

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-90(6)C
Corporation Tax
February 15, 1990

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C890619A

On June 19, 1989, a Petition for Advisory Opinion was received from MCI Telecommunications Corporation, 1133 19th Street, N.V., Washington D.C. 20036.

The issue raised by Petitioner, MCI Telecommunications Corporation, is in regard to the tax consequences resulting from the proposed introduction of a 900 Commercial Service. The questions involve (1) Franchise Tax on Transmission Companies, section 184 of Article 9; (2) Tax on the furnishing of Utility Services, section 186-a of Article 9; and (3) Sales Tax, Articles 28 and 29 of the Tax Law. The sales tax questions will be considered in a separate Advisory Opinion to be subsequently issued.

MCI Communications Corporation (hereinafter "MCI") is a corporation organized and existing under and by virtue of the laws of the State of Delaware, with its principal office located in Washington, D.C. MCI Telecommunications Corporation, MCI International Telecommunications Corp., RCA Global Communications, Inc. and Western Union International Inc. are wholly owned operating subsidiaries of MCI. MCI and its subsidiaries are hereinafter collectively referred to as MCI.

MCI is planning to introduce a Domestic 900 Commercial Service. The 900 Service offering is a switch based interactive service. The service permits MCI's customer (hereinafter "900 Sponsor") to receive telephonic communications from callers located in all or a limited portion of the country. Through use of the 900 Service, the 900 Sponsor will be able to offer various services or goods for a fee to callers (hereinafter "End Users") calling its 900 number or to receive donations from such End Users. As part of the 900 Service, MCI will offer billing and collection services to the 900 Sponsor.

The MCI charge to the 900 Sponsor for the 900 Service will be made up of two functional components that will appear as one charge. The first component of the charge will represent the cost of the communications service which MCI is providing to the 900 Sponsor. This service is similar to Domestic 800 Service functionally. The second component of the charge will represent the cost of billing and collection services for the 900 Sponsor. MCI presently intends to bill these two components, pursuant to a tariffed rate filed with the Federal Communications Commission (hereinafter "FCC") at a flat charge to the Sponsor of 40 cents for the first minute and 4 cents for each additional 6 second period. The amount of these charges is subject to change. The two components will not be separately charged to the 900 Sponsor, although a Sponsor could break-out the cost of each component by referencing MCI's tariffed rate for 800 Service.

The End User will pay a fee established by the 900 Sponsor for placing a call to the 900 number. MCI will not determine what such rate will be. The End User charges for goods or service provided by the 900 Sponsor will be collected by MCI or its agents. If the End User is an MCI long distance customer, MCI will bill and collect the charge. If the End User is not an MCI customer, MCI will collect the charges by providing the Local Exchange Carrier (hereinafter "LEC") with the billing information. The LEC will in turn bill the charge along with other MCI long distance traffic and remit the amounts collected to MCI. MCI will pay over to the 900 Sponsor the amounts billed, offset by: (i) the amount due MCI from the 900 Sponsor for the communications service; (ii) the billing and collection services, and, (iii) an amount estimated to equal the uncollected amount billed to End Users. (It is assumed that the billing and collection services component of MCI's charge to the 900 Sponsor includes both (ii) and (iii) above.) In addition, MCI or an LEC may undertake the billing and collection of New York State sales taxes on products or services furnished to End Users. Taxes so collected will either: (i) be paid over directly by MCI to the Department of Taxation and Finance, or (ii) be turned over to the Sponsor for it to remit to the Department of Taxation and Finance along with its filing of sales tax returns. In the former case, the remaining net balance will be remitted by MCI to the 900 Sponsor. The offsetting of the amounts received by MCI from End Users by the amount owed by the 900 Sponsor to MCI for services is being done solely for administrative convenience. The 900 Sponsors have a separate, legal liability to pay for MCI's communication and billing and collection services. That liability is not affected by whether the End Users pay their bills for the Sponsor's goods or services.

Although an unlimited number of products or services may be offered by the 900 Sponsors, MCI can envision at least six basic products or service categories which may be offered. These product or service categories can be identified as follows:

Product 1: The 900 Sponsor will conduct an informal opinion poll. By telephoning a selected number, the End User will be able to express an opinion without speaking. Typically, the End User will be billed a nominal charge (\$.50 - \$1.00) for making the call. For example, a news program will pose a question to its viewers. One telephone number will be established for affirmative responses and a second number will be established for negative responses. Another example of this type of product would be where the End User will answer a number of questions by use of touch tone telephone. To express an answer to a specific question the End User will push the appropriate number on a telephone which corresponds to the answer.

Product 2: The 900 Sponsor will provide a recorded message service. The End User will be able to telephone the selected telephone number to listen to a prerecorded message. The End User will be billed a charge (either fixed or variable based on the elapsed time of the call), which is established by the 900 Sponsor. For example, this service could include what is commonly referred to as dial-a-prayer, dial-a-recipe, newslines or sports-line.

Product 3: The 900 Sponsor provides a financial or information service to an End User. The End User, by telephoning a selected number (and entering an account number and/or a personal identification number) will be able to access various data files through use of a touch-tone telephone. The End User may be charged either a fixed or variable amount (based upon the elapsed time of access to the service, or number of requests made) for accessing the service. For example, a bank may offer its customers access to various account balance information over the telephone. The customer would call the 900 number and enter a special access code to retrieve the data.

Product 4: The 900 Sponsor will provide an interactive conversation with one person, or a party call with a number of other End Users. The End User will be charged a flat fee for the first minute plus an additional charge for each additional minute. Examples of this type of service include telephoning an attorney for legal advice or calling an astrologer to receive a personal forecast. Another example may also include a service such as "teen-line", where the End User dials into a "party line" to talk to other teenagers living throughout the United States.

Product 5: The 900 Sponsor will be a charitable organization. By calling the selected telephone number an End User will be able to make a pledge or gift to the 900 Sponsor's organization. These organizations could include either charitable organizations exempt from federal income tax under section 501(a) of the Internal Revenue Code or non-exempt organizations. Different numbers may be established for different pledge or gift amounts. For example, through a telethon or by the use of other media, a 900 Sponsor may seek pledges by having viewers call a specified number for pledge of one amount (e.g., \$10) and another number for pledge of another amount (e.g., \$20). In conjunction with the pledge, the 900 Sponsor may have a pre-recorded message thanking the End User. In addition, the 900 Sponsor might provide the End User with some acknowledgment of the donation such as a commemorative book or token.

Product 6: The 900 Sponsor will be a dealer of goods. The 900 Sponsor will advertise a product. The End User will telephone a selected telephone number for each product. The End User may provide the 900 Sponsor with his name and address. The 900 Sponsor will deliver the merchandise, and the End User will be billed for the merchandise on his telephone bill. For example, a television shopping network may sell items such as a blender or a pocket fisherman by calling a specified number.

MCI may agree with a 900 Sponsor to charge applicable New York sales taxes to the End User. In such an event, MCI will bill, or cause the LEC to bill, sales taxes on the product or service furnished to the End User. The amount of sales taxes received by MCI (or by the LEC which, in turn, will pay this amount over to MCI) will either be remitted to the 900 Sponsor or paid to the Department of Taxation and Finance.

1. Are the amounts billed to End Users by MCI or an LEC subject to taxes imposed by section 184 of the Tax Law?
2. Are the amounts of MCI's charge to the 900 Sponsors for providing communications service to be included in MCI's "gross earnings" for purposes of section 1847
3. Are the amounts of MCI's charge to the 900 Sponsors for providing billing and collection services to be included in MCI's "gross earnings" for purposes of section 1847
4. Do the answers to questions (2) or (3) depend on whether the amounts charged to Sponsors are billed as one lump sum or are separately stated?

MCI contends that the amounts billed to End Users by MCI or an LEC are not taxable under section 184 of the Tax Law. MCI acknowledges that the amount charged to Sponsors for communications service is taxable under section 184. However, MCI contends that charges for billing and collection services are not to be included in MCI's gross earnings because such services are not transmission services.

The franchise tax imposed by section 184 of the Tax Law is based upon "gross earnings from all sources within this state". The term "gross earnings" has long been held to include "all receipts arising from or growing out of the employment of its capital" (People ex rel N.Y.C. & H.R.R.R. CO. v Roberts, 32 App Div 113, 115, affd, 157 NY 677).

Section 72-1.1(d) of the Franchise Tax on Transportation and Transmission Corporations Regulations (hereinafter "Regulations") provides that a telephone or telegraph corporation shall include in its computation of gross earnings all gross operating revenues derived from intrastate transmission services and that portion of gross operating revenues from interstate and foreign transmission services attributable to New York State. For example, gross operating revenues of telephone corporations from transmission services include all operating revenues, such as Local Service Revenues (including subscribers' station revenues, public telephone revenues, service station, local private line services, and other local service revenues), Toll Service Revenues (including message tolls, wide area toll services, toll private line services and other toll service revenues) and Miscellaneous Revenues (such as telegraph commissions, directory advertising and sales, rent revenues, revenues from general services and licenses and other operating revenues not provided for elsewhere).

Telecommunications corporations that are regulated by the FCC must keep their financial accounts according to the Uniform System of Accounts prescribed by the FCC in Part 32 of the FCC Regulations. (47 CFR 32) Under the prescribed system, the revenue accounts reflect a market perspective of natural groupings based primarily upon the products and services purchased by customers. Section 32.4999(a) of the FCC Regulations provides that the revenue accounts are intended to include the actual cash inflows (or equivalent) that occur as a result of the company's ongoing major or central operations. They include the revenues which arise from furnishing

regulated telecommunications services to others, from directory advertising, rentals of telecommunications assets and from providing other services which are directly associated with the division of regulated telecommunication services. (47 CFR 32.4999(a))

Section 32.4999(i)(2) of the FCC Regulations provides that billing and collections service provided under exchange access tariffs shall be included in the group of revenue accounts. (47 CFR 32.4999) Section 32.5261 of the FCC Regulations provides that the special billing arrangements revenue account includes revenue derived from the provision, either under tariff or through contractual arrangements, of special billing information to customers. Such special billing information provides detail not normally provided in the standard billing rendered for the regulated telephone services utilized by the customer. (47 CFR 32.5261) Section 32.5270 of the FCC Regulations provides that the carrier billing and collection revenue account includes revenue derived from the provision of billing and collection services to other telecommunications companies. This includes amounts charged for services such as message recording, billing, collection, billing analysis, and billing information services, whether rendered under tariff or contractual arrangements. (47 CFR 32.5270) Both the special billing arrangements revenue account and the carrier billing and collection revenue account come within the "Miscellaneous Revenue" group of revenue accounts.

Accordingly, for purposes of the FCC, billing and collection revenues are considered directly associated with the regulated telecommunications services. Therefore, for purposes of section 72-1.1(d) of the Regulations, billing and collection revenues are operating revenues from transmission services and are included in a telephone corporation's gross operating revenues.

Herein, MCI's charge to the 900 Sponsor for the 900 Service will be made up of two components that will appear as one charge. The two components are:

1. the cost of the communications service that MCI is providing to the 900 Sponsor which is similar to Domestic 800 Service, and
2. the cost of billing and collection services for the 900 Sponsor.

The billing and collection services will include the collection of the fee for placing a call to the 900 number as well as other End User charges for goods or services provided by the 900 Sponsor. Such End User charges may include New York State sales tax on the goods or services furnished to the End User.

For purposes of section 184 of the Tax Law, gross earnings should include only those receipts arising from or growing out of the employment of a taxpayer's capital and does not include receipts collected by a taxpayer which are required to be paid over to others. Herein, MCI's gross earnings are derived from the charges to the 900 Sponsors. Therefore, the total amount billed (including any sales tax) to an End User by MCI or an LEG is not included in MCI's gross earnings.

In addition, it does not matter whether the charge to a 900 Sponsor is broken out separately into the two components or whether the entire amount is billed as one lump sum.

Pursuant to section 72-1.1(a) of the Regulations, MCI must include in its gross earnings all gross operating revenues from New York State intrastate transmission services and that portion of gross operating revenues from interstate and/or foreign transmission services attributable to New York State. Pursuant to section 72-1.1(d) of the Regulations, MCI's gross operating revenues include both the component representing the cost of the communications service which MCI provides to the 900 Sponsor, and the component representing the cost of billing and collection services for the 900 Sponsor. The billing and collection component must be included in MCI's gross operating revenues because a telephone corporation's gross operating revenues include all operating revenues from transmission services. It has been established herein, that the revenue from billing and collection services is directly associated with MCI's regulated transmission services.

MCI argues that if it is concluded that billing and collection services are included in transmission services then only MCI's profit, as opposed to the gross amount, should be included. MCI is relying on Howgen Transport Co., Inc., State of New York Tax Appeals Tribunal Decision, January 12, 1989, TSB-D-89(1)C. Therein, it was held that "gross earnings", for purposes of section 184, do not include receipts from the sale of goods to the extent the receipts represent the "cost of raw materials incorporated into the good". MCI contends that the rule should not be any different where the subject is services rather than goods. In such a case, MCI contends that the cost of providing the services is analogous to the "cost of the raw materials incorporated into the good"

However, MCI's reliance on Howgen Transport is misplaced. In Howgen Transport, it was held that Howgen was not entitled to deduct the cost of hired trucks in computing its gross earnings under Tax Law section 184. "The expenditures for the [hired] trucks represent Howgen's employment of its capital, in the same manner as the purchase of trucks, to perform its transportation services. The purchase or lease of trucks to provide a service is clearly distinguishable from the purchase of raw materials which are sold as a commodity. The former are the employment of capital, the gross earnings from which are specifically subject to tax (People v Roberts, *supra*; see also, People ex rel, Westchester Lighting Co. v Gaus, 199 NY 147; Chesapeake & Potomac Telephone Co. v District of Columbia, 137 F2d 674)." Howgen, *supra*.

The Tax Appeals Tribunal, in deciding Howgen Transport, *supra*, concluded that the interpretation of gross earnings under section 186 of the Tax Law (as it existed prior to the 1907 amendment) is controlling. The Tribunal stated that the words "receipts arising from or growing out of the employment of its capital" characterized those receipts to be included in the gross earnings computation. However, those words are not defined further in Roberts, *supra*, but their meaning is clarified in Brooklyn Union Gas Co. v Morgan (114 AD 266, *aff'd* 195 NY 616). In Brooklyn Union the computation of gross earnings for Tax Law section 186 purposes was directly at issue and the language under analysis was exactly the same as that used in section 184.

The taxpayer 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 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" The essence of the Court's decision is that 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 to calculate his gross earnings. (Howgen Transport, supra.) Prior to the amendment of Tax Law section 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 tel Westchester Lighting Co v Gaus, 199 NY 147). 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 when section 184 has not been similarly addressed, as in the present case. The two expressions should be given the same meaning in the absence of an indication that the Legislature intended a contrary meaning. (Howgen Transport, supra.)

Accordingly, when computing gross earnings from the billing and collection services component, MCI must include the gross amount charged to the 900 Sponsor for the billing and collection component without any deductions. As in Howgen Transport, supra. "expenses incurred to provide a service is clearly distinguishable from the purchase of raw materials which are sold as a commodity."

Issue II - Tax on the Furnishing of Utility Services-Section 186-a

1. Are the amounts billed to End Users by MCI or an LEC subject to taxes imposed by section 186-a of the Tax Law?
2. Are the amounts of MCI's charge to the 900 Sponsor for providing communications service to be included in MCI's "gross income" for purposes of section 186-a?
3. Are the amounts of MCI's charge to the 900 Sponsors for providing billing and collection services to be included in MCI's "gross income" for purposes of section 186-a?
4. Do the answers to questions (2) or (3) depend on whether the amounts charged to Sponsors are billed as one lump sum or are separately stated?

MCI contends that the amounts billed to End Users by MCI or an LEC are not taxable under section 186-a of the Tax Law. MCI acknowledges that except for Product 4, the amount charged to Sponsors for communications service is taxable under section 186-a. However, MCI argues that receipts from Product 4 are not subject to tax because the Sponsor is not the ultimate consumer or user of the "party line" service. In addition, MCI argues that the charge for providing the billing and collection services for a Sponsor should not be included in MCI's gross income to the extent it represents MCI's cost of providing such services. Therefore, MCI contends that only the profits from providing such services should be taxable.

Section 186-a of the Tax Law imposes a tax on the furnishing of utility services, equal to 3% of "gross income". Gross income is defined in section 186-a.2 of the Tax Law. Such section 186-a.2, as amended by Chapter 61 of the Laws of 1989, provides that:

gross income with respect to the sale of telephony or telegraphy or the furnishing of telephone or telegraph service, except as otherwise provided with respect to the provision of carrier access service to interexchange carriers, shall include receipts received in or by reason of all sales made or service furnished in this state (whether or not for ultimate consumption or use by the purchaser) but, if telephony or telegraphy which is sold in this state by a utility or telephone or telegraph service which is furnished in this state by a utility is then resold by the purchaser with respect to such a sale, there shall be allowed a deduction from the receipts of such purchaser from the resale the amount paid to his seller or furnisher for such telephony or telegraphy or telephone or telegraph service; provided, further that receipts of an exchange carrier paid by interexchange carriers for the provision of carrier access which is resold by such interexchange carriers shall be excluded from the gross income of such exchange carrier and no deduction shall be allowed to such interexchange carriers for the amount so paid for such access service. "Gross income" also includes..., profits from any transaction (except sales for resale and rentals) within this state whatsoever (emphasis added)

The definition of gross income was amended to provide for taxation on the initial sale or furnishing of telephony or telegraphy service within New York State rather than taxation on the sale or furnishing of telephony or telegraphy for ultimate consumption or use by the purchaser within New York State. Therefore, effective July 1, 1989, the sale for resale deduction (other than exempt carrier access services sold by an exchange telephone company to an interexchange telephone company) will not be allowed. However, a reseller that purchases telephone or telegraph services within New York State and subsequently resells such service is allowed to deduct

from gross income the cost of such service on which tax under section 186-a was paid by the utility which furnished such service to the reseller.

Herein, MCI's gross income is derived from the charges to the 900 Sponsors. The total amount billed (including any sales tax) to an End User by MCI or an LEC is not included in MCI's gross income. In addition, it does not matter whether the charges to a 900 Sponsor are broken out separately into the two components or whether the entire amount is billed as one lump sum.

For purposes of section 186-a of the Tax Law, MCI must include in its gross income the amount charged to a 900 Sponsors for providing communications service. However, MCI is allowed to deduct from gross income, the cost of telephone service within New York State (other than carrier access service) purchased from the utility which furnished such service to MCI where such utility paid the tax under section 186-a. MCI may not deduct the cost of the carrier access service. Because of the 1989 amendment to section 186-a, the amount charged to a 900 Sponsor for Product 4 is subject to tax even though the Sponsor is not the ultimate consumer.

MCI must also include in its gross income, the amount charged to a 900 Sponsor for the billing and collection services. However, MCI's contention that only the profits from such services should be included in gross income is in error.

Section 501.14 of the Tax on the Furnishing of Utility Services Regulations, provides that "profits from any transaction.., within this state whatsoever" shall be included in gross income. "This class of transactions includes profits from labor not performed in the conduct of the taxpayer's principal business and from sales of materials and supplies other than merchandise purchased for resale "

Pursuant to Part 32 of the FCC Regulations, it has been established that the billing and collection services MCI provides for its 900 Sponsors is directly associated with the regulated telecommunication services and are included in the revenue accounts that reflect MCI's ongoing major or central operations.

Therefore, since the billing and collection services are an integral part of the sale or furnishing of telephone service within New York State, and the gross receipts from such services must be included in gross income. These services may not be classified as transactions taxable on the profits only because such services are performed in the conduct of MCI's principal business of providing telephone service.

DATED: February 15, 1990

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.