STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| **VERIZON NEW YORK INC.** | : | DETERMINATION<br>DTA NO. 829240 |
| for Redetermination of a Deficiency or for Refund of Corporation Tax under Article 9 of the Tax Law for the Years 2008 through 2011. | : | |

Petitioner, Verizon New York Inc., filed a petition for redetermination of a deficiency or for refund of corporation tax under article 9 of the Tax Law for the years 2008 through 2011.

A hearing was held before Donna M. Gardiner, Administrative Law Judge, in New York, New York, on June 28, 2022, with all briefs to be submitted by November 4, 2022, which date began the six-month period for the issuance of this determination. Petitioner appeared by Eversheds Sutherland (US) LLP (Eric S. Tresh, Esq. and Chelsea E. Marmor, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (David Markey, Esq., of counsel).

## *ISSUES*

I. Whether Tax Law § 184 imposes tax on the gross receipts of Verizon New York Inc. for the tax years ended December 31, 2008 through December 31, 2011.

II. If so, whether such taxation violates the Internet Tax Freedom Act of 2007.

## *FINDINGS OF FACT*

1. Petitioner, Verizon New York Inc. (Verizon), is incorporated in New York State.

2. During the tax years ended December 31, 2008 through December 31, 2011, petitioner filed transportation and transmission corporation franchise tax returns on gross receipts, forms CT-184, and the transportation and transmission corporation MTA surcharge returns, forms CT-184-M.

3. Petitioner reported its gross receipts from sales of local telephone services on its forms CT-184.

4. Petitioner did not include its receipts from asymmetric digital subscriber line (ADSL), and fiber broadband aggregation services and fiber broadband access services (Fiber Broadband), (collectively, Verizon's services) and other Internet access services on its forms CT-184.

5. In addition, petitioner also filed the transportation and transmission corporation franchise tax returns on capital stock, forms CT-183, and transportation and transmission corporation MTA surcharge returns, forms CT-183-M, for the years at issue.

6. The Division of Taxation (Division) audited petitioner's forms CT-184 for the years 2008 through 2011 (audit period).

7. At the conclusion of the audit, the Division determined that petitioner was liable for additional tax pursuant to Tax Law § 184 on its gross receipts from Verizon's services and made other adjustments.

8. On December 20, 2018, petitioner paid $2,637,365.00 attributable to all adjustments at issue in the audit, other than the gross receipts from Verizon's services described in finding of fact 4.

9. On December 27, 2018, the Division issued a notice of deficiency, assessment number L-049302050 (notice), to petitioner in the amount of $12,046,229.00 in tax, plus interest and penalty, for additional tax pursuant to Tax Law § 184 and MTA surcharge due on Verizon's services for the audit period.

10. On March 25, 2019, petitioner filed a timely petition with the Division of Tax Appeals in protest of the notice.

11. A hearing was held on June 28, 2022.

12. Heather Marciszewski, Tax Auditor I, appeared at the hearing, on behalf of the Division. The Division decided to forego presenting a direct examination of the auditor and, instead, submitted an eight-page affidavit from her. There being no objection from petitioner, the auditor was sworn in as a witness and she affirmed that the contents of her affidavit were true and accurate. The auditor was subject to cross examination.

13. The auditor noted that her affidavit was created with the attorneys at the Division.

14. The auditor agreed that Verizon's services are Internet access services, however, not the Internet access services within the scope of the Internet Tax Freedom Act (ITFA). She reasoned that petitioner is not selling its services directly to the customer and, as such, the transactions do not constitute Internet access service. The auditor claimed that for petitioner's services to be exempted from tax liability under both Tax Law § 184 and ITFA, petitioner must supply its services directly to the end-user of the services. The auditor concluded that since petitioner sold its services to Internet Service Providers (ISPs), who then sold the services to the end-users, petitioner failed to qualify for an exemption from tax.

15. Petitioner presented three witnesses in support of its petition.

16. Mario Manniello currently serves as the Executive Director of Income and Transaction Tax Audits at Verizon Communications, Inc. Mr. Manniello testified that, during the audit period, he managed the team that was involved in the audit. He testified that Verizon's services constitute Internet access services.

17. Lance Koenders currently serves as the Vice President of Mobile Product Management at Verizon Communications, Inc. He testified that prior to his current position, he served in a variety of engineering and technical roles overseeing the development and

deployment of the Internet, including network systems design, integration and expansion that built out the Internet for public use.

18. In his testimony, Mr. Koenders explained the Internet and how it operates, as well as Verizon's services and how they operate. He provided a demonstration on a computer to illustrate his testimony. He stated that the ADSL and Fiber Broadband services are the technology that allows access to the Internet. His opinion was that Verizon's services are Internet access services and interstate services. The Division declined the opportunity to cross examine Mr. Koenders.

19. The Internet is an interstate transport network that moves data around the world. Verizon's services are components of the Internet network that transmits information. ADSL is technology that delivers access to the Internet by transmitting information over copper wires. Fiber Broadband services are technologies that deliver access to the Internet by transmitting information over fiber optic cables.

20. ISPs purchase Verizon's services to provide access to the Internet to their customers.

21. ISPs' customers cannot access the Internet without Verizon's services.

22. Petitioner's final witness was Richard Pomp, a distinguished professor at the University of Connecticut School of Law and an adjunct professor at New York University School of Law.

23. Professor Pomp was heavily involved in the drafting and consideration of policy implications of ITFA and was consulted by the United States Treasury Department on ITFA. As such, he was admitted as an expert of ITFA.

24. Professor Pomp explained that 25 years ago, no one fully comprehended the nature of the Internet. He explained that when the Internet was first viewed as an industry, the goal was

to allow it an opportunity to grow before determining its taxability. He testified that in the enacted versions of ITFA, the federal law provided certain protections that were revisited based on the growth of the Internet and the technology that drove it.

25. Professor Pomp stated that ITFA intended to cast a wide net and extend the protection from tax as broadly as possible due to the many taxing jurisdictions in the country with differing taxing statutes. The drafters worried that the taxation of the Internet would not be even-handed applications of any potential law, given the multitude of jurisdictions and laws. He stated that there was a fear that one state would treat one kind of provider differently from another kind of provider, i.e., discrimination between provider to provider and then discrimination between Internet and non-Internet transactions.

26. In his opinion, Professor Pomp stated that ITFA excluded four categories of taxes from its language: net income tax, capital stock tax, net worth tax and property tax. His testimony was that ITFA was intended to prevent broad-based taxation so that it would not deter growth and technological innovations to the Internet.

27. Pursuant to State Administrative Procedure Act (SAPA) § 307 (1), both parties submitted proposed findings of fact. Petitioner submitted 41 proposed findings of fact. They have generally been incorporated and reworded to the extent that they are relevant and supported by the record. The Division submitted 16 proposed finding of fact. To the extent the Division's proposed findings of fact are supported by the record, they are generally incorporated herein, except for portions of proposed findings of fact 1, 8 and 9 that are rejected as legal conclusions.

## *CONCLUSIONS OF LAW*

A. Tax Law § 184 imposes an additional franchise tax on the gross earnings from all sources of corporations principally engaged in the conduct of a local telephone business. This franchise tax is imposed on such corporations for the privilege of exercising their corporate franchise or generally doing business in New York (***see*** Tax Law § 184 [1]). The additional metropolitan transportation business tax surcharge provided by section 184-a is similarly based on a taxpayer's gross earnings from all sources within the state.

The tax is imposed on the taxpayer's "gross earnings from all sources within this state . . . shall exclude the following earnings . . . derived by such taxpayer from sales for ultimate consumption of telecommunications service to its customers (i) thirty percent of separately charged intra-LATA toll service (which shall also include interregion regional calling plan service) and (ii) one hundred percent of separately charged inter-LATA, interstate or international telecommunications service" (Tax Law § 184 [1]).

B. It is well established that when the Division issues a notice of deficiency to a taxpayer, a presumption of correctness attaches to the notice (***Matter of Greenfeld***, Tax Appeals Tribunal, March 7, 2019; ***see Matter of Leogrande v Tax Appeals Trib.***, 187 AD2d 768 [3d Dept 1992], ***lv denied*** 81 NY2d 704 [1993], ***Matter of Tavolacci v State Tax Commn.***, 77 AD2d 759 [3d Dept 1980]). Petitioner bears the burden of proof by showing through clear and convincing evidence that a deficiency assessment is erroneous (***see Matter of Greenfeld***; ***see also Matter of O'Reilly***, Tax Appeals Tribunal, May 17, 2004).

In this case, petitioner excluded receipts from the ADSL and Fiber Broadband services from its gross earnings. It is the characterization of these services that is in dispute. The Division argues that these services constitute carrier access services provided by petitioner to

other carriers and ISPs that, in turn, sell the Internet services to their customers. The Division states that petitioner's customers are not the end-users of the Internet, but rather, these services sold by petitioner to ISPs are sales for resale to the ISPs' customers and not provided by petitioner directly to consumers. The Division argues that the Verizon services are not "toll service" or "telecommunications service" eligible for exclusion under section 184 of the Tax Law.

Petitioner, on the other hand, argues that its gross receipts from the sales of its services should be included in the 100% deduction set forth in Tax Law § 184 (1) (ii). Petitioner states that its services are interstate telecommunication services within the meaning of Tax Law § 184.

Tax Law § 184 allows a 100% deduction for gross receipts from sales on interstate telecommunication services sold for ultimate consumption. It is this last phrase "sold for ultimate consumption," that is the focus in the present matter.

Telecommunication companies are subject to the franchise tax on gross earnings under article 9. "These statutes, *inter alia*, impose a franchise tax upon every domestic corporation 'principally engaged in the conduct of a transportation or transmission business.'" (***Matter of NewChannels Corp. v Tax Appeals Trib.***, 279 AD2d 164, 166 [3d Dept 2001]).

Telecommunications companies (except for non-local telephone companies) subject to the article 9 franchise tax under Tax Law § 183 are also subject to the additional franchise tax under Tax Law § 184, i.e., every corporation required to file forms CT-184 is required to file forms CT-183. The franchise taxes under article 9 are imposed on a corporation "for the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in this state in a corporate or organized capacity" (Tax Law § 184 [1]).

The language of Tax Law § 184 (1) is clear. The statutory exclusion explicitly states it applies to gross receipts from sales on interstate telecommunication services sold for ultimate consumption. The Division correctly points out that Verizon's services are sold to ISPs, that, in turn, sell petitioner's services to customers, who are the end-users. As such, Verizon's services are taxable within the meaning and intent of Tax Law § 184.

C. The next issue to address is whether ITFA preempts the section 184 Tax on Verizon's services.

In 1998, Congress enacted ITFA to promote an emerging industry by adopting a broad prohibition, with a few limited exceptions, against taxes on Internet access. ITFA was originally enacted on a temporary basis to require Congress to continuously monitor the industry's development and revise the language of ITFA to ensure Congress' intent was clearly enumerated before making ITFA permanent (***see*** Pub L 105-277, Div. C, Title XI § 1101 [Oct. 21, 1998] [enacted as a statutory note to 47 USC § 151], amended by Pub L 107-75, Pub L 108-435, Pub L 110-108, Pub L 113-164, Pub L 113-235, Pub L 114-53, Pub L 114-113, and Pub L 114-12).

ITFA prohibits state and local governments from imposing taxes on Internet access and multiple or discriminatory taxes on electronic commerce (***see*** ITFA § 1101 [a]). A prohibited "tax on Internet access" is a "tax on Internet access, regardless of whether such tax is imposed on a provider of Internet access or a buyer of Internet access and regardless of the terminology used to describe the tax" (ITFA § 1105 [10] [A]). "Tax on Internet access" does not include a "tax levied upon or measured by net income, capital stock, net worth, or property value" (ITFA § 1105 [10] [B]). A "tax" is defined in ITFA as "any charge imposed by any governmental entity

for the purpose of generating revenue for governmental purposes, and is not a fee imposed for a specific privilege, service, or benefit conferred" (ITFA § 1105 [8] [A] [i]).

"Internet access" is defined as a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. The term does not include telecommunications services (***see*** ITFA § 1104 [5] [1998]; ITFA § 1104 [c] [1] [2008]). Congress amended the definition of "Internet access" effective November 1, 2003, to include telecommunication services "to the extent such services are purchased, used or sold by a provider of Internet access to provide Internet access" (Internet Tax Nondiscrimination Act, Pub L 108-435, §§ 2-6 A, 118 Stat. 2615-2618 [2004]). This definition was in effect during the tax years at issue and remains so.

In determining the definition of "Internet access" under ITFA, the Division lobbies for a definition consistent with the Tax Law. However, ITFA is a federal law and, therefore, is not bound by this State's use of the term Internet access. "The first step in interpreting a statute is to determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case" (***Robinson v Shell Oil Co.***, 519 US 337, 340 [1997] [citations omitted]). "The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole" (***Robinson v Shell Oil Co.***, 519 US at 341 [citations omitted]).

The statute in question states, in pertinent part, that: "[t]he term 'tax on Internet access' means a tax on Internet access, regardless of whether such tax is imposed on a provider of Internet access or a buyer of Internet access and regardless of the terminology used to describe the tax" (ITFA § 1105 [10] [A]). Internet access is defined, in part, as follows:

> "(A) means a service that enables users to connect to the Internet to access content, information or other services offered over the Internet; (B) includes the purchase, use or sale of telecommunications by a provider of a service described in subparagraph (A) to the extent such telecommunications are purchased, used or sold—(i) to provide such service; or (ii) to otherwise enable users to access content, information or other services offered over the Internet" (ITFA § 1105 [5] [A]; [B]).

As the testimony explained, the intent of the amendment to exclude telecommunications purchased, used, or sold to provide access to the Internet was to ensure that ITFA applied broadly to all components of the Internet and technology used to provide the Internet. Congress recognized that, as the industry developed, it would be necessary to make amendments to clarify ITFA and capture its original intent, which was a broad, sweeping prohibition to tax any portion, form of or access to the Internet.

The Division argues that ITFA § 1105 (5) (A) states that Internet access refers to "a service that enables users to access content, information, electronic mail, or other services offered over the Internet" and that petitioner does not provide such service. The Division relies on the language contained in Tax Law § 184 (1) as support for its interpretation of the definition of Internet access set forth in ITFA. The Division's constrained definition of Internet access is focused on the retail sale from the ISP to the retail customer and, as such, argues that all the other connections between the ISP and the Internet are not Internet Access. This argument is contrary to the drafters' intent that ITFA should be broad in scope.

Verizon's services transmit information through the use of wires and fiber optics which are part of the interconnected network that provides consumers with access to the Internet. Without this technology, consumers would be unable to access the Internet. The Division has not addressed the ever-changing technological innovations that allow Internet access. The Division states that an end-user of the Internet also would not be able to access the Internet

without the local utility company that powers their home computer or even the retailer that sold them the computer. This argument demonstrates a lack of understanding regarding petitioner's services. Technology is always evolving. Such evolution was not contemplated in drafting Tax Law § 184. The Division is relying on language drafted well before the Internet was conceived and applying such language to the current set of facts. These arguments are simply unpersuasive.

In conclusion, Verizon's services are Internet access services within the meaning and intent of ITFA and, as such, the gross receipts from its services are preempted from taxation pursuant to Tax Law § 184.

D. The petition of Verizon New York Inc. is granted and the notice of deficiency, dated December 27, 2018, is canceled.

DATED: Albany, New York
May 04, 2023

/s/ Donna M. Gardiner
ADMINISTRATIVE LAW JUDGE