

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Taxpayer Guidance Division

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Sales Tax
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Application of Sales Tax to Leases of Dedicated Telecommunications Circuits

The Tax Department has received inquiries as to whether certain purchases of telecommunications services by an information services provider, Company A, under the facts described below, are excluded and/or exempt from sales tax imposed by Tax Law section 1105(b)(1)(B). Three distinct questions are presented:

1. Are the dedicated circuits leased by Company A (“A”) purchased for resale and therefore excluded from sales tax?
2. Is A eligible for the exemption in Tax Law section 1115(a)(12) for machinery or equipment used in the production of tangible personal property, gas, electricity, refrigeration or steam for sale? Alternatively, is A eligible for exemption under Tax Law section 1115(a)(12-a) for tangible personal property used predominantly in the receiving, transmitting, etc., of telecommunications services for sale?
3. Is A’s purchase of the dedicated circuits at issue excluded from sales tax on the ground that it constitutes the purchase of interstate and international telephony?

Facts

A is a provider of information services. A also provides its customers with certain equipment. A requires that customers use a dedicated telecommunications circuit to access its service. Before 2001, customers leased dedicated telecommunications circuits directly from telecommunications service providers. Customers were free to select their provider and the bandwidth of the leased circuit. Beginning in 2001, A required customers to lease their dedicated circuits directly from A. This change was instituted in order to address quality control issues. Each customer is required to enter a “Schedule of Services” agreement with A, which includes the terms of the lease of dedicated circuits. After a customer signs the “Schedule of Services” agreement, A then leases the necessary circuits from a telecommunications provider. The leased circuits are used by A solely to provide its customers with access to A’s information service. In the event that a customer terminates its use of A’s information service, the lease of the dedicated circuit is terminated as well.

A’s customers access its information service by a request beginning at the customer’s location. Each customer can access up to four information “sessions” simultaneously. A “session” is a real-time connection over a dedicated circuit to the source application located in A’s data centers. The applications include: e-mail; news stories; real time and historical quotes for bonds, equities and other financial instruments; data analytics; research; regulatory information and compliance tools; and insurance risk analysis. A has two data centers; one in New York and one in New Jersey. Both of A’s data centers run parallel, using identical equipment and providing identical information services. Each data center accepts approximately 40%-60% of the network traffic at all times. Neither data center exists strictly as a backup for

the other; they were designed to run concurrently. In the event that one data center is unable to function, all traffic is routed to the other data center. However, this limits customers' ability to access all four "sessions" simultaneously.

The dedicated circuits are used to allow A's customers to access its information service. Most of A's customers connect to a remote node located in a carrier's central office by using a dedicated circuit (e.g., T-1 or T-3 line). There are approximately 10 remote nodes in New York State. From the remote node site, the transmission is routed over A's network backbone to either the New York or New Jersey data center. Computer software located in the nodes determines which data center the transmission will be routed to, based on system-wide traffic flow at the time. Approximately 1% of A's customers are located in close proximity to one of the data centers. In these circumstances, the dedicated circuit connects the customer location directly to one of the data centers, bypassing the remote nodes.

Resale Exclusion

The first question is whether A's purchases of telephony are purchases for resale, and therefore eligible for the resale exclusion.

Sales tax is imposed on "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 . . ." Tax Law § 1105(b)(1)(B). "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 consumer." Sales and Use Tax Regulations § 527.2(d)(4).

Purchases of a telecommunications service by a telecommunications service provider for resale as such may be made without payment of sales tax. See Sales and Use Tax Regulations § 527.2(e); see also *Matter of Phone Programs, Inc.*, Dec Tx App Trib, April 6, 2000, DTA No. 815759 (holding that purchases of telephony by a provider of entertainment and information service subject to tax under Tax Law section 1105(c)(9) were not subject to the resale exclusion because they were not resold as such).

Here, A's customers are required to access A's service through the use of a dedicated telecommunications circuit. Before 2001, customers were permitted to purchase their own dedicated circuits. After 2001, customers were required to lease these circuits directly from A. A enters into a Schedule of Services agreement with its customers for the provision of the dedicated circuits, and then leases the circuits from a telecommunications provider. These circuits may be used only to access A's information services. If customers discontinue A's information services, A's lease of the dedicated circuits is simultaneously discontinued. Based on these facts, we conclude that A is not reselling the dedicated circuits "as such." Rather, A is using the circuits to provide its information service to its customers. The provision of the dedicated circuit to the customer is not a separate sale of telecommunications service, as those

services are ordinarily understood. See *Holmes Electric Protective Co. v McGoldrick*, 262 App Div 514 (1st Dept 1941); see also, *Quotron Systems Inc. v Gallman*, 39 NY2d 428 [1976]. Accordingly, A's lease of the dedicated circuits is not eligible for the resale exclusion.¹ Moreover, because A's lease of the dedicated circuits is not for resale, the charge for that service is just another expense incurred by A in providing its information service. As a result, the charge for the dedicated circuit must be included in the receipt subject to sales tax, because the amount of the receipt is determined "without any deduction for expenses." Tax Law § 1101(b)(3).

Production Exemptions

The second question asks whether A qualifies for exemption under Tax Law section 1115(a)(12) or 1115(a)(12-a).

Tax Law section 1115(a)(12) provides an exemption for "Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property, gas, electricity, refrigeration or steam for sale, by manufacturing, processing, generating, assembling, refining, mining or extracting" A is a provider of information services. It does not produce tangible personal property, gas, electricity, refrigeration or steam for sale. Consequently, A is not eligible for the exemption in Tax Law section 1115(a)(12).

Tax Law section 1115(a)(12-a) provides an exemption from the tax imposed by section 1105(a) on "Tangible personal property for use or consumption directly and predominantly in the receiving, initiating, amplifying, processing, transmitting, retransmitting, switching or monitoring of switching of telecommunications services for sale or internet access services for sale or any combination thereof" In order to be eligible for this exemption, the taxpayer must be producing telecommunications services or Internet access service for sale. Because A is using the dedicated circuits in the provision of its information service, A's provision of the dedicated circuit to its customers is not a sale of telecommunications services. Therefore, A is not producing telecommunications services for sale, and is not eligible for the exemption on its equipment under section 1115(a)(12-a).

Interstate Exclusion

The third question asks whether the dedicated circuits leased by A constitute the purchase of interstate or international telephony.

¹ We note that if A were reselling telecommunications as such, although its purchase of the circuit would be excluded from tax, it would be required to collect sales tax from its customers on the resale of the circuits. In addition, A would then qualify as a provider of telecommunications services and would be subject to the telecommunications excise tax imposed by Tax Law section 186-e on receipts from the sale of telecommunications services, which includes "any equipment and services provided therewith."

Sales tax is imposed on receipts from the sale of “telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service” The determination of whether telecommunications services are intrastate, interstate, or international is based on the origination and termination points of the transmission. Transmissions that originate and terminate in New York are intrastate telecommunications and are subject to sales tax; transmissions that originate and/or terminate outside New York are not subject to sales tax. A transmission that originates and terminates in New York remains an intrastate transmission, even if the transmission is routed through another state. See *Western Union Telegraph Company*, Dec St Tx Comm, February 4, 1983, TSB-H-83(57)S. All charges for telecommunications services are presumed to be subject to sales tax until the contrary is established. See Tax Law § 1132(c). Periodic flat-fee charges for telecommunications service, where the fee remains constant for a fixed billing period, regardless of the number or duration of calls, are subject to New York state and local sales taxes, since such fees represent receipts from the sale of access to telecommunications service provided in New York. See New York Tax Guidance, entitled *Taxation of Internet Telephony*, June 20, 2007, NYT-G-07(2)C, (3)S; *New York Telephone Company*, Adv Op Comm T&F, January 5, 1988, TSB-A-88(8)S; *Rochester Telephone Corporation*, Adv Op Comm T&F, December 9, 1987, TSB-A-88(1)S.

Here, A leases dedicated circuits to enable its customers to access its information service. In most circumstances, the dedicated circuits connect the customer with a remote node. A small percentage of A’s customers that are located in close proximity to A’s data centers are connected by dedicated circuits directly with a data center, bypassing the remote node. Approximately 10 remote nodes are located in New York.

We conclude that A’s leases of dedicated circuits to enable its customers to access its information service are subject to New York State and local sales tax under the following circumstances: (1) where the customer is connected by a dedicated circuit to a remote node and both the customer location and the remote node are located in New York; and (2) where the customer’s location is in New York and the customer is connected directly to the New York data center. A’s telecommunications provider is required to collect, and A is required to pay, State and local sales tax on these leases. A’s leases of dedicated circuits to connect its customers located outside New York, whether to a remote node or directly to either data center, are not subject to sales tax, since those purchases would always constitute interstate telecommunications.

Reliance on the Tax Appeals Tribunal’s decisions in *Matter of Concentric Network Corp.*, Dec Tx App Trib, March 16, 2006, DTA No. 819533; *Matter of Fastnet Corp.*, Dec Tx App Trib, March 16, 2006, DTA No. 819632; and *Matter of Frontline Communications*, Dec Tx App Trib, March 16, 2006, DTA No. 819786, to support the claim that A’s leases of the dedicated circuits are the purchase of interstate telephony, is misplaced. The Tribunal’s reasoning in those cases was grounded on the interstate and international character of the public Internet. The Tribunal stated that Internet communications had “no geographical reference” and

that “any intrastate aspect of access to the internet is merely random and incidental to an interstate and international service.” See *Matter of Fastnet, supra*. These dedicated lines are not merely “random or incidental” to A’s service, but a necessary component to ensure service quality and security.

Furthermore, the *Concentric* line of cases focused on the purpose for which the purchased telecommunications would be used (i.e., the sale of Internet access by the Internet service provider to its customers), rather than the specific transaction at issue (i.e., the sale from the telecommunications provider to the Internet service provider). It is clear that the Tribunal ruled as it did because of the unique character of the public Internet. Neither A’s information service, nor the dedicated circuits purchased by A to connect its customers to that service, is Internet access service. Rather, the circuits purchased by A to connect its customers is similar to traditional and Voice over Internet Protocol (VoIP) telecommunications service billed on a periodic flat-fee basis. See NYT-G-07(2)C, (3)S, *supra*. Both traditional and VoIP telecommunications services offer intrastate, interstate, and international calling capability, often for a single, periodic charge. Where the provider does not separately identify the interstate/international communications, the entire charge is subject to tax. Here, because the dedicated circuits purchased by A allows its New York customers to connect either to the New York or New Jersey data center, and A does not separately identify where each transmission is routed, the entire flat-fee charge is subject to sales tax.

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