STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **FASTNET CORPORATION** 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 1998 through 2002.	: : : : :	DECISION DTA NO. 819632

Petitioner Fastnet Corporation, 3864 Courtney Street, Suite 130, Bethlehem, Pennsylvania 18017, filed an exception to the determination of the Administrative Law Judge issued on March 10, 2005. Petitioner appeared by Anderson, Gulotta and 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. No reply brief was filed. 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 purchases of 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).

III. Whether petitioner's purchases of certain equipment qualify for exemption under Tax Law § 1115(a)(12) as in effect prior to September 1, 2000.

FINDINGS OF FACT

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

Petitioner, Fastnet Corporation ("Fastnet"), which began doing business in 1994 and is headquartered in Bethlehem, Pennsylvania, is an internet access service provider ("ISP") with customers located in New York, Pennsylvania and New Jersey. Petitioner, via its connected network of circuits, enables its customers to access the Internet. The "Internet" has been defined as "many large computer networks joined together over high-speed backbone data links ranging (in speed) from 56 Kbps to T-1, T-3, OC-1 and OC-3."[1]

The Internet works as a "packet switched network" based on a family of protocols known as "TCP/IP," that is Transmission Control Protocol/Internet Protocol, a system of networking protocols providing communication between computers with diverse hardware architectures and various operating systems across interconnected networks. Internet Protocol ("IP") defines how information is broken down into packets and routed. Transmission Control Protocol ("TCP") adds reliability to the IP packets, which helps the packets reach their destination in the proper

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[1] To further explain, a T-1 (Trunk Level 1) line is a digital transmission link with a total signaling speed of 1.544 megabits per second (1,544,000 bits per second which may be divided into up to 24 separate voice-quality channels which may be utilized as a single two-way high speed data stream). In turn, a T-3 connection is a digital transmission link with a total signaling speed of 44.736 megabits per second with a capacity equivalent to 28 T-1 lines. OC-1 and OC-3 (Optical Circuit) connections are wireless connections which, over certain distances, are able to transmit data at T-1 speeds, with an OC-3 being approximately equivalent to three T-3 lines.

fashion. 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.

During the period in issue, December 1999 to February 2002, petitioner provided its New York customers with dial-up access to the Internet, dedicated T-1 access to the Internet, e-mail services, and web hosting services. Petitioner did not provide voice communication services during the period in issue.

In early 2000, petitioner acquired the assets of Cybertech, Inc. ("Cybertech"), a Rochester, New York based wireless Internet service provider, and thereafter petitioner offered wireless Internet access to some of its customers in certain locales in New York State. In 2001, petitioner acquired the assets of Applied Theory Corporation of Syracuse, New York, which allowed petitioner to provide an expanded dial-up Internet presence in New York State.

Petitioner had a primary network center in Bethlehem, Pennsylvania, and also maintained a network center in Philadelphia, Pennsylvania. Petitioner's connected network of circuits, or backbone, went from Buffalo to Rochester to Syracuse to Albany to Manhattan, with smaller spurs (i.e., connected circuits) out from all of those locations.

In order to function, an ISP must establish a network that spans from the point where the ISP's customer accesses the ISP to the point of presence ("POP"), which is the gateway to the global Internet. To provide this network, petitioner had to purchase access to three kinds of circuitry (either wireline or wireless), as follows:

a) an assembled network of circuitry, referred to in the aggregate as the "Backbone," that connected all of petitioner's own facilities together, and that ultimately connected all of these facilities to petitioner's network centers in Bethlehem, Pennsylvania and Philadelphia, Pennsylvania.

b) circuitry connecting petitioner's Backbone with the global Internet (at a POP), which occurred at either Bethlehem, Pennsylvania or Philadelphia, Pennsylvania.

c) dial-access and dedicated access circuits which connected petitioner's customers to petitioner's backbone facilities. These circuits were either dedicated T-1 circuits or PRI ("Primary Rate Interface") circuits connected to local telecommunications carriers' central offices.[2]

All of the circuits described above carried data to and from petitioner's customers' locations in New York State. During the period in issue, all of petitioner's routers and e-mail servers were located in Bethlehem, Pennsylvania, and virtually all of petitioner's customers' data was routed through Bethlehem, Pennsylvania regardless of the location of its intended destination.

For its dial-access customers, petitioner purchased PRI lines from various telecommunications providers. Petitioner's customers would use their modems and home telephone service to dial into the telecommunications providers' central office, at which point the provider would connect the customers' data calls to petitioner's PRI circuits in order to carry the data traffic to and from the Internet, via petitioner's backbone network and its routers and servers in Bethlehem, Pennsylvania.

For its dedicated access customers, petitioner purchased point to point T-1 lines from various telecommunications providers. These circuits enabled petitioner's customers to have a

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[2] Petitioner purchased PRI lines, representing an ISDN ("integrated services digital network") that carries digital data over the leased lines. Petitioner also purchased "customer access lines" from "incumbent local exchange carriers" which allowed petitioner's customers to gain connection to petitioner's modem pool. For its wireless (Cybertech) customers, petitioner purchased "access point equipment" providing an "access point which can feed a number of customers at the network end, and a subscriber unit at the customer end."

constant connection directly to petitioner's backbone network with a data transfer capability of 1.54 megabits per second. The data traffic from these customers was directed to and from the Internet in the same manner as with petitioner's dial-access customers, that is via petitioner's backbone network and its routers and servers in Bethlehem, Pennsylvania.

To connect petitioner's own backbone network to the global Internet, petitioner purchased internet access service from AT&T, UU Net, and Sprint.

On a monthly basis during the period in issue, petitioner purchased (via lease) circuit connections in order to connect its customers to the Internet. These circuits consisted of T-1 connections, PRI connections and internet access connections, and were purchased from the vendors Focal, XO Communications, Time Warner, Verio, and Frontier.

Petitioner paid New York State and local sales taxes to the above-referenced vendors in the aggregate amount of $40,418.05 during the period in issue on its purchases of access to these circuits.

During the period in issue, petitioner also purchased various pieces of equipment in order to provide Internet access service to its customers, that is, to direct data traffic to its intended destinations. This equipment, including routers, modems, servers, and wireless access points (large [23 gigahertz OC-3] radio transmitters), was purchased from the vendors Giganet, Dell, Adaptive Broadband, Grainger, Graybar, JPM, MPX, Tessco, and TCN.

Petitioner paid New York State and local sales taxes to the above-referenced vendors in the aggregate amount of $55,149.84 during the period in issue on its purchases of equipment.

On December 16, 2002, the Division of Taxation ("Division") received from petitioner an Application for Credit or Refund of Sales or Use Tax (Form AU-11) seeking a refund of the above-described amounts of tax paid by petitioner, aggregating $95,567.89, on its purchases of access and transport lines and equipment. Petitioner's refund claim was premised upon the exemption afforded pursuant to Tax Law § 1115(a)(12-a) for tangible personal property purchased for use in providing Internet access for sale, the exemption afforded pursuant to Tax Law § 1115(a)(12) for machinery and equipment purchased for use in producing tangible personal property for sale, and the resale exclusion of Tax Law § 1101(b)(1).

By a letter dated April 21, 2003, the Division granted petitioner's claim to the extent of $866.39 (representing tax paid on certain equipment purchased after September 1, 2000), but denied the $94,701.50 balance of petitioner's claim. The Division's denial letter specified that the exemption in Tax Law § 1115(a)(12-a) applies to tangible personal property purchased for use directly and predominantly in providing Internet access for sale if such property was purchased on or after September 1, 2000, and further does not apply to purchases of telecommunications services whenever purchased. The Division's letter further explained that the exemption in Tax Law § 1115(a)(12) applies only to purchases of machinery and equipment for use directly and predominantly in the production of tangible personal property for sale, as opposed to items used in the provision of Internet access service. Finally, the Division's letter explained that telecommunications services purchased for use in providing Internet access services for sale, rather than for resale as a telecommunications service, do not qualify for the resale exclusion.[3]

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[3] The Division's denial letter also noted that any tax paid on purchases made prior to September 1, 1999 would not be refundable as beyond the three-year statute of limitations for refunds per Tax Law § 1139. This assertion was not further addressed at hearing or by brief and appears, based on the dates of the purchases in question, to be no longer in issue.

The dollar amounts of tax paid by petitioner, and the dollar amounts of refund sought by petitioner for the period in issue, are not in dispute.

At hearing, petitioner distinguished the vendor Verio from the other vendors listed above. As noted, in 2000 petitioner acquired Cybertech, a wireless Internet service provider. Cybertech, in turn, had been purchasing its own Internet access (i.e., its POP access) from the Internet service provider Verio, and this practice continued for a period of time after petitioner's acquisition of Verio.

Petitioner provided in evidence invoices for all the purchases (both line access purchases and equipment purchases) for which refund is sought in this proceeding, including eleven invoices from Verio which set forth the charges paid by petitioner to Verio. These invoices differ from those of the other line access vendors in that they do not list line access charges or call count summaries (presumably since Cybertech was a wireless as opposed to a wireline provider), but rather list "Internet service charges." The "Internet service charges detail" portion of each of these invoices reflects the following descriptive information regarding the amounts charged:

DESCRIPTION	IDENTIFIER	AMOUNT
Equipment lease	Router	$0.00
Co-Location Co-Lo in Verio POP, Special Order	palma	[see chart below]

The amount charged in each instance for "Equipment Lease" was zero, while the amounts charged for "Co-Location; Co-Lo in Verio POP, Special Order" are specified in the chart below.

The information from the eleven Verio invoices is set forth as follows:

INVOICE NUMBER	AUDIT INVOICE REF. NUMBER	SERVICE DATES	INTERNET SERVICE CHARGE	TOTAL STATE AND LOCAL TAXES
50916163	1494	01/19/00 - 02/18/00	$2,085.00	$166.80
51130870	1495	02/19/00 - 03/18/00	$5,268.55	$4212.48
51989000	1496	06/19/00 - 07/18/00	$9,375.00	$750.00
52205963	1497	07/19/00 - 08/18/00	$9,375.00	$750.00
51564903	1498	03/20/00 - 05/18/00	$18,447.58	$1,475.81
51776566	1499	05/19/00 - 06/18/00	$9,375.00	$750.00
52441038	1500	08/19/00 - 09/18/00	$9,375.00	$750.00
52662520	1501	09/19/00 - 10/18/00	$9,375.00	$750.00
52889546	1502	10/19/00 - 11/18/00	$9,375.00	$750.00
53121517	1503	11/19/00 - 12/18/00	$9,375.00	$750.00
53370559	1504	12/19/00 - 01/18/01	$9,375.00	$750.00
TOTAL				**$8,064.09**

The Verio invoices do not specify or distinguish the portion of the charges attributable to Internet access service versus the portion attributable to rental of co-location space. As specified elsewhere in the record, "co-location" is described as "leased space within another data center to put our equipment and conduct our interconnects."

Petitioner's witness, Rafe Scheinblum, who was vice-president of operations during the period in issue, testified in explanation of the Verio invoices as follows:

> Verio is an Internet provider that sold two different services to Cybertech.
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> Cybertech was a wireless Internet company which meant that instead of buying T-1's to get out to their customers, they would do so with radios, a wireless T-1 link-out to the customers.
>
> In order for Cybertech to connect to the Internet, they purchase their Internet access from Verio, and this invoice is for Internet access as well as rental of co-location space within one of Verio's network centers in Rochester.
>
> It looks like they also leased us use of a router at no charge to connect to.

Mr. Scheinblum confirmed that petitioner continued this purchase arrangement for some time after its acquisition of Cybertech, but eventually ceased purchasing Internet access from Verio and instead routed all of the Cybertech traffic to the global Internet through petitioner's network center in Bethlehem, Pennsylvania, thus saving the cost of purchasing essentially unnecessary (i.e., third party) Internet access service as well as co-location lease charges from Verio.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The determination of the Administrative Law Judge first addressed petitioner's assertion that charges from Verio for "co-location" were exempt from tax because they were payments for the lease of real property. The determination found that the evidence in the record did not permit the portions of its payments to Verio to be allocated between internet access and the leasing of space for the co-location of petitioner's equipment. Accordingly, petitioner's claim was denied.

The Administrative Law Judge next held based on the broad language of the Tax Law and 20 NYCRR 512.2(a)(2) and 527.2(d)(2) that petitioner's payments for line access constituted telephony or telegraphy or telephone or telegraphic services under Tax Law § 1105(b)(1)(B).

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,

> For each of the purchases at issue herein, the line access service was delivered to and consumed by petitioner at various locations in New York State. The lines in question had terminal points in New York. . . . Petitioner was the purchaser of line access, and used the lines to provide an entirely separate service . . . (Determination, conclusion of law "M").

The fact that petitioner used the purchased line access to provide an interstate service to its customers was found not to affect the taxability of the purchases.

With respect to the claim for refund for purchases of equipment used in connection with the delivery of internet access services for periods prior to September 1, 2000, the Administrative Law Judge concluded that the equipment was not used "directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication or in receiving, amplifying, processing, transmitting and retransmitting telephone or telegraph signals" as was required by former Tax Law § 1115(a)(12) as in effect for periods prior to September 1, 2000. Accordingly, the refund claim was found to have been properly denied.

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 circuit purchases made by the Petitioner did not involve the purchase of **transmission**, because in a packet-switched network, transmission is performed . . . in each individual user's computer" (Petitioner's brief in support, p. 5, emphasis in original).

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 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 portions of the long distance service the Division sought to tax was a component part of the overall interstate service. The Tribunal ruled:
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>> In 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 [footnote omitted].
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> * * *
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> Internet access is, by its nature, an interstate activity. Based on the precedent set [in] Southern Pacific Communications Company, the Petitioner's purchases of T-1 and PRI lines can not be isolated from the overall interstate product, known as internet access. . . . [B]y virtue of the Petitioner's interstate usage of the line access, and the entirely interstate data traffic that was carried over these lines, the Division of Tax Appeals should conclude that purchases at issue are sales tax exempt as purchased and used by the Petitioner (Petitioner's brief in support, pp. 8, 10-11).

Petitioner argues that payments to Verio for so-called co-location were charges for the lease of real property and not for the service of storage which would be subject to tax under Tax Law § 1105(c)(4) (***see***, Petitioner's brief in support, p. 12). Petitioner relies on 20 NYCRR 527.6 which states, in part, as follows:

> While the tax is imposed on the service of providing storage space, it is not imposed on the lease of real property for storage. A lease

> can be distinguished from the provision of storage space, in that under a lease, the tenant contracts for a certain amount of footage in a specific location, the tenant has unlimited control of access to the space, and may supply his own racks, cabinets and other physical facilities.

Finally, with respect to its equipment purchases petitioner argues that "if it is determined that the Petitioner's line access purchases are considered 'telecommunications' purchases, the Petitioner would argue that the wireless devices at issue here are tangible personal property used to transmit and receive telecommunications services, and are therefore exempt from taxation" (Petitioner's brief in support, p. 13).

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 "communications 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 a telephone service (Division's brief in opposition, pp. 6-7).

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. Finally, the Division endorses the reasoning of the Administrative Law Judge with respect to co-location charges paid to Verio and the equipment purchases before September 1, 2000.

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: "[t]he term *telephony and telegraphy* includes use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals."

Chapter 615 of the Laws of 1998 added a new section 179 of the Tax Law, effective October 8, 1998, which provides as follows:

> 1. For purposes of this article, Internet access service shall not constitute a telecommunications service, nor shall the provision of Internet access service constitute the carrying on of a telephone, local telephone, telegraph, or transmission business.
>
> 2. The term "Internet access service" shall have the meaning ascribed thereto in subdivision (v) of section eleven hundred fifteen of this chapter.

Chapter 615 of the Laws of 1998 also added a new subdivision (v) to section 1115 of the Tax Law (as referred to in subdivision [2] above) which, effective October 8, 1998 and applying to sales and uses occurring on or after February 1, 1997, provides as follows:

> (v) Receipts from the sale of Internet access service, including start-up charges, and the use of such service, shall be exempt from the taxes imposed under this article. For purposes of this subdivision, the term "Internet access service" shall mean the service of providing connection to the Internet, but only where such service entails the routing of Internet traffic by means of accepted Internet protocols. The provision of communication or navigation software, an e-mail address, e-mail software, news headlines, space for a website and website services, or other such services, in conjunction with the provision of such connection to the Internet, where such services are merely incidental to the provision of such connection, shall be considered to be part of the provision of Internet access service.

Prior to September 1, 2000, Tax Law § 1115(a)(12) provided, in relevant part, that receipts from the following shall be exempt from sales and use taxes:

> telephone central office equipment or station apparatus or comparable telegraph equipment for use directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication or in receiving, amplifying, processing, transmitting and retransmitting telephone or telegraph signals . . . .

In 2000, Chapter 63 of the Laws of 2000 removed the foregoing language from Tax Law § 1115(a)(12), and added a new paragraph (12-a) to such section which provided that, effective September 1, 2000, receipts from the following shall be exempt from sales and use taxes:

> Tangible personal property for use or consumption directly and predominantly in the receiving, initiating, amplifying, processing, transmitting, retransmitting, switching or monitoring of switching of telecommunications services for sale *or* internet access services for sale or any combination thereof. Such tangible personal property exempt under this subdivision shall include, but not be limited to, tangible personal property used or consumed to upgrade

> systems to allow for the receiving, initiating, amplifying, processing, transmitting, retransmitting, switching or monitoring of switching of telecommunications services for sale or internet access services for sale or any combination thereof. As used in this paragraph, the term "telecommunications services" shall have the same meaning as defined in paragraph (g) of subdivision one of section one hundred eighty-six-e of this chapter.

Tax Law § 186-e(1)(g), in turn, defines "telecommunications services" as follows:

> "Telecommunication services" means telephony or telegraphy, or telephone or telegraph service, including, but not limited to, any transmission of voice, image, data, information and paging, through the use of wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar media or any combination thereof and shall include services that are ancillary to the provision of telephone service (such as, but not limited to, dial tone, basic service, directory information, call forwarding, caller-identification, call-waiting and the like) and also include any equipment and services provided therewith. Provided, the definition of telecommunication services shall not apply to separately stated charges for any service which alters the substantive content of the message received by the recipient from that sent.[3]

The term "tangible personal property" means corporeal personal property of any nature having a material existence and perceptibility to the human senses (Tax Law § 1101[b][6]; 20 NYCRR 526.8[a]).

The first issue presented in this case is whether petitioner's purchases from its vendors – Focal, XO Communications, Time Warner, Verio, 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

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[3] This definition of "telecommunication services" was added to the Tax Law by Chapter 2 of the Laws of 1995, effective January 1, 1995.

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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> * * *
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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. 47-59). 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. In ***Matter of Phone Programs*** (Tax Appeals Tribunal, April 6, 2000), 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.***, Testimony of Rafe Scheinblum). 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 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.

Tax Law § 1105(c)(4) imposes tax on the receipts from every sale, except for resale of "[s]toring all tangible personal property not held for sale in the regular course of business and the rental of safe deposit boxes or similar space." 20 NYCRR 527.6(a) provides the following definition: "*Storage* is the provision of a place for the safekeeping of goods, without regard to the manner of payment or length of time of the service." As discussed above, the payments to Verio for "co-location" were described as for "leased space within another data center to put our equipment and conduct our interconnects" (Hearing Tr., p. 20). Whether the arrangement with Verio rose to the dignity of a lease of real property as petitioner contends or some more casual arrangement, it involved the use of space in the active conduct of petitioner's business and not "safekeeping" its property in the sense of storage in a warehouse or safety deposit box. Accordingly, payments for such co-location were not subject to tax under section 1105(c)(4). Since we have also concluded above that payments to Verio for line access were not taxable, the inability to allocate the payments between the two categories is not an obstacle to finding that such payments were exempt in their entirety.

Petitioner's purchases of equipment governed by Tax Law § 1115(a)(12) prior to its amendment were entitled to exemption from sales tax only if the equipment was used "directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication or in receiving, amplifying, processing, transmitting and retransmitting telephone or telegraph signals." Based on the reasoning of our prior decision in ***Matter of Sprint Intl. Communications Corp.*** (***supra***)**,** which is discussed at length above, and the persuasive analysis set forth in Conclusions of Law "P," "Q" and "R" of the determination of the Administrative Law Judge, we conclude that petitioner's activities do not fall within the class of telephone or telegraph services contemplated by section 1115(a)(12) prior to its amendment. Accordingly, petitioner's claim for refund was in this respect properly denied.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Fastnet Corporation is denied to the extent that the purchases of equipment subject to Tax Law § 1115(a)(12) as in effect prior to September 1, 2000 are not exempt purchases, but is otherwise granted;

2. The determination of the Administrative Law Judge is sustained in accordance with paragraph "1" above, but in all other respects is reversed;

3. The petition of Fastnet Corporation is granted in accordance with paragraph "2" above; and

4. The claim for refund is granted as modified in accordance with paragraph "1" above.

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