

Cite as Det. No. 17-0234, 37 WTD 171 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| In the Matter of the Petition for Correction of) | <u>D E T E R M I N A T I O N</u> |
| Assessment of) | |
|) | No. 17-0234 |
|) | |
| ...) | Registration No. . . . |
|) | |

[1] RCW 82.04.080(1), RCW 82.04.290(2): B&O TAX – GROSS INCOME OF THE BUSINESS – TELECOMMUNICATIONS – A telecommunications company’s receipts of support distributions under the federal Universal Service Fund (USF) program, supporting affordable services in non-urban areas, are subject to service and other activities B&O tax as gross income of the business. The company voluntarily imposes a surcharge on sales of telecommunications services in order to recoup its business costs of its federally mandated USF contributions. The taxpayer did not establish that the Department subjected the taxpayer’s proceeds from telecommunications service sales to B&O tax a second time by imposing service and other activities B&O tax on its USF support receipts.

[2] RCW 82.32A.020: B&O TAX – RIGHT TO RELY ON WRITTEN ADVICE – SILENCE TO AN ISSUE IN PREVIOUS AUDIT FINDINGS. A taxpayer may not rely on the absence of an issue or explanation in previous audit findings as a form of written advice from the Department.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Eckholm, T.R.O. – A telecommunications company sought review of an assessment of service and other activities business and occupation (B&O) tax imposed on receipts of Universal Service Fund (USF) support distributions. The taxpayer asserted that the Department cannot tax those receipts because the taxpayer previously paid B&O tax on the revenue it used to contribute to the USF. The taxpayer also asserted that the assessment should be waived based on the Department’s silence on the issue in prior audits. The Department denies the taxpayer’s petition.¹

ISSUES

1. Are USF support receipts subject to B&O tax [as “gross income of the business”] under RCW 82.04.080, when the taxpayer [received the amounts for providing telephone services to

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

customers in areas where the cost of providing the services is more expensive than the national average, but the taxpayer] previously paid B&O tax on the revenues it used to contribute to the USF?

2. Does the taxpayer have the right to have its tax deficiency assessment, and related interest and penalties, canceled under RCW 82.32A.020, based on the Department's failure to notify the taxpayer of its incorrect reporting during prior audits?

FINDINGS OF FACT

. . . (the taxpayer) is a telecommunications company that is headquartered [out-of-state]. The taxpayer's business activities in Washington included retail and wholesale sales of wireless telephone services and equipment, and providing various related services such as internet access. In addition, the taxpayer maintained retail stores or kiosks, technical and support offices, and cell and switch sites at numerous locations within Washington.

The Department's Audit Division audited the taxpayer's records for excise tax purposes for the period January 1, 2008, through December 31, 2011 (audit period). As a result of the audit, the Department issued an assessment against the taxpayer in the total amount of \$² The only portion of the assessment at issue in this review is service and other activities B&O tax of \$. . . , imposed on unreported receipts of "USF High-Cost Program" support distributions. The Department previously audited the taxpayer in 2007 and 2010. The audit reports in those prior audits do not include any reference to the taxpayer's receipt of "USF High-Cost Program" support distributions or discussion of taxation of USF support receipts, and the taxpayer was not assessed tax on USF support receipts.³

USF and High-Cost Program framework.

The Federal Communications Commission (FCC) created the USF to meet a Congressional universal service mandate, originally promulgated in the Communications Act of 1934, that all Americans should have access to telecommunications services at reasonable rates. *See* 47 U.S.C. § 151 (universal service mandate codified as amended).⁴ All telecommunications carriers that provide interstate telecommunications services are required to contribute to the USF. 47 U.S.C. § 254(d); *see also* 47 C.F.R. § 54.706(a). Every entity required to contribute to the USF contributes on the basis of its projected collected interstate and international end-user telecommunications revenues, subject to annual reconciliation. 47 C.F.R. § 54.706(b).⁵

² Document No. . . . , issued on July 27, 2016, included assessment of retail sales tax of \$. . . , retailing business and occupation (B&O) tax of \$. . . , wholesaling B&O tax of \$. . . , service and other activities B&O tax of \$. . . , use tax and/or deferred sales tax of \$. . . , and interest of \$. . . , for a total amount of \$

³ *See* Audit No. . . . , Auditor's Detail of Differences and Instructions to Taxpayer, and Document No. . . . , dated July 17, 2007; Audit No. . . . , Auditor's Detail of Differences and Instructions to Taxpayer, and Document No. . . . , dated September 28, 2010.

⁴ *See* <https://www.fcc.gov/general/universal-service> (last visited August 21, 2017).

⁵ *See* <http://www.usac.org/cont/payers/annual-true-up.aspx> (last visited September 8, 2017).

The proceeds of the USF are distributed to eligible telecommunications carriers (ETCs) through four separate programs:

- High-Cost
- Low-Income
- Schools and Libraries
- Rural Health Care⁶

The taxpayer received USF support distributions that originated from the High-Cost Program.⁷ The goal of the High-Cost Program is to keep telephone service affordable for customers in areas where, absent the USF support, telephone service would be more expensive than the national average cost of such services.⁸ USF support is disbursed under the High-Cost Program to ensure that consumers in all regions of this country have access to and pay rates for telecommunications services that are reasonably comparable to those in urban areas.⁹ The High-Cost Program fulfills this universal service goal through disbursements to eligible carriers who serve these areas so they may recover some of their operating costs.¹⁰

The FCC formed the Universal Service Administration Company (USAC) to manage the contribution of funds to, and the distribution of funds from, the USF. *See* 47 C.F.R. § 54.701(a).¹¹ USAC is an independent corporation whose purpose is to impartially distribute funds from the USF in a manner that best meets the needs of the four programs. *Id.*¹² The USAC is also responsible for billing contributors and collecting contributions to the USF. 47 C.F.R. § 54.702(b).

In order to receive USF support distributions, a carrier must be designated as an ETC, usually by a state regulatory commission. 47 C.F.R. § 54.201(a)-(b).¹³ In Washington, the regulatory commission responsible for determining if a telecommunications company is an ETC is the Washington Utilities & Transportation Commission ([Commission]), which has adopted regulations to address this issue in chapter 480-123 WAC. Under WAC 480-123-020, an ETC means a “carrier designated by the commission as eligible to receive support from federal universal service mechanisms in exchange for providing services supported by federal universal service mechanisms.” The [Commission] will approve a petition for designation as an ETC if “the petition meets the requirements of WAC 480-20-123-030, the designation will advance some or all of the purposes of universal service found in 47 U.S.C. § 254, and the designation is in the public interest.” WAC 480-123-040.

⁶ *See* <https://www.fcc.gov/general/universal-service> (last visited August 21, 2017).

⁷ The High-Cost Program is now known as the Connect America Fund ([Fund]). In 2011, the FCC created the [Fund] to replace all existing high-cost support mechanisms. The primary goals of the [Fund] are to extend broadband and mobile voice services to areas that would not otherwise have those services, while preserving voice service. *See* <https://www.fcc.gov/general/universal-service> (last visited August 21, 2017). This determination refers to the High-Cost Program as it existed during the audit period.

⁸ *See* <https://www.fcc.gov/general/universal-service> (last visited August 21, 2017).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *See also* <https://www.fcc.gov/general/universal-service> (last visited August 21, 2017).

¹² *See also* <http://www.usac.org/about/default.aspx> (last visited August 21, 2017).

¹³ *See also* <http://www.usac.org/hc/join-the-program/step01/default.aspx> (last visited August 21, 2017).

USF support distributions are provided in exchange for the carrier's fulfillment of all the requirements of an ETC in providing services supported by federal universal services mechanism. *See* 47 C.F.R. § 54.201-202. Generally, USAC determines the amount of High-Cost Program support it will distribute to an ETC based upon a detailed analysis of an ETC's expenses and total operating costs. *See* 47 C.F.R. Part 54, Subpart D.

The taxpayer indicated that it made more USF contributions during the audit period than it received in USF support distributions. The taxpayer also indicated that to assist in recouping its USF contribution costs, the taxpayer voluntarily includes a "Federal Universal Service Fund surcharge" when billing its customers for telecommunications services. The FCC does not require carriers to impose this surcharge on their customers in order to meet USF contribution requirements.¹⁴

ANALYSIS

The taxpayer asserts that the Department cannot assess service and other activities B&O tax on its receipts of USF support distributions because it previously paid B&O taxes on the revenue it used to contribute to the USF. The taxpayer also asserts that the assessment should be canceled because the Department did not assess its USF support receipts in prior audits and such a change in Department practice requires prior notice through published guidance or rule.

1. Taxation of USF support receipts.

In Washington, "there is levied and collected from every person that has a substantial nexus with this state a tax for the act or privilege of engaging in business activities." RCW 82.04.220. This tax is referred to as the B&O tax. For purposes of the B&O tax, "business" is broadly defined to include "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. It is well settled that by enacting Washington's B&O tax system, the legislature intended to impose that tax on virtually all business activities carried on within the state. *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971). *See Budget Rent-A-Car of Washington-Oregon Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 175, 500 P.2d 764 (1972).

According to RCW 82.04.220(1), the B&O tax "is measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be." Every person engaging within Washington in any business activity, not taxed explicitly under another section of chapter 82.04 RCW, or RCW 82.04.290(1), (3), is subject to service and other activities B&O tax. RCW 82.04.290(2)(a). *See also* WAC 458-20-224. Service and other activities B&O tax is measured by "gross income [of the business]," defined in RCW 82.04.080,¹⁵ and subject to the rate of 1.5 percent. RCW 82.04.290(2)(a).

The taxpayer seeks cancellation of the service and other activities B&O tax assessed on its receipts of USF support distributions because it previously paid B&O taxes on the revenue it used to

¹⁴ *See* [<https://www.fcc.gov/sites/default/files/billingshockinfographic.pdf>].

¹⁵ ["Gross income of the business" is defined as "the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, . . . and other emoluments however designated," without deduction for the taxpayer's costs of doing business. RCW 82.04.080(1).]

contribute to the USF. The taxpayer stated that the funds it used to make its USF contributions included “Federal Universal Service Fund surcharges” that it voluntarily imposed on sales of telecommunication services. The taxpayer stated that it paid B&O taxes on the proceeds from its sales of telecommunication services, including the surcharge amounts; therefore, the Department is now attempting to impose B&O tax on the same amounts that were already taxed. Yet, the taxpayer does not assert that receipts of USF support distributions do not constitute gross income under RCW 82.04.080. Nor has the taxpayer identified any deduction or exemption excluding the USF support receipts from gross income or cited to authority in support of its argument.¹⁶ The taxpayer has not shown how the USF support receipts are nontaxable distributions of its USF contributions and fails, at the least, to establish a direct relationship between its USF contributions and its USF support receipts as an ETC.

The requirement that a carrier contribute to the USF is not based on receipt of USF support distributions. All telecommunications carriers that provide interstate telecommunications services are required to contribute to the USF, not just those ETCs that receive USF support disbursements. *See* 47 U.S.C. § 254(d); 47 C.F.R. § 54.706(a). Every entity required to contribute to the USF, contributes on the basis of its projected collected interstate and international end-user telecommunications revenues, net of projected contributions. *See* 47 C.F.R. § 54.706(b). USF contributions are not based on a carrier’s collection of surcharges it voluntarily imposes on the sales of its services or projected amounts of USF support distributions it may receive as an ETC.

USF support is distributed based on an ETC’s fulfillment of its requirements as an ETC in providing services supported by federal universal services mechanisms, not based on the fact that the ETC contributed to the USF. 47 C.F.R. § 54.201-202. [Thus, the support distributions represent taxable gross income of the business as “compensation for the rendition of services” under RCW 82.04.080(1).] There is no [support distribution] requirement related to a carrier’s USF contributions. *Id.* The amount of USF support to be disbursed is based on a complex analysis of the ETC’s costs, not on the amount an ETC contributes to the USF. *See* 47 C.F.R. Part 54, Subpart D.

The taxpayer’s voluntary imposition of a surcharge on sales of telecommunications services is its own way of recouping its business costs of the USF contributions. The USF support distributions are not a return of the surcharges the taxpayer voluntarily imposed on its sales of telecommunications services. The taxpayer has not established that the Department subjected the taxpayer’s proceeds from telecommunications service sales to B&O tax a second time by imposing service and other activities B&O tax on its USF support receipts.

2. Reliance on the Department’s failure to assess USF support receipts in prior audits.

The taxpayer asserts that it should not be liable for tax assessed on USF support receipts because the Department did not assess USF support receipts in prior audits. The taxpayer argues that the current assessment represents a change in Department policy that should only be implemented with prior notice through published guidance or rule, particularly where Department personnel orally informed the taxpayer that the Department would issue guidance in this area in the future.

¹⁶ The taxpayer representative confirmed at the review hearing that it was not asserting, under WAC 458-20-111, that its USF support receipts are excluded from the measure of tax as reimbursements of its USF contributions.

The taxpayer does not assert that Department personnel stated that USF support receipts were not subject to tax or instructed the taxpayer not to report tax on those receipts pending any future guidance. The taxpayer has not identified any Department written statements to the taxpayer that its USF support receipts were not subject to tax.

Taxpayers are responsible to “[k]now their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the department of revenue.” RCW 82.32A.030(2). *See* Det. No. 15-0151, 35 WTD 182, 188 (2016). Though a taxpayer carries this responsibility, it has the right “to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer” RCW 82.32A.030(2). Where the taxpayer has shown that it relied on those instructions to its detriment, it also has the right “to have interest, penalties, and in some instances, tax deficiency assessments waived.” *Id.*

Here, the taxpayer has not shown that it sought tax reporting instructions or that it relied on written tax reporting instructions, or official written advice, from the Department. An absence of Department written instructions or advice, or the absence of assessment on a certain stream of income in a prior audit, does not qualify for waiver of an assessment under RCW 82.32A.020(2). Det. No. 15-0353, 36 WTD 183, 189 (2017); Det. No. 15-0184, 35 WTD 149, 157 (2016). To the extent a prior auditor did not discover and assess the taxpayer’s receipt of USF support disbursements, such a mistake or inadvertence does not prevent the Department from assessing those receipts in a future audit. *See Kitsap-Mason Dairymen's Assoc. v. Tax Commission*, 77 Wn.2d 812, 818, 467 P.2d 316 (1970); *Dep’t of Revenue v. Martin Air Conditioning*, 35 Wn. App. 678, 688, 668 P.2d 1286 (1983).

The taxpayer has not established that the Department previously taxed its USF support receipts by taxing its proceeds from telecommunication service sales, or that the Department is required to cancel the assessment based on the Department’s silence on the issue in a prior audit. The Department denies the taxpayer’s petition.

DECISION AND DISPOSITION

The taxpayer’s petition is denied.

Dated this 18th day of September 2017.