. Communications Corp.*** (Tax Appeals Tribunal, July 27, 1995), which concluded that providing services similar to those provided by petitioner did not constitute telegraphic services for purposes of the gross receipts tax. Moreover, petitioner states that the "purchase of line access is analogous to the purchase of an open pipe line" with "transmission" occurring at the computer of the end user (Petitioner's reply brief, p. 2). Petitioner also asserts that the Administrative Law Judge erred in drawing support from the fact that the line access purchased by petitioner could have been used for transmission of traditional voice communications.

Petitioner argues alternatively that even if the purchases of line access involved telephony or telegraphy it is exempt from tax because the line access constituted interstate and international telephony and telegraphy and telephone and telegraph service. Its brief states in this connection as follows:

> In the Matter of the Petition of Southern Pacific Communications Company, New York Division of Tax Appeals, Tax Appeals Tribunal (File No. No. [sic] 800275, May [14], 1991), the Tribunal considered whether long distance telephone services are subject to NY sales tax. The Tribunal found that long distance telephone services were not subject to tax because the portion of the long distance service the Division sought to tax was a component part of the overall interstate service. The Tribunal ruled, "[I]n determining whether a taxpayer's activities are in interstate commerce, it is improper to isolate and individually examine separate components of the overall activity being engaged in by the taxpayer." The Tribunal relied on the NY Court of Appeals decision in Matter of Moran Towing and Transportation Co., Inc. v. New York State Tax Commission, 531 NYS2d 885, 72 NY2d 166 (New York Court of Appeals, July 12, 1988) finding that tugboat services and supplies were exempt from tax even though the tugboats activities were conducted entirely in New York waters because the tugboats were engaged in interstate activities (Petitioner's brief in support, p. 6).

Finally, petitioner asserts that the imposition of tax in these circumstances would discriminate against petitioner and other independent ISPs in violation of the Federal Internet Tax Freedom Act of 1998, as extended by the Internet Tax Nondiscrimination Act of 2003, because an integrated telecommunications company which owns its own lines can provide internet access to retail customers without incurring the tax at issue here.

The Division argues that the line access purchased by petitioner falls within the broad definitions of telephony and telegraphy set forth in the Tax Law and the regulations. Its brief reads, in part, as follows:

> Tax Law §1105(b) imposes sales tax on the receipts of telephony and telegraphy and telephone and telegraph service of whatever nature. The words "of whatever nature" indicate that a broad construction is to be given the terms describing the items taxed. 20 NYCRR 527.2(a)(2). Telephony and telegraphy and telephone and telegraph service is defined in the sales tax regulations as "communication by means of devices employing the principles of telephony and telegraphy." 20 NYCRR 527.2(d)(1). The Regulations go on to provide that "the term telephony and telegraphy includes use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals." 20 NYCRR 527.2(d)(2). Under these definitions, the right to use a phone line from a telecommunications company is the purchase of telephone service (Division's brief in opposition, p. 7).

The Division also rejects petitioner's characterization of the purchased services as interstate because the line access services were delivered to and consumed by petitioner within New York. The Division also asserts that the Federal statute relied upon by petitioner does not apply to the years involved in the present case.

OPINION

Tax Law § 1105(b)(1)(B) imposes sales tax upon the receipts from every sale, other than sales for resale, of "telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service . . . ." The regulations provide that the words "of whatever nature" contained in Tax Law § 1105(b) "indicate that a broad construction is to be given the terms describing the items taxed" (20 NYCRR 527.2[a][2]).

20 NYCRR 527.2(d)(1) states that "[t]he provisions of section 1105(b) of the Tax Law with respect to telephony and telegraphy and telephone and telegraph service impose a tax on

receipts from intrastate communication by means of devices employing the principles of telephony and telegraphy."

20 NYCRR 527.2(d)(2) provides as follows: "The term *telephony and telegraphy* includes use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals."

The first issue presented in this case is whether petitioner's purchases from its vendors – MCI Worldcom, Eagle Communications and Frontier – were telephony or telegraphy or telephone or telegraph service. An important test for whether an activity constitutes telephony or telegraphy is whether the activity constitutes "transmission" of the type conducted by an ordinary telephone or telegraph company. In ***Quotron Systems v. Gallman*** (39 NY2d 428, 384 NYS2d 147, 149), the Court of Appeals described this activity as follows: "[A] telegraph company normally functions as a mere conduit, transmitting to third-party recipients messages given it by various originators."

In ***Matter of Sprint Intl. Communications Corp.*** (***supra***), we concluded that a corporation providing packet switching and electronic mail services in a way that appears to have been the technological predecessor of petitioner's operations in the present case was not engaged in telephony or telegraphy because its activities did not include the "transmission" of data. That decision stated, in part, as follows:

> 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" . . . . It was stipulated that a BTS is "just a conduit for the information" . . . . 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).
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> * * *
>
> 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.

Petitioner's reliance on our decision in ***Sprint*** is misplaced. The issue in the present case is not whether petitioner was engaged in telephony or telegraphy but whether the services it purchased from its vendors constituted telephony or telegraphy. To the extent that the services provided by those vendors resemble the services provided by the Basic Transmission Services in ***Sprint***, that case is unfavorable to petitioner's argument.

Petitioner also argues that it was not purchasing a transmission function from its vendors but was "only buying access to the circuits so that the customers could transmit data to and from the internet backup" (Oral Argument Tr., p. 5). According to petitioner, "the transmission function is performed at the individual user's computer . . . the circuits are mere pathways over which the data flows" (Oral Argument Tr., p. 5). Some support for this argument might be found in the Division's Advisory Opinion TSB-A-05(32)S (August 18, 2005) which distinguishes the provision of "dark" and "lit" fiber optic cable. It holds that providing "dark" fiber cable where the vendor provides only the physical cable without the equipment to activate it for the

transmission of communications, does not constitute telephony or telegraphy within the meaning of section 1105(b)(1) of the Tax Law. It seems clear from the record in this case that the services that petitioner was purchasing from its vendors were not the mere lease of lifeless equipment but rather the acceptance and delivery of data in an active way that strongly resembles the role of the traditional telephone or telegraph company (***see,*** Hearing Tr., pp 31-40). Moreover, we find nothing in the record establishing that the home computer is any more the engine of transmission than the traditional black rotary telephone. Accordingly, we conclude that the subject of petitioner's purchases falls within the statutory category of "telephony and telegraphy and telephone and telegraph service."

We next consider whether petitioner's purchases qualify for exemption as purchases of interstate and international telephony and telegraphy and telephone and telegraph service. We note that the exemption for interstate and international telephony and telegraphy is not an expression of a constitutional limitation on the authority of the State of New York to impose tax. The imposition of tax on interstate telephone calls is permissible as long as it satisfies the four-part test set forth in ***Complete Auto Transit v. Brady*** (430 US 274, 51 L Ed 2d 326) (***Goldberg v. Sweet***, 488 US 252, 102 L Ed 2d 607). Accordingly, the issue presented here is one of statutory interpretation only.

In ***Matter of Moran Towing & Transp. Co. v. New York State Tax Commn.*** (72 NY2d 166, 531 NYS2d 885, 886), the Court of Appeals considered the applicability of an exemption from sales tax for receipts derived from the retail sale of "commercial vessels primarily engaged in interstate or foreign commerce and property used by or purchased for the use of such vessels for fuel, provisions, supplies, maintenance and repairs." The vessels in question were tugboats

operating entirely within New York waters but the vessels towed by the tugboats were traveling between New York and ports in other states and foreign countries. The court held that the exemption applied and stated its rationale as follows:

> Historically, interstate commerce has been defined by reference to the origin and destination of what is moved in commerce. That the taxpayer's activities were conducted entirely within the waters of the State of New York does not affect the interstate character of those activities [citations omitted]. The focus is on what the actor does, not where he does it. Indeed both this court and the United States Supreme Court have held that stevedoring, the business of loading and unloading ships, was part of interstate or foreign commerce provided that the goods loaded or unloaded were actually moving in foreign or interstate commerce [citations omitted]. If stevedores are engaged in interstate commerce when they provide service to a vessel on an interstate or international voyage, there can be no doubt that Moran's tugboats are engaged in interstate commerce when they propel or direct the interstate vessels into and out of New York harbor (***Matter of Moran Towing & Transp. Co. v. New York State Tax Commn.***, ***supra***, 531 NYS2d 885, 887).

In ***Matter of Southern Pacific Communications Co.*** (Tax Appeals Tribunal, May 14, 1991), we considered the application of the sales tax under section 1105(b) to various services provided by a long distance telephone company. In reliance on the Court of Appeals decision in ***Moran Towing***, we concluded that "the overall nature of the telephone service determines whether it is in interstate commerce and excepted from tax" and that it would be inappropriate to "segment an interstate service into components" for the purpose of isolating and taxing the purely intrastate elements of the service. The overall nature of the services was established by a stipulation of facts entered into by the Division and the petitioner which stated that the only service that the Federal Communications Commission had authorized the petitioner to provide was interstate long distance service. We also relied on ***Davidson v. Rochester Tel. Corp.*** (Sup

Ct, Albany County, Apr. 10, 1989 [Prior, J.], ***affd*** 163 AD2d 800, 558 NYS2d 1009, ***lv denied*** 76 NY2d 714, 564 NYS2d 717) and ***Matter of Callanan Marine Corp.*** (98 AD2d 555, 471 NYS2d 906, ***lv denied*** 62 NY2d 606, 479 NYS2d 1026) stating, "If, as these opinions hold, an intrastate service retains a single intrastate identity in spite of an incidental interstate aspect, we can see no reason for a different rule which would segment an interstate service into components" (***Matter of Southern Pacific Communications Co.***, ***supra***; ***see also, Matter of M & G Convoy v. State Tax Commn.,*** 55 AD2d 204, 389 NYS2d 656, ***affd*** 42 NY2d 1017, 398 NYS2d 657 [intrastate aspect of interstate trucking business not isolated from overall business in applying franchise tax]). Based on the foregoing principles, we held that the telephone services involved in ***Southern Pacific*** were exempt from tax as "interstate and international," stating, in part, as follows:

> While it is true that portions of the components at issue included long distance service between points within the State, these components are clearly part of the overall interstate service provided by petitioner. Accordingly, the portions of petitioner's interstate service which the Division is seeking to tax must be treated as a component part or adjunct to the overall interstate service provided by petitioner. Therefore, we find that the charges at issue here are excluded from the imposition of sales tax pursuant to section 1105(b) of the Tax Law.
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> * * *
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> Nothing in this decision is intended to address the application of the sales tax to an audit that identified and taxed only those services that took place entirely in New York State and which were not *an intrastate strand of an interstate service*. Examples of such services might include switched services for calls originating in New York State and going to New York State locations and private line circuits between points in New York State which were not *connected to a circuit going to another state* (***Matter of Southern Pacific Communications Co.***, ***supra***, emphasis added).

The services in ***Southern Pacific*** were the transmission of traditional voice communications. The principles applied in that case are equally applicable to the transmission of packet switched data for internet access that is presented in this case. Under the second quoted paragraph above, if the traditional long distance company bills the customer for each call, it is easy enough to add sales tax to the intrastate calls. If such identification is impossible or impractical, under the rule of the first paragraph we need to determine whether the predominant character of the service is interstate or intrastate. That characterization will determine the taxability of all the services involved even though a particular activity might be viewed otherwise if considered in isolation.

The Division argues that the services in question simply link places within New York in the course of petitioner's business and the interstate character of that business does not cause the links to be interstate. Thus, the Division's closing argument at the hearing before the Administrative Law Judge included the following:

> The petitioner is the purchaser of telecommunication services. Telecommunication services and in state telecommunication services are subject to sales tax. It doesn't matter what you do to use and provide them. Just to give you an example, there is a case cited in the Division's Answer, and in [its] Hearing Memo, [***Matter of Phone Programs,*** Tax Appeals Tribunal, April 6, 2000].
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> Someone provides a 900 number sports line, something like that. If it has a phone connection from a racetrack to the office so they can get the call of the race[, they] are recording his place there, and the customers across the NAP say the office is located in New York, the racetrack is Belmont, located within New York, local telephone call, then the customers call up the service from California, Pennsylvania, New Jersey to listen to the call. All right, they are purchasing an on-line entertainment information

> service, but they have nothing to do with the fact that the phone call that the vendor provided was an in-state telecommunications service. That vendor would be the retail consumer of that telecommunications service for the purposes of the sales tax (Hearing Tr., pp. 100-101).

In ***Phone Programs***, the petitioner purchased telephone links between sports events, *e.g.,* a racetrack, located in New York and its offices located in New York for the purpose of frequently updating a voice recording of sports information which could be heard by individuals who called the petitioner's office. The petitioner claimed unsuccessfully that the telephone services it purchased to connect the sports events to the office were exempt from tax as sales for resale on the theory that it was "reselling" telephone service to its customers who called for the latest sports information. There was no assertion that the purchased telephone service had an interstate character because some customers called its number from outside New York.

Although not directly relevant, the factual analysis applied in ***Phone Programs*** supports the conclusion that the character of the purchaser's business as interstate or intrastate should not control the characterization of the telephone service that it purchases. The local calls of an airline are no less intrastate than those of a grocery store. Unlike the provision at issue in ***Matter of Moran Towing & Transp. Co. v. New York State Tax Commn.*** (***supra)*** which expressly treated local purchases as exempt if the purchaser's operations had an interstate character, Tax Law § 1105(b)(1)(B) requires that the thing purchased have an interstate character to qualify for exemption.

At oral argument, the Division sought to distinguish ***Southern Pacific*** on the following basis:

> [O]ne distinction that I did want to draw between this case and the ***Southern Pacific*** case is that the petitioners in ***Southern***

> ***Pacific*** . . . were in the business of selling telephone service. Petitioners here are not in the business of selling telephone service. They are in the business of providing internet access (Oral Argument Tr., p. 23).

We do not find support in ***Phone Programs*** or elsewhere for the proposition that the purchaser's use of purchased telephony can affect the characterization of the telephony as interstate *vel non* only if the purchaser is itself engaged in telephony. The Division's argument in this regard seems to be importing a test for entitlement to a resale exemption – viz. whether the thing purchased has the same nature as the thing resold – as a standard for when we should look to the purchaser's use of the thing purchased in considering whether it has an interstate character.

Although the nature of the purchaser's business will not determine the character of telephone or telegraph service as interstate or intrastate, that character may be influenced by the use to which the purchaser puts the service. For example, as both parties agreed at oral argument, if a subscriber to traditional voice long distance service places a separately billed call from Albany to Buffalo the sales tax will apply; a call from Albany to Boston will be exempt. The long distance service in ***Southern Pacific*** was found to qualify as interstate based on its predominant character even though the service was used to some extent to carry intrastate calls. It is consistent to characterize the telephony or telegraphy in the present case as interstate or intrastate by reference to the nature of the data traffic carried over the provided lines and the destination of those communications.

The record includes extensive descriptions of the operation of the internet (***see***, ***e.g.***, Div. Exhibits "H" and "J;" Pet. Exhibit "3"). It would be hard to imagine a communications activity more imbued with interstate and international characteristics than the use of the internet. Subscribers to the services of an internet service provider like petitioner may use the internet for

a wide range of activities including sending and receiving electronic mail messages, visiting web sites for recreational, commercial, or academic information, and ordering goods and services which may be delivered through the mail or downloaded directly to the user's computer. In conducting these activities, it is impossible to avoid interstate communications. A subscriber in Albany, New York is as likely to have an electronic mail box maintained on a computer in Virginia as in his home state. If he sends an e-mail message to his grandmother who lives in Buffalo, it might be received in her mail box maintained on a computer in California. She might read the message on a hand held wireless device while visiting Chicago or at an internet café in Istanbul. A message to a cousin in California might end up in an electronic mail box on a computer in New York State. If the subscriber goes to the world wide web site of a local newspaper to check the latest high school basketball scores, he might be surprised to be told that he is communicating with the computer of a web hosting business thousands of miles away. It seems that any intrastate aspect of access to the internet is merely random and incidental to an interstate and international service.

In some circumstances, the lines at issue apparently carried communications between subscribers located in New York and petitioner's point of presence in New York. It is artificial, however, to treat the point of presence as the destination of these communications in the sense that a voice call to a telephone number at a residence in Buffalo has a destination in Buffalo. If these lines were not in some way "connected to a circuit going to another state," as contemplated in ***Southern Pacific***, the line access would be useless in accomplishing the purpose for which it was purchased by petitioner. The data originating in the key strokes on the subscriber's computer flow out to the internet through petitioner's point-of-presence facilities and data flows

back in a continuous process that has no geographical reference that is perceptible to the subscriber or his interlocutors. Accordingly, the link in question seems is merely "an intrastate strand of an interstate service."

Applying the principles of ***Southern Pacific*** to the present facts leads us to conclude that petitioner's purchases of transmission services used for internet access by petitioner's subscribers is excluded from the application of sales tax as "interstate and international telephony and telegraphy and telephone and telegraph service" within the meaning of Tax Law § 1105(b)(1)(B).

In light of the foregoing we need not consider petitioner's assertion that the imposition of tax would violate federal law.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Concentric Network Corporation is granted;

2. The determination of the Administrative Law Judge is reversed;

3. The petition of Concentric Network Corporation is granted; and

4. Petitioner's claim for refund as modified consistent with the finding of fact contained herein is granted.

DATED: Troy, New York
March 16, 2006

/s/Charles H. Nesbitt
Charles H. Nesbitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott
Robert J. McDermott
Commissioner