

STATE OF NEW YORK

DIVISION OF TAX APPEALS

---

In the Matter of the Petition :  
of :  
**CENTRAL NEW YORK ONLINE** : DETERMINATION  
 : DTA NO. 819631  
for Revision of a Determination or for Refund of :  
Sales and Use Taxes under Articles 28 and 29 of the :  
Tax Law for the Years 1999 through 2002. :

---

Petitioner, Central New York Online, 124 Owasco Street, Auburn, New York 13021, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the years 1999 through 2002.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on June 2, 2004 at 1:30 P.M. with all briefs to be submitted by September 17, 2004, which date commenced the six-month period for the issuance of this determination. Petitioner appeared by Anderson, Gulotta and Hicks, P.C. (Michael A. Gruin, Esq. and Anthony C. Gulotta, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Lori P. Antolick, Esq., of counsel).

***ISSUE***

Whether the Division of Taxation properly denied petitioner's claim for refund of sales and use taxes paid on its purchases from the telecommunications providers Sprint and Intermedia on the basis that such purchases were of intrastate telephone services subject to tax pursuant to Tax Law § 1105(b)(1)(B).

***FINDINGS OF FACT***

1. Petitioner, Central New York Online (“Central New York”), which began doing business in 1995 and is headquartered in Auburn, New York, is an Internet access service provider (“ISP”) with customers located in New York and Pennsylvania. Petitioner 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.”<sup>1</sup>

2. 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 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.

---

<sup>1</sup> 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.

3. During the period in issue, petitioner provided its approximately 3,500 New York residential customers with dial-up access to the Internet. Petitioner did not provide voice communication services during the period in issue.

4. In order to function, an ISP such as petitioner 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 its network, petitioner had to purchase access to two kinds of circuitry, as follows:

- a) dial-access T-1 circuits which connected petitioner's customers to petitioner's facilities;
- b) circuitry connecting petitioner's facilities to the global Internet.

5. Petitioner's founder, Greg Rigby, explained that Central NY customers would dial up petitioner's POP located in Liverpool, a suburb of Syracuse, New York, where petitioner maintained a remote access server ("RAS"). In order to connect its customers to its RAS, petitioner purchased various dial access T-1 lines from various telecommunications providers, including Verizon and ACC Telecom. 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 RAS. Petitioner's purchases of these customer connect lines are not at issue in this matter.

6. Petitioner's RAS would collect all of those customer calls and "funnel" them through a router onto an Internet backbone line purchased by petitioner and directly accessing the world wide web (Global Internet). This line connecting petitioner's RAS to the Global Internet was purchased by petitioner during a portion of the period in issue from Intermedia, and for the balance of the period in issue from Sprint. These lines are described on the Intermedia invoices

as “dedicated access charges,” and on the Sprint invoices as “recurring charges.” It is the tax imposed on the charges petitioner paid for these lines which is at issue.

8. Petitioner paid New York State and local sales taxes to the above-referenced vendors Intermedia and Sprint, in the aggregate amount of \$2,711.92 during the period in issue on its purchases of access to these circuits.

9. On June 7, 2002, the Division received from petitioner an Application for Credit or Refund of Sales or Use Tax (Form AU-11) seeking a refund of tax paid by petitioner, aggregating \$5,068.02, on its purchases of access 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).

10. By a letter dated January 3, 2003, the Division granted petitioner’s claim to the extent of \$1,458.32 (representing tax paid on certain equipment purchased after September 1, 2000), but denied the \$3,609.80 balance of petitioner’s claim. At hearing, petitioner specified that the \$897.88 portion of its refund claim relating to equipment purchases which was denied is no longer at issue, and that petitioner only seeks refund of the \$2,711.92 in tax paid on its purchases from Intermedia and Sprint, as described above.

11. With its brief, petitioner submitted six proposed findings of fact, each of which has been included in the foregoing Findings of Fact.

#### ***CONCLUSIONS OF LAW***

A. 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 . . . .”

B. Regulations of the Commissioner of Taxation at 20 NYCRR 527.2(a)(2) provide, in relevant part, that the words “of whatever nature” as contained in Tax Law § 1105(b) “indicate that a broad construction is to be given the terms describing the items taxed.” Such regulations go on to provide as follows:

The term *telephony and telegraphy* includes use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals.

\* \* \*

Example 3: Message switching services, transmitted to a computer over lines leased from a communication carrier are telegraph services subject to the tax imposed under section 1105(b) of the Tax Law. (20 NYCRR 527.2[d][2].)

A service is not considered telegraphy or telephony if either of these services is merely an incidental element of a different or other service purchased by the customer.

Example 6: A company offers its customers a protective service using a central station alarm system, which transmits signals telegraphically. The customer is purchasing a protective service. (20 NYCRR 527.2[4].)

C. 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.

D. Petitioner initially claimed in its petition that its purchases of line access from Intermedia and Sprint were exempt from tax as sales for resale. This claim has not been further argued and appears to have been abandoned. In any event, it is undisputed that petitioner is an Internet access service provider and does not sell telephone or telegraph services to its customers, and thus its purchases would not be exempt in any event as purchases for resale. In *Matter of Phone Programs, Inc.* (Tax Appeals Tribunal, April 6, 2000), the Tribunal explained that "the resale exclusion for utility services demands that the services be resold as utility services, i.e., telephone services (20 NYCRR 526.6[c]; 527.2[e])."

E. In denying petitioner's claim for refund on line access charges, the Division maintains that petitioner purchased intrastate telephone service from the noted providers. The Division asserts that petitioner's use of such lines has no impact on the taxability of such purchases at the time of purchase. In contrast, petitioner maintains that it purchases line access to provide its customers with Internet access via a packet switched network which is distinguishable from

sound reproduction networks. More to the point, petitioner asserts that, in this case, it purchased Internet access service as opposed to telephone or telegraph service.

F. Tax Law § 1115(v) provides that receipts from the sale of Internet access service shall be exempt from sales and use taxes. Petitioner, an ISP, purchased its own Internet access service (dedicated access) from Intermedia and Sprint, by which petitioner's customers' data accessed the Global Internet from petitioner's POP in Liverpool, New York. The charges for such access paid by petitioner were charges for Internet access, were improperly subjected to tax, and petitioner is entitled to a refund thereof.

Petitioner's situation, and the purchases in issue, may be distinguished from that of an ISP which purchases circuitry and combines the same into a network through which its customers' data traffic is carried to the ISP's own network center, or POP, at which point such traffic accesses the Global Internet via the ISP's own Internet access provider. Such network circuitry purchases, like local exchange purchases, are clearly subject to tax, pursuant to Tax Law § 1101(b)(1)(B); § 179(1), (2); § 1115(v), and § 186-e(1)(g), as purchases of taxable telecommunications services notwithstanding that the same are, in turn, used in the provision of a nontaxable service, to wit, Internet access (*see* TSB-M-97[1.1]C; TSB-M-97[1.1]S).

G. The petition of Central New York Online is hereby granted, as is petitioner's claim for refund of \$2,711.92 in tax paid on access charges.

DATED: Troy, New York  
March 10, 2005

---

/s/ Dennis M. Galliher  
ADMINISTRATIVE LAW JUDGE