



ERNIE FLETCHER
GOVERNOR

OFFICE OF THE SECRETARY
FINANCE AND ADMINISTRATION CABINET
383 CAPITOL ANNEX
FRANKFORT, KENTUCKY 40601
(502) 564-4240
(502) 564-6785 FAX

ROBBIE RUDOLPH
SECRETARY

In the matter of:

[REDACTED] INC

Contact: [REDACTED]

Final Ruling No. 2006-07
February 23, 2006

\$ [REDACTED] Assessment
For the tax period January 1, 2000 through December 31, 2002

FINAL RULING

The Department of Revenue's audit of [REDACTED] Inc. for the taxable period January 1, 2000 through December 31, 2002 resulted in an assessment of \$ [REDACTED] tax due to the Commonwealth.

Assessment as of February 14, 2006

Tax Year	Tax Due	Interest	Penalty	Total Due
11/30/2001	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
12/31/2001	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
12/31/2002	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

The taxpayer was notified by letter that an audit of the sales and use taxes for the above mentioned taxpayer had been initiated and additional information was requested. On July 14, 2004, an additional assessment was made by the Department in the amount of \$ [REDACTED] in tax and interest. Then in a letter dated [REDACTED], 2004, the Department was notified that the tax assessments were being protested. On October 12, 2004, the taxpayer paid the uncontested portion of the tax due and accrued interest. Penalties and fees were requested waived and the request was subsequently granted.

At issue is the application of the sales tax statutes on [REDACTED]'s purchases of local telephone exchange services from other telecommunication providers.

It is the taxpayer's position that these telephone exchange service fees are not taxable. Based upon this position, the company adjusted its receipts derived from the sale of local phone service to its customers by deducting the purchase price of local telephone exchange services upon which ██████████ paid tax to its communications service provider before reporting receipts on its sales and use tax return. ██████████ took this action because its communications service provider refused to accept a resale certificate and properly charged tax on the sale of local telephone exchange services.

In its protest letter dated ██████████ 2004, ██████████, Inc. disagrees with the Department's assessment of sales tax upon the additional receipts from its sales of local telephone exchange services. The company protests on the grounds that it omitted the reporting of these receipts to claim a credit on purchases of local telephone exchange services for resale and that the Department's taxation of these fees is in direct conflict with the Federal Telecommunications Act of 1996.

The Department contends that these service fees for communications services are retail sales subject to Kentucky sales tax. Below is a further discussion of the basis for this position as reflected in statutory language in place for the audit periods in question.

KRS 139.200 imposed the 6% sales tax on the gross receipts of any retailer derived from "retail sales" or "sales at retail" made within the Commonwealth on and after July 1, 1990. KRS 139.100(1)(a) defined "retail sale" to include:

1. A sale for any purpose other than resale in the regular course of business of tangible personal property, or
2. The furnishing of the facilities and services mentioned in subsection (2) of this section.

KRS 139.100(2)(d) further specifies that "retail sale" or "sale at retail" shall include but shall not be limited to the furnishing of communications services to a service address in this state, regardless of where those services are billed or paid, when the communications service: originates and terminates in this state; originates in this state; or terminates in this state. These references indicate that communications services sold to or by ██████████, Inc. are retail sales subject to tax and that such taxable services are not covered by the resale exclusion provided only for tangible personal property in KRS 139.100(1)(a)1.

The statutory definition (KRS 139.160) for "tangible personal property" in effect for the assessment periods is personal property which may be seen, weighed, measured, felt or touched, or which is in any other manner perceptible to the senses and includes natural, artificial and mixed gas, electricity, water, and prepaid calling arrangements.... Since communication services are not tangible personal property, the resale provisions do not apply. Furthermore, regulation 103 KAR 28:140 section 2 states:

Communications service providers that purchase communications services from facilities-based carriers to resell to their own customer base shall not claim the communications services purchased are exempt as being transactions for resale.

Finally, the Kentucky General Assembly enacted Governor Fletcher's Tax Modernization provisions in House Bill 272 during the 2005 Session partly to reform the manner of taxation for telecommunications providers in this state. Effective January 1, 2006, KRS 139.195(4)(b)7 excludes the sale of communications services to a communications provider that is buying the communications service for sale or incorporation into a communications service for sale from the definition of taxable communications services. Kentucky sales tax law had no resale provision for communications service until this amendment became effective.

With respect to the taxpayer's assertion that the Federal Telecommunications Act (the "Act") pre-empts Kentucky from taxing this transaction, the Act also states that "[n]othing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunication services and safeguard the rights of consumers." Kentucky treats all communication providers as consumers of the communication services that they purchase, who must pay sales tax on those purchases. Similarly, Kentucky requires all communication providers to collect taxes on the communication services they provide. If a company chooses to do both, it is taxed on each separate transaction. This treatment puts it on equal footing with companies that buy communication services and are required to pay tax, and companies that sell communication services and are required to collect tax from their customers. As a result, no double taxation occurs, all companies are treated equally with respect to these two types of transactions, and there is no conflict with the Act.

On ██████████, 2005, the Department notified the taxpayer that the Department maintains their position and that no adjustments were warranted. Then on ██████████, 2005, the taxpayer notified the Department of its request for a final ruling being issued.

This letter is the final ruling of the Department of Revenue.

APPEAL

You may appeal this final ruling to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.110, KRS 131.340-131.365, 103 KAR 1:010 and 802 KAR 1:010. If you decide to appeal this final ruling, your petition of appeal must be filed at the principal office of the Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40602-2120, within thirty (30) days from the date of this final ruling. The rules of the Kentucky Board of Tax Appeals, which are set forth in 802 KAR 1:010, require that the petition of appeal must:

1. Be filed in quintuplicate;
2. Contain a brief statement of the law and facts in issue;

3. Contain the petitioner's or appellant's position as to the law and facts; and
4. Include a copy of this final ruling with each copy of the petition of appeal.

The petition of appeal must be in writing and signed by the petitioner or appellant. Filings by facsimile or other electronic means shall not be accepted.

Proceedings before the Kentucky Board of Tax Appeals are conducted in accordance with 103 KAR 1:010, 802 KAR 1:010 and KRS 131.340-131.365 and KRS Chapter 13B. Formal hearings are held by the Board concerning the tax appeals before it, with all testimony and proceedings officially reported. Legal representation of parties to appeals before the Board is governed by the following rules set forth in Section 2 (3) of 802 KAR 1:010:

1. An individual may represent himself in hearings before the Board;
2. An individual who is not an attorney may not represent any other individual, corporation, trust, estate, or partnership before the Board; and
3. An attorney who is not licensed to practice in Kentucky may practice before the Board if he complies with Rule 3.030(2) of the Rules of the Kentucky Supreme Court.

You will be notified by the Clerk of the Board of the date and time set for any hearing.

Sincerely,
FINANCE AND ADMINISTRATION CABINET



THOMAS H. BROWN
Director
Division of Protest Resolution

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

