STATE OF NEW YORK

DIVISION OF TAX APPEALS

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

Petitioner, Sprint International Communications Corporation, 12490 Sunrise Valley Drive, Reston, Virginia 22096, filed a petition for redetermination of deficiencies or for refund of corporation tax under Article 9 of the Tax Law for the years 1983 through 1987.

A hearing was commenced before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on December 15, 1992 at 1:15 P.M. and continued to conclusion at the same location on December 16, 1992 at 9:30 A.M. Petitioner submitted its brief on June 14, 1993, the Division of Taxation submitted its brief on August 24, 1993 and petitioner submitted its reply brief on September 22, 1993. Petitioner appeared by Kelley, Drye & Warren (Jeffrey S. Cook, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

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 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

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-

[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.

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
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

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

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

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

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.

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 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:

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[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.

(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 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

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

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

through 1987 in computing tax due under Tax Law § 186-a for the years at issue.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner alleges that it provides a value-added packet-switching network service and other services and products, which go beyond BTS. Petitioner claims it functions as "more than a mere conduit" between sender and receiver, and is therefore not subject to Tax Law § 186-a. Petitioner manipulates and alters data to overcome the limitations of BTS, and in virtually all cases changes data. Its value-added network manipulates or alters the format, speed, code, protocol and language of the information, which meets the FCC definition of an "enhanced service".

Petitioner goes on to argue that because it leases transmission lines or wires in the furnishing of packet-switching services it is not subject to Tax Law § 186-a. Petitioner provides a value-added service which enhances the transmission of messages by regulated utilities. Petitioner argues that it does not bear any of the characteristics of a regulated utility and the legislative history and relevant case law indicate that Tax Law § 186-a was intended to apply only to regulated utilities and to certain nonregulated persons who are in direct competition with regulated utilities.

Petitioner further contends that its other non-network services and products such as Telemail, MINET and FINET, and its hardware and software sales are not taxable under Tax Law § 186-a, that its gross operating income and gross earnings must, in any event, be reduced by telephone company costs and charges under Tax Law §§ 184 and 186-a, that it is not taxable under Tax Law §§ 183 and 184 as a transmission company, and that the imposition of penalties would be improper.

Finally, petitioner contends that the Division's attempt to tax its business under Tax Law § 186-a is selective enforcement, a violation of equal protection and a violation of due process.

The Division contends that telephone or telegraph service is the transmission of communication, and that a company providing such services functions as a conduit, transmitting to third-party recipients messages given it by various originators. A telephone or telegraph

company transmits information for or to its customers.

The Division further contends that the substance/content of a message sent via petitioner's packet-switching network does not change. According to the Division, petitioner emphasizes the accuracy of its network and does not add any new intelligence or information to messages which it transmits. Therefore, the Division argues that petitioner was providing telephone/transmission services during the years at issue and is subject to Tax Law §§ 183, 184 and 186-a.

It is the Division's position that the essential component of Telemail, FINET and MINET is the delivery of messages. Such a service is a transmission service subject to tax under Article 9. The Division further contends that petitioner is not entitled to deduct the cost of phone service it resold in computing gross earnings for purposes of Tax Law § 184, as such section does not contain any language limiting receipts subject to tax.

Finally, the Division contends that its attempt to tax petitioner does not involve selective enforcement and does not violate the equal protection and due process clauses.

According to the Division, penalties were properly imposed and no reasonable cause exists to abate such penalties.

CONCLUSIONS OF LAW

A. The Division seeks to subject petitioner to tax as a "utility" under Tax Law §§ 186-a and 186-c. Such sections impose a tax on every "utility" doing business in the State. The tax imposed on a "utility" such as Sprint, which is not regulated by the Department of Public Service, is based upon "gross operating income" (Tax Law § 186-a[1]). The term "utility" includes every person, whether or not subject to supervision of the Department of Public Service:

> "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]).

Similarly, "gross operating income" is defined as:

> "receipts received in or by reason of any sale . . . made for ultimate consumption or use by the purchaser of . . . telephony or telegraphy, or in or by reason of the

> furnishing for such consumption or use of . . . telephone or telegraph service . . ." (Tax Law § 186-a[2]).

Section 186-c provides for a surcharge on such "utilities", also based upon gross operating income as apportioned to the metropolitan commuter transportation district.

In addition, the Division seeks to subject petitioner to tax under Tax Law §§ 183, 183-a, 184 and 184-a as a corporation conducting a telegraph, telephone or transmission business.

Section 183(1) 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."

B. In re-enacting Tax Law § 186-a in 1941, the State Legislature stated, in its 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).

Unfortunately, the statute does not define either "telegraphy" or "telegraphic service". In the absence of such statutory definition, the meaning ascribed to a word or phrase by lexicographers may be useful as a guidepost in determining the sense in which a word was used (McKinney's Cons Laws of NY, Book 1, Statutes § 234). Webster's Third New International Dictionary defines "telegraphy" as the "use or operation of a telegraph apparatus or system . . .

for transmitting or receiving communications." Furthermore, the intent of the Legislature is to be ascertained in determining the meaning of the statute.

The relevant New York case law dealing with Tax Law § 186-a has defined telegraphy as the "transmission of communications" (New York Quotation Co. v. Bragalini, 7 AD2d 586, 184 NYS2d 924). 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 Electric Protective Co. v. McGoldrick, 262 App Div 514, 30 NYS2d 589, 593, affd 288 NY 635; New York Quotation Co. v. Bragalini, supra). "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" (Quotron Systems v. Gallman, 39 NY2d 428, 384 NYS2d 147, 149).

Based upon a review of the definition, legislative intent and relevant case law, it is concluded that Sprint is a "utility" furnishing telegraphic service. In addition, it is concluded that the cases primarily relied upon by Sprint, Holmes Electric Protective Co. v. McGoldrick (supra) and Quotron Systems v. Gallman (supra), are distinguishable from the present matter. Here, the service provided by petitioner is the transmission of data from one point to another on behalf of the customer.

Telegraph service in the ordinary sense envisions a sender, a transmitter and a receiver, with the sender delivering a message to the transmitter for transmission. Such is the situation that exists herein. A customer (sender) will contact Sprint (transmitter) to have certain information delivered to the receiver. The transmission of the data is the service that is being paid for by the sender and provided by Sprint. "[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)."[8] 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, but in the end it must be concluded that it is offering a telegraphic service; it is transmitting data in a way that the integrity of the data is insured. Sprint's additional technologies improve the BTS and offer a superior product, but the product remains the transmission of the sender's data to a receiver. Sprint moves the data originating with the sender from one point to another without adding or altering the substance of the information transferred. The service of transmitting the data is complete upon receipt by the customer (New York Quotation Co. v. Bragalini, supra).

Although certainly not determinative in this matter, the manner in which Sprint held itself out to the public is relevant. The use of "communication" in Sprint's name and its declaration on its franchise tax reports that "data communication" is its principal business suggests that Sprint considers itself involved in more than just a packet-switching

business; it considers itself involved in the larger operation of transmitting information (see Matter of RVA Trucking v. State Tax Commn., 135 AD2d 938, 522 NYS2d 689).

C. Both Quotron Systems v. Gallman (supra) and Holmes Electric Protective Co. v. McGoldrick (supra), in which the taxpayers were each held not to be subject to Tax Law § 186-a, are distinguishable from the present matter. 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,

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[8]Petitioner's Post-hearing Brief, pp. 13-14.

once compiled by Quotron, was transmitted upon request of its customers. Thus, Quotron was more than a mere conduit. 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 fact that Sprint, unlike Quotron, did not in any sense compile the information which it ultimately transmitted suggests that it could be considered to be directly in competition with ordinary telegraph companies (see, Quotron Systems v. Gallman, supra). The service of Sprint is the transmission of data originating with its customers and on behalf of its customers, not the compilation of data for transmission to receivers upon request.

In Holmes, the taxpayer was involved in the business of protecting its customers' premises against burglary or unauthorized entry. Holmes wired the premises to be protected so that upon any disturbance of the circuit from unauthorized entry or other physical contact, an electric alarm signal was sent over wires leased from the New York Telephone Company connecting the customers' premises with one of the taxpayer's offices. In the case of authorized entry, code signals were sent over the wires by the customers to signal their arrival or departure. Where the taxpayer supplied a watchman, the watchman was obligated from time to time to signal the taxpayer's central office to show he was still on the watch. A central station emergency alarm service could be installed which, when a signal was received from the customer's premises over the wires, required the taxpayer to promptly notify the Police Department of the location of the premises from which the alarm was received.

The electric signals transmitted over the taxpayer's wires were only incidental to the ultimate contractual purpose between the taxpayer and its customers, namely, protection of the customers' premises from unauthorized entry. The customers did not buy and pay for a telegraph service. The taxpayer's customers were purchasing and Holmes was selling what began when the electric signals were transmitted, namely, some form of protection of the customers' premises. In contrast, Sprint's customers were purchasing the mere transmission of communications, and Sprint's service was completed when the message was transmitted (see,

Holmes Electric Protective Co. v. McGoldrick, supra).

D. 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.

Classifications 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 Electric 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.

As previously discussed in Conclusions of Law "B" and "C", Sprint offers and its customers purchase the service of data communication, which allows its customers to transmit data from one location to another. Therefore, Sprint is also subject to taxation under Tax Law §§ 183, 183-a, 184 and 184-a.

E. Petitioner's Telemail service, a nationwide electronic mail service, is subject to tax under the applicable Tax Law sections. Sprint's Telemail service involves the mere transfer of messages between a sender and a receiver. In this case, Sprint transmits the message from the sender to the "mailbox" and then from the "mailbox" to the receiver when the "mailbox" is accessed. The customers are paying for and Sprint is providing the mere transmission of communications, the service of Sprint being completed when the message has been transmitted (New York Quotation Co. v. Bragalini, supra). The fact that Sprint stores the messages prior to access by the receiver is not sufficient to bring this service outside of the impact of the Tax Law sections at issue (see, Quotron Systems v. Gallman, supra; Matter of Teleregister Corp. v. Beame, 18 AD2d 631, 235 NYS2d 107, affd 13 NY2d 834, 242 NYS2d 355). Sprint does not compile or alter the substance of the message in any way, but transfers it from sender to receiver via the "mailbox".

F. Sprint was regulated by the FCC as an IRC during the years at issue, and was also regulated by the FCC as a VACC and as a Vendor of Dedicated Data Networks. Sprint operated a nationwide VAN. In order to attain the status of a VACC, a common carrier must demonstrate that it offers an "enhanced service" (see, Computer II, 77 FCC 2d 384 [1980]; 47 CFR § 64.702[a]). The term "enhanced service" shall refer to:

> "services offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscribers transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information."

Thus, a VACC provides services and functions in its network beyond a BTS.

The classification and regulation of Sprint as a provider of enhanced services, although relevant, is not binding in this matter. The FCC's classification was conceived with different goals in mind than that of the Tax Law (see, Computer I, 28 FCC 2d 267 [1971]; Computer II, 77 FCC 2d 384 [1980]), and therefore does not control herein (see St. Joe Resources Co. v. State Tax Commn., 72 NY2d 943, 533 NYS2d 51).

G. As previously discussed, Tax Law § 184 imposes a tax upon the "gross earnings from all sources within this state" of every corporation formed for or principally engaged in the conduct of a transmission business. The issue to be resolved is whether amounts paid to Sprint for the cost of its nationwide telephone company charges fall within the definition of "gross earnings".

The computation of gross earnings for Tax Law § 186 purposes was directly at issue and the language under analysis was exactly the same as that used in section 184 in Brooklyn Union Gas Co. v. Morgan (114 App Div 266, 99 NYS 711, affd 195 NY 616). The taxpayer in Brooklyn Union bought coal and oil as raw materials which it converted into gas and sold to customers. This purchase of raw materials was characterized as an investment of capital which came back to the taxpayer in cash as part of the price of the gas sold. The court stated:

> "capital of a corporation which must first be invested before it begins to earn anything cannot be said to be a part of the earnings of such corporation merely because it is turned into cash and thus in one sense becomes a receipt of the corporation. Earnings do not include capital but are the productions or outgrowth

of capital" (Brooklyn Union Gas Co. v. Morgan, supra).

Thus, in calculating his gross earnings, a section 186 taxpayer who actually sells a good is entitled to deduct from the receipt for the good the cost of the raw materials incorporated into the good (Matter of Howgen Transport Co., Tax Appeals Tribunal, January 12, 1989).

In 1907, apparently reacting to the decision of the Appellate Division in Brooklyn Union, the Legislature amended section 186 by providing a statutory definition of the term "gross earnings". Prior to the amendment of Tax Law § 186 (L 1907, ch 734), sections 184 and 186 had identical language in that both merely referred to gross earnings without any further explanation of the term. Section 186 was amended to define "gross earnings" as "all receipts from the employment of capital without any deduction." This amendment was made to overcome the result of Brooklyn Union (People ex rel Westchester Lighting Co. v. Gaus, supra). No similar amendment was made to section 184. Since the statutes were enacted together (L 1896, ch 908) and they employed the term "gross earnings" in similar ways, they may be considered as in pari materia as they respectively impose gross earnings taxes on different types of businesses. Because of this close relationship between the two statutes, it is proper to look to the interpretation of section 186 as an aid in interpreting section 184, since section 184 has not been similarly addressed. The two expressions should be given the same meaning in the absence of an indication that the Legislature intended a contrary meaning. Further, it has been held that there is a presumption that similar meaning attaches to use of similar words as they appear in other statutes of like import (see, McKinney's Cons Laws of NY, Book 1, Statutes § 236). As a result, it is appropriate to look to the interpretation of section 186, prior to its amendment in 1907, for assistance in interpreting gross earnings as used in section 184 (Matter of Howgen Transport Co., supra).

Applying this rule to the facts of the instant case, it is determined that Sprint is not entitled to deduct the nationwide telephone company costs and charges, as apportioned to New York State, in computing its gross earnings under Tax Law § 184. The expenditures for the costs and charges relating to the nationwide telephone company represent Sprint's employment

of its capital, in the same manner as the purchase or lease of trucks, to perform its transmission services. The nationwide telephone company costs and charges incurred, as apportioned, to provide a service is distinguishable from the purchase of raw materials converted into a good and sold. The former are the employment of capital, the gross earnings from which are specifically subject to tax, while the latter involves receipts from the sale of goods in which the receipt represents the replacement of capital, i.e., the recovery of the cost of the raw materials incorporated into the good (People ex rel New York Cent. & H.R.R.R. Co. v. Roberts, 32 AD 113, 52 NYS 859, affd 157 NY 677; People ex rel Westchester Lighting Co. v. Gaus, supra; Chesapeake & Potomac Telephone Co. v. District of Columbia, 137 F2d 674; Matter of Howgen Transport Co., supra).

H. It was established at the hearing by Sprint that one of its competitors had been audited or subject to a deficiency under Article 9 of the Tax Law. No information was available as to the remaining competitors. The information relating to Uninet was not available because Sprint refused to provide it.

In order to establish an unconstitutional claim of selective enforcement:

> "there must be not only a showing that the law was not applied to others similarly situated but also that the selective application of the law was deliberately based upon an impermissible standard such as race, religion or some other arbitrary classification" (Matter of 303 West 42nd St. Corp. v. Klein, 46 NY2d 686, 416 NYS2d 219, 223).

The establishment by petitioner that one of its competitors and itself were audited or subject to a deficiency under Article 9 without providing information as to the remaining competitors does not prove that the Division did not perform similar audits of other businesses similarly situated to petitioner (Matter of Petro Enterprises,Inc., Tax Appeals Tribunal, October 15, 1992). In addition, Sprint has not introduced any evidence relating to the second element of the claim, i.e., that the alleged selective enforcement was the result of an intentional and invidious plan of discrimination on the part of the Division (see, Matter of G & B Publ. Co. v. Dept. of Taxation & Fin., 57 AD2d 18, 392 NYS2d 938, lv denied 42 NY2d 807, 398 NYS2d 1029). Therefore, petitioner has not established that it was subject to selective enforcement by the Division.

With respect to Sprint's claim that the statutory definitions of the terms "telephone", "telegraph", "transmission", "telephony" and "telegraphy" are unconstitutionally vague, it is noted that this forum is without jurisdiction to rule on the constitutionality of the laws as written (Matter of Orvis, Inc., Tax Appeals Tribunal, January 14, 1993; Matter of Fourth Day Enterprises, Tax Appeals Tribunal, October 27, 1988).

The audit of Sprint, the New York case law and the memorandum of the Taxpayer Services Division provide, in total, a rational basis for the Division's assessment of Sprint.

I. The Division has assessed penalties on Sprint for its failure to pay the amounts shown as tax on the returns required to be filed for the years at issue pursuant to Tax Law § 1085(a)(2), and further penalties for Sprint's substantial understatement of tax liability pursuant to Tax Law § 1085(k).

When analyzing State statutes modeled after Federal statutes, it is appropriate to look to Federal cases for interpretive guidance (Matter of Levin v. Gallman, 42 NY2d 32, 396 NYS2d 623; Matter of Sener, Tax Appeals Tribunal, May 5, 1988). The corporate tax penalty provisions at issue were modeled after those in the income tax laws (see, L 1970, ch 1005; L 1983, ch 15; Memorandum of Department of Tax and Finance, 1964 McKinney's Session Laws of NY), and were enacted during the same legislative sessions as their income tax counterpart. The income tax penalty provisions were modeled after similar Federal statutes (see, Internal Revenue Code § 6651 [former 6661]) and were extended to continue the process of conforming the State's income tax laws to comparable provisions of Federal law (see, L 1970, ch 1005; Governor's Legislative Memorandum, 1970 McKinney's Sessions Laws of NY; L 1983, ch 65). Thus, in essence, the corporate tax penalty provisions were modeled after the Federal statutes which may be used for guidance.

The Internal Revenue Service has ruled that 26 USC § 6651(a)(2) (the equivalent Federal provision to Tax Law § 1085[a][2]) was intended to impose a penalty upon the taxpayer who filed a return, thereby acknowledging that the amount shown on the return was due as tax, without paying the tax shown on the return (Rev Rul 76-5623, 1976-2 C.B. 430). Therefore, the

section 1085(a)(2) penalty is cancelled as there is no tax shown on any return upon which the penalty may be imposed.

The Division imposed a penalty pursuant to Tax Law § 1085(k) for a substantial underpayment of tax for any taxable year. The amount of the understatement is to be reduced by the portion of the understatement which is attributable to the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment. While "substantial authority" is not defined in the statute or regulations, it is based on the similar Federal provision previously found in Internal Revenue Code ("IRC") § 6661 and now found in IRC § 6662. The Treasury Regulations define "substantial authority", in relevant part, in section 1.6661-3, as follows:

> "(a)(2) Substantial authority standard. The substantial authority standard is less stringent than a 'more likely than not' standard (that is, a greater than 50-percent likelihood of being upheld in litigation), but stricter than a reasonable basis standard (the standard which, in general, will prevent imposition of the penalty under section 6653(a), relating to negligence or international disregard of rules and regulations). Thus, a position with respect to the tax treatment of an item that is arguable but fairly unlikely to prevail in court would satisfy a reasonable basis standard, but not the substantial authority standard.
>
> "(b) Determination of whether substantial authority is present -- (1) Evaluation of authorities. There is substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary positions. All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether substantial authority exists and the weight of those authorities is determined in light of the pertinent facts and circumstances in the manner prescribed in paragraph (b)(2) of this section. There may be substantial authority for more than one position with respect to the same item. The taxpayer's belief that the authorities with respect to the tax treatment of an item constitute substantial authority is not taken into account in determining whether there is substantial authority."

The matters of Quotron Systems v. Gallman (supra), Holmes Electric Protective Co. v. McGoldrick (supra) and Automatic Data Processing,Inc. (supra) certainly meet the substantial authority standard of section 1.6661-3(a)(2) of the Treasury Regulations. Coupled with the fact that this type of business was only recently being held subject to Article 9 tax, it is determined that there was no understatement of tax for the purposes of Tax Law § 1085(k) and therefore no penalty is imposed.

J. The petition of Sprint International Communications Corporation is granted to the extent indicated in Conclusion of Law "I" and the notices of deficiency dated September 7, 1990 are to be modified accordingly. Except as so modified, the notices are sustained.

DATED: Troy, New York
March 17, 1994

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE