

# PRIVATE TAXPAYER RULING LR97-001

May 9, 1997

The following private taxpayer ruling is in response to your letter dated February 24, 1997, in which you request a ruling as to whether income derived from Internet access charges is subject to the transaction privilege tax under the telecommunications classification. While your ruling request also questions the taxability of income derived from various other business activities, the taxability of these business activities will be resolved separately.

As described by your letter, a prospective customer may request computer software which can be installed on the customer's computer. The provided Internet software package includes additional software which makes navigating the Internet easier. After installing the Internet access software, the customer can connect to the Internet, send and receive electronic mail, and browse the World Wide Web. Your company charges the customer a monthly fee for unlimited access to the Internet.

Pertinent statutory provisions, case law, and administrative guidance:

Arizona Revised Statutes (A.R.S.) § 42-1310.04 *Telecommunications classification*, imposes the transaction privilege tax on the business of providing "intrastate telecommunications services", which is defined as transmitting signs, signals, writings, images, sounds, messages, data or other information of any nature by wire, radio waves, light waves or other electromagnetic means if the information transmitted originates and terminates in this state.

Taxing statutes are interpreted strictly against the state, and any ambiguities are resolved in favor of the taxpayer. *Alvord v. State Tax Commission*, 69 Ariz. 287, 213 P.2d 363 (1950).

A.R.S. § 42-1310.01 *Retail classification*, imposes the transaction privilege tax on the gross proceeds of sales or gross income derived from the business of selling tangible personal property at retail.

A.R.S. § 42-1301.16 defines "tangible personal property" as personal property which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses.

Discussion:

A.R.S. § 42-1310.04 imposes the transaction privilege tax on the business of providing "intrastate telecommunications services". This term is defined as transmitting signs, signals, writings, images, sounds, messages, data or other information of any nature by wire, radio

waves, light waves or other electromagnetic means, if the information transmitted originates and terminates in this state. The statute provides exclusions from the tax which apply to *interstate* transmissions of data or information which are received in Arizona and rebroadcast within Arizona by an Arizona telecommunications service provider.

The Internet is a unique communications medium. As described by a U.S. District Court's Findings of Fact in *American Civil Liberties Union v. Reno*, 929 F. Supp. 824 (June 11, 1996), the Internet is "a decentralized, global medium of communications - or 'cyberspace' - that links people, institutions, corporations, and governments around the world. The Internet is an international system. This communications medium allows any of the literally tens of millions of people with access to the Internet to exchange information. These communications can occur almost instantaneously, and can be directed either to specific individuals, to a broader group of people interested in a particular subject, or to the world as a whole."

An Internet access business typically enables an Arizona personal computer user to reach the Internet via modem telephone access to a computer or computer network linked to the Internet. The Arizona personal computer user is able to send and receive messages and data from other computer users or computer servers storing information anywhere in the world. While the "link" to the Internet may be located in Arizona, the vast majority of available information and data accessed from global Internet sites by an Arizona personal computer user does not originate in Arizona.

A.R.S. § 42-1310.04 imposes the transaction privilege tax on businesses which provide *intrastate* telecommunications services, if the information transmitted originates and terminates in Arizona. Due to the predominantly *interstate* and international nature of information received via the Internet, income derived from Internet access charges is not subject to the transaction privilege tax under the telecommunications classification.

A.R.S. § 42-1310.01 *Retail classification* levies the transaction privilege tax on the business of selling tangible personal property at retail. All sales of tangible personal property by a person engaged in business under this classification is subject to tax unless specifically excluded by statute.

Arizona Transaction Privilege Tax Ruling TPR 93-48 addresses the taxation of computer hardware, software, and related services. The ruling provides that either the sale or the licensing of computer software programs are subject to tax under the retail classification. Therefore, *sales* of canned computer software programs which either enable access to the Internet or provide for easy navigation of Internet sites, are subject to tax under the retail classification. Additionally, sales of other tangible personal property by your company are subject to tax under the retail classification.

However, A.R.S. § 42-1310.01(A)(1) and (2) provide an exclusion from the transaction

privilege tax imposed under the retail classification for the gross income from professional or personal service occupations and services rendered in conjunction with retail sales. As addressed by TPR 93-48, charges for services such as consulting, training, installation of software, and technical phone support, in relation to *retail* sales of tangible personal property, are exempt from the transaction privilege tax if separately stated.

Ruling:

The following ruling is given based on the facts presented:

The department rules that ... income derived from charges to access the Internet are not subject to transaction privilege tax. The department also rules that the sale or licensing of canned computer software, or other sales of tangible personal property are subject to the transaction privilege tax under the retail classification.

The taxability of the other issues raised by your private taxpayer ruling request, which do not qualify for a private taxpayer ruling, will be addressed in a separate letter.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in your letter dated February 24, 1997.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.