

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
XO NEW YORK, INC.	:	DETERMINATION DTA NO. 820634
for Revision of a Determination or for Refund of Sales and : Use Taxes under Articles 28 and 29 of the Tax Law for the Period September 1, 1998 through August 31, 2001.	:	

Petitioner, XO New York, Inc., c/o Michael O'Day, 11111 Sunset Hills Road, Reston, Virginia 20190, 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 period September 1, 1998 through August 31, 2001.

On March 8, 2006, petitioner, by its representative Anderson & Gulotta, P.C. (Anthony C. Gulotta, Esq., of counsel) and the Division of Taxation by Mark F. Volk, Esq. (Lori P. Antolick, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by June 28, 2006, which commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Arthur S. Bray, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Federal universal service fund fee is subject to New York State sales tax.

FINDINGS OF FACT

1. Petitioner, XO New York Inc. (“XO”), is a telecommunications corporation based in Reston, Virginia. It provides telecommunications services to customers located in New York State.

2. Petitioner issues bills to its customers for its services. Under the heading of “State and Local Charges,” petitioner’s bill includes a charge for “Fed. Universal Service Fund Surcharge.” Petitioner did not collect and remit sales tax on the Federal Universal Service (“USF”) fees.

3. In or about the end of November 2001, the Division of Taxation (“Division”) commenced an audit of XO. To the extent relevant here, XO executed a Test Period Audit Method Election form for review of its sales records. A test period of September 1, 1998 through November 30, 1998 was chosen because it was considered representative of XO’s business activity. As a result of an examination of the test period, the Division concluded that petitioner had erroneously failed to collect and remit sales tax on the USF fees. On the basis of this conclusion, the Division calculated the amount of tax due, \$22,532.40, through a detailed audit of petitioner’s records for the entire audit period.

4. On or about April 24, 2002, petitioner remitted a check payable to the Commissioner of Taxation and Finance for the amount of tax due plus interest. On May 13, 2006, the Division received an Application for Credit or Refund of Sales and Use Tax from petitioner. In a letter dated January 30, 2004, petitioner was advised that its claim for refund was denied because “Universal Service Fund Fees charged to the vendor’s customers constitute receipts from the sale of telephone services pursuant to Section 1105(B) [sic] of the Tax Law and Section 527.2 of the Sales and Use Tax Regulations.”

SUMMARY OF THE PARTES' POSITIONS

5. In its brief, petitioner argues that the USF fee included on its customers' bills should not be subject to New York State sales and use tax because the fee is assessed as a percentage of only the charges for interstate and international telephone calls. Petitioner then notes that the receipts from the sale of interstate and international telephone service is excluded from sales tax. Petitioner further argues that the USF fee is incidental to interstate and international telephone service rather than intrastate calls and therefore should not be subject to sales and use tax.

6. The Division maintains that the USF fee is an expense of doing business in New York and elsewhere and that pursuant to Tax Law § 1101(b)(3) the fee should be regarded as part of the taxable receipt of the sale of telephone service in New York State. The Division further argues that, in accordance with 20 NYCRR 526.5(b)(1)(i) and (2), excise taxes imposed on manufacturers and not consumers are included in taxable receipts. The Division also maintains that its position is supported by the reasoning employed in Advisory Opinion, TSB-A-88(8)S. The Division next maintains that petitioner's reliance upon 20 NYCRR 527.2(d)(4) to establish that the USF fee is incidental to interstate telephony is misplaced since this regulation applies to services and not fees.

7. In a reply brief, petitioner contends that the proper standard of review is the one that applies to the interpretation of an exception. Petitioner further maintains that the Division's reliance upon the Advisory Opinion cited above is misplaced because it fails to distinguish between the fees at issue in that opinion and the USF fees at issue in the present matter. Lastly, petitioner submits that the Division's attempt to bring the USF fee within the scope of the sales tax is unreasonable.

CONCLUSIONS OF LAW

A. Section 1105(b) of the Tax Law imposes a tax on “the receipts from the sale . . . of telephone and telegraphy and telephone and telegraph service of whatever nature *except interstate and international telephony and telephone and telegraph service.*” (Emphasis added.) Section 1101(b)(3) defines receipt as “the amount of the sale price of any property and the charge for any service under this article . . . without any deductions for expenses”

B. The issue presented is whether the USF fee which is imposed on XO and then passed on to XO’s customers should be considered a receipt from the sale of intrastate telephone service or a receipt from the sale of exempt interstate and international telephony and telephone and telegraph service. In analyzing the forgoing arguments, one begins with the well-settled proposition that statutes and regulations authorizing exemptions from taxation are to be strictly and narrowly construed (*see, Matter of International Bar Assn. v. Tax Appeals Tribunal*, 210 AD2d 819, 620 NYS2d 582, *lv denied* 85 NY2d 806, 627 NYS2d 323). In order to qualify for the exemption, petitioner bears the burden of clearly proving its entitlement to the exemption sought (*see, Matter of Grace v. New York State Tax Commn.*, 37 NY2d 193, 371 NYS2d 715, *lv denied* 37 NY2d 708, 375 NYS2d 1027).

C. An understanding of the nature of the fee is central to reaching a proper conclusion. The Universal Service Fund is a program that was initiated by Congress in the Communications Act of 1934. The USF was a mechanism by which interstate long distance carriers were assessed in order to subsidize telephone service to low-income households and areas with a high cost of living. The goal of the act was to provide rapid, efficient communications service to all people in the United States at a reasonable charge. In the Telecommunications Act of 1996, the

traditional definition of universal service was augmented to include rural health care providers and eligible schools and libraries.

Telecommunication companies are required to pay a specific percentage of their interstate and international revenues into the Universal Service Fund (47 CFR 54.706). The percentage is called the contribution factor. Companies are not required by the Federal Communications Commission to recover their contributions from their customers. However, they are permitted to do so (47 CFR 47.712). Each company makes a decision regarding whether and how to recover Universal Service costs.

D. The USF fee is clearly a product of interstate and international telephone service. The fee is only incurred when a customer purchases interstate or international telephone service. Conversely, if a customer makes only intrastate calls, the fee is not incurred. Under the circumstances, it is clear that petitioner's collection of this fee is a receipt from the sale of interstate or international telephone service which is exempt from tax by the express language of Tax Law § 1105(b).

E. In its brief, the Division relies upon the reasoning set forth in TSB-A-88(8)S. Although this advisory opinion is not binding or otherwise precedential (*see*, Tax Law § 171(24); 20 NYCRR 2376.4), the rationale employed is instructive. In this advisory opinion, the issue presented concerned end-user common line charges ("EUCL"). The EUCL is a fee on local telephone lines for access to long distance lines. The charge is imposed regardless of whether long distance calls are made and whether or not the long distance calls are interstate or intrastate. The advisory opinion concluded that the charges were subject to sales tax. In reaching this conclusion, it reasoned that since the taxpayer in that case could not purchase the

local service without access to the long-distance services, the EUCL was simply a component of the local charge. The Advisory Opinion reasoned as follows:

The EUCL charges are billed to each subscriber without regard to the actual long-distance interstate calls, if any, made by each subscriber. Although earned pursuant to an FCC tariff, the EUCL charges are nothing more than an accounting procedure used in an attempt to segregate and calculate from its basic charge, an item of expense incurred by Petitioner in providing each of its subscribers with access to an interstate long-distance carrier. The EUCL charges do not necessarily represent actual expenses incurred by Petitioner to provide interstate access to a particular subscriber nor is the activity represented by such charges any more interstate than any other component of the charges for basic telephone service.

F. It is readily evident that the fee in this case is distinguishable from the charge in the Advisory Opinion. First, there is no connection between the USF fee and the charge for local service. If a customer did not make an interstate or international call, a USF fee would not be incurred. Second, unlike the EUCL charges, the USF fee is based solely on long distance charges. Therefore, unlike the EUCL charges, the collection of the USF fee is a component of receipts from interstate or international calling.

G. Lastly, it is noted that the Division's regulations do not call for a different conclusion. The Commissioner's regulations at 20 NYCRR 527.2(d)(1)(1) provide that:

The 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.

As set forth above, the USF fee is not a receipt from intrastate communication.

The Division's reliance upon 20 NYCRR 526.5(b)(1)(i) is also misplaced. This section provides:

Generally, excise taxes which are imposed on manufacturers, importers, producers, distributors or distillers are included in the receipts on which sales tax is computed.

The relevance of this provision is questionable since petitioner does not clearly fall within any of the categories mentioned in the section. Further, the section itself begins with a qualifying term indicating that it does not apply in all instances. Certainly, it cannot be assumed that it was intended to contravene the provisions of Tax Law § 1105(b).

H. The petition of XO New York, Inc. is granted, and the Division is directed to refund to petitioner the sum of \$22,532.40, plus such interest as is allowed by law.

DATED: Troy, New York
December 28, 2006

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE