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Tax Type: Retail Sales and Use Tax
Description: Court Case : Exemption - Software, Equipment (Internet Service Provider Broadcasting and Amplification), Services Administration : Interest - Refund
Topic: Court Case
Date Issued: 05-11-2022

Virginia: In the Circuit Court of the City of Richmond, John Marshall Court Building

ALCATEL-LUCENT USA INC., Applicant,

v. **Case No.: CL 20-3591**

VIRGINIA DEPARTMENT OF TAXATION, Respondent.

ORDER

On September 14, 2021 and September 15, 2021, the parties appeared for trial in person and by Counsel. At trial, the Court heard arguments and evidence from both parties. At the conclusion of the evidence the Court ordered the parties to submit proposed findings of fact and conclusions of law with specific reference to transcript page numbers and exhibits, in support of any proposed findings.

Upon consideration of the evidence, argument, and the parties' proposed findings of fact and conclusions of law, the Court **FINDS** that the software, equipment, and related services are exempt from retail sales and use tax pursuant to *Virginia Code* § 58.1-609.5(1) and *Virginia Code* § 58.1-609.6(2), and herby **FINDS** in favor of the Applicant against the Respondent and **ORDERS** the Respondent to refund the principal sum of $1,469,698.66 plus prejudgment interest to the Applicant. In support of this finding and Order the Court approves, adopts, and **INCORPORATES** herein by reference the Applicant's proposed findings of fact and conclusions of laws 1-33 and 35-46.

Pursuant to Rule 1:13 of the Supreme Court of Virginia, the Court dispenses with the parties' endorsement of this Order and all arguments of the Respondent contrary to this Order are noted as objections to this Order.

The Clerk is directed to forward a certified copy of this Order to all parties. It is so **ORDERED**.

ENTER: 10/26/21 - W. Reilly Marchant, Chief Judge

ALCATEL-LUCENT USA INC.'S
PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

I. Findings of Fact

A. Lucent's refund applications

1. Alcatel-Lucent USA Inc. ("Lucent") filed two refund applications with the Virginia Department of Taxation ("Department"). The applications concerned sales tax that Lucent remitted to the Department on software and equipment (and related services) it sold to the company now called Shenandoah Personal Communications, LLC ("Shentel PCS") between December 1, 201 l and March 31, 2015. Plaintiff's Trial Exhibit ("PX")-01; PX-02; Trial Day 1 Tr. at 43:18- 46:19.

2. A Department auditor approved a partial refund for some of the software sales and some service charges. The auditor approved no refund for equipment sales. The auditor also denied interest on the partial refund. PX-04.

3. Lucent thereafter timely appealed to the Virginia State Tax Commissioner ("Commissioner") pursuant to *Virginia Code* § 58.1-1821. PX-06; Trial Day 1 Tr. at 96:20-97:21.

4. The Commissioner issued a determination letter on Lucent's appeal. PX-07. He agreed that Lucent is entitled to interest. *Id.* at 7-8. He denied Lucent's appeal in all other respects. He wrote that the equipment was not exempt because he did not believe Shentel PCS was a "retail ISP [Internet Service Provider]." *Id.* at 5. He wrote that the software was not exempt because there was no "sales invoice, contract or other sales agreement" that "expressly certif[ies] the electronic delivery of the software and that no tangible medium for that software has been furnished to the customer." *Id* at 6-7.

5. The Commissioner also identified two matters he said the auditor noted during her review. The first was that "certain types of software offered for sale by the Taxpayer appeared to include the transfer of that software on a disc or other tangible medium in addition to electronic delivery." *Id.* at 7. The second was instances of "transactions in which software charges were billed in connection with sales of equipment or hardware." *Id.* The Commissioner did not say he relied on either ground to deny a refund.

6. Lucent filed a request for reconsideration with the Commissioner. PX-08, Trial Day 1 Tr. at 115:4-22. While awaiting the Commissioner to rule on the request, Lucent filed this lawsuit under *Virginia Code* § 58.1-1825(A) as the one-year deadline for appealing the Commissioner's denial neared. The Commissioner thereafter denied the reconsideration request. PX-09; Trial Day 1 Tr.121:11-20.

B. Shentel PCS's wireless network

7. Shenandoah Telecommunications Company ("Shentel") is a telecommunications company headquartered in Edinburg, Virginia. During the period in question Shentel (through its subsidiaries) provided traditional landline telephone service (local and long distance), cable television service and digital wireless (cell phone) communications service. Trial Day l Tr. at 132:14-22; 133:12-134:4.

8. Shentel 's wireless business was conducted by its subsidiary Shentel PCS. Its digital wireless network covered western Virginia and parts of several adjacent States, constituting at one point the sixth largest digital wireless network in the country with over a million retail subscribers. Trial Day 1 Tr. at 134:13-136:5.

9. Consumers used Shentel PCS's network to make voice calls on mobile phones. They also used the network to transmit data on mobile phones, including sending and receiving texts, accessing emails and browsing the Internet. Trial Day 1 Tr. at 135:10-19; 140:3-16.

10. Shentel PCS was a concern under the regulation and supervision of the U.S. Federal Communications Commission ("FCC"). It held hundreds of FCC permits for its wireless network. Numerous FCC regulations governed its operation of the network. Trial Day 1 Tr. at 237: 13- 246: 19; PX-16 & 21.

11. Shentel PCS operated the wireless network as an affiliate of Sprint Communications, Inc. ("Sprint"). Shentel PSC's contracts with Sprint gave Shentel PCS exclusive rights to the Sprint brand in its territory. Defendant's Trial Exhibit ("DX")-21; Trial Day 1 Tr. at 205 :3-208:7; 216:9-11. Pursuant to those contracts, Shentel PSC marketed its wireless service under the Sprint brand and filed fictitious name registrations to trade as Sprint. Trial Day 1 Tr. at 228: 10-21.

12. Shentel PCS also had the exclusive right in its territory to broadcast wireless transmissions over the portion of the spectrum, i.e., radio frequencies, for which Sprint held licenses f om the FCC. Sprint agreed not to use those frequencies, or otherwise provide wireless service, in Shentel PCS' s territory and had no wireless infrastructure in that territory. Trial Day 1 Tr. at 204:7-205:2; 216:4-20; 218:16-219:8.

13. Retail customers who had Sprint-branded cell phone service in Shentel PCS's service territory while this affiliation was in place were Shentel PCS's customers. When such a consumer used a mobile phone to place a call or access the Internet when in Shentel PCS's territory, the transmission occurred over Shentel PCS' s wireless network. Trial Day 1 Tr. at 215:20-216: 15; 234:2-14.

14. Shentel PCS received the payments from these customers, less a percentage Sprint retained as compensation for Shentel PCS's use of Sprint's brand and permission to use Sprint's licensed portion of the spectrum. Shentel PCS also retained Sprint to provide certain back office services, such as billing. Shentel PCS paid Sprint for those services. PX-13; Trial Day 1 Tr. at 228:22-231 :20.

15. The Commissioner's determination letter says that Shentel 's website contained no information about the provision of wireless service. Its website, however, in fact contains many references to the company's providing wireless service, including Internet access. PX-08 at Exhibits IV-VI; PX-18 19, 23 & 24· Trial Day 1 Tr. at 116:1-121:5 & 249:14-256:16.

16. The Commissioner's determination letter says that Internet searches did not identify Shentel as an ISP. However, that was because Shentel PCS advertised its wireless services exclusively under the Sprint brand. Trial Day 1 Tr. at 249:6-13.

17. The Commissioner's determination letter says various on-line articles refer to Shentel as Sprint's wholesale partner. There were only two such articles however, and in neither did Shentel refer to itself as a wholesaler. Trial Day 2 Tr. at 29:3-35:21.

C. Equipment and services

18. Lucent requests in this lawsuit a refund of $1,319,977.89 in sales tax remitted on equipment and related services. Of that amount, $1,019,017.47 is for equipment. The balance of $300,960.42 is for services. PX-30.

19. Shentel PCS used all of the equipment that is the subject of Lucent's refund request in its wireless network. Some of the equipment was used exclusively for data transmissions, including Internet access. Some enabled both voice and data transmissions. PX-28 & 30; Trial Day 1 Tr. at 136:6-140:2 & 141 :1-149:3.

20. The service charges were for engineering support m connection with the equipment's installation. PX-30; Trial Day 1 Tr. at 145:9-147:7 & 149:4-10.

D. Software

21. Lucent requests in this lawsuit a refund of $149,720.77 in sales tax remitted on software. PX-40.

22. Shentel PCS used the software that is the subject of Lucent's refund request to enable features and capacity on its wireless network. Trial Day 1 Tr. at 156:18-157:3; 158:8-13.

23. Lucent transmitted all of that software electronically to Shentel PCS via two electronic portals Lucent maintained, called the Alcatel-Lucent Electronic Delivery ("ALEO") and the License Key Delivery & Infrastructure ("LKDI") systems. None of the software at issue was sent to Shentel PCS on a tangible medium. PX-41, 42 & 43; Trial Day 1 Tr. at 160: 14-176:9.

II. Conclusions of Law

24. The Commissioner's decision denying Lucent's refund is deemed *prima facie* correct. Accordingly, Lucent has the burden to prove that the decision is erroneous or otherwise improper. *Va. Code* § 58.l-1825(D).

25. Lucent has carried its burden of proving that the Commissioner's denial of its refund is erroneous. lt is entitled to the full requested refund plus interest for the reasons that follow.

A. Software Exemption

26. The software that is the subject of Lucent's refund request in this lawsuit was exempt from sales tax pursuant to *Virginia Code* § 58.1-609.5(1).

27. Section 58.1-609.5(1) exempts, among other things, "services not involving an exchange of tangible personal property which provide access to or use of the Internet and any other related electronic communication service, ***including software***, data, content and other information services ***delivered electronically via the Internet***." *Va. Code* § 58.1-609.5(1) (emphasis added). The evidence shows that all the software at issue meets this test.

28. The Commissioner's position that the software was not exempt because no invoice, contract or other sales agreement certified that the software was delivered electronically lacks merit. The plain

language of § 58.1-609.5(1) contains no requirement for such documentation and does not condition the exemption on any such certification.

29. No deference is entitled the Commissioner's contrary reading of that statute. As the Supreme Court of Virginia has made clear: "'[a] court never defers to the Tax Commissioner's interpretation of a statute.'" *City of Richmond v. Va. Elec. & Power Co.*, 292 Va. 70, 74, 787 S.E.2d 161, 163 (2016), quoting *Nielsen Co. (US), LLC v. County Bd. of Arlington County*, 289 Va. 79, 89,767 S.E.2d 1, 15 (2015).

30. The Commissioner bases his position on his rulings in applications by other taxpayers, known as Public Documents. Those rulings have no legal significance. Pursuant to *Virginia Code* § 58.1-205(4), those rulings "shall not be admitted into evidence and shall be accorded no weight... " *Accord Chesapeake Hosp. Auth. v. Commonwealth*, 262 Va. 551,554 S.E.2d 55 (2001) ("under Code § 58.1-205, the Tax Commissioner's prior rulings and policies themselves are not entitled to great weight, unless expressed in regulations").

31. The two matters noted by the auditor that are mentioned in the Commissioner's determination letter likewise do not defeat Lucent's refund. The software that the auditor noted was offered for sale on a tangible medium was 5620 SAM software. No 5620 SAM software is among the software for which Lucent seeks a refund in this lawsuit. Likewise, software that was billed on the same invoice as equipment was still transmitted solely by electronic means over the Internet. Trial Day 1 Tr. at 60:6-64:9; 77:4-78:6; 111 :9-112:13; 185:12-186:21; 187:4-189:20.

B. Equipment Exemption

32. The equipment that is the subject of Lucent's refund request in this lawsuit is exempt from sales tax pursuant to *Virginia Code* § 58.1-609.6(2).

33. Section 58.1-609.6(2) defines two categories of exempt equipment: (i) broadcasting equipment and parts and accessories thereto; and (ii) amplification, transmission and distribution equipment. The statute exempts such equipment from sales tax when used by certain entities, as follows:

Broadcasting equipment and parts and accessories thereto and towers ***used or to be used by*** commercial radio and television companies, wired or land based wireless cable television systems, common carriers or video programmers using an open video system or other video platform provided by telephone common carriers, or ***concerns which are under the regulation and supervision of the Federal Communications Commission*** and ***amplification, transmission and distribution equipment used or to be used by*** wired or land based wireless cable television systems, or ***open video systems*** or other video systems provided by telephone common carriers.

Va. Code § 58.1-609.6(2) (emphasis added).

34. The evidence shows that the equipment qualifies as broadcasting equipment and parts and accessories thereto used by a concern under the regulation and supervision of the FCC.

35. The evidence also shows that the equipment qualifies as amplification equipment used by an open video system. "Amplification, transmission and distribution equipment" means, but is not limited to, "production, distribution, and other ***equipment used to provide Internet access services***, such as

computer and communication equipment and software used for storing, processing and retrieving end-user subscribers' requests." *Virginia Code* § 58 .1-602 (emphasis added). "Open video system" means "an open video system authorized pursuant to 47 U.S.C. § 573 and, for purposes of this chapter only, ***shall also include Internet service regardless of whether the provider of such service is also a telephone carrier***." *Id.* (emphasis added). "Internet service" means "a service that enables users to access proprietary and other content, information electronic mail, and the Internet as part of a package of services sold to end-user subscribers." *Id*. Taken together, these provisions exempt equipment used to provide Internet access.

36. The Commissioner's contention that the equipment is not exempt because Shentel PCS was not a retail ISP is incorrect as a matter of law. Neither the broadcasting exemption nor the amplification exemption is limited to retail ISPs. The Commissioner's position reads words into the statute and adds a limitation that the General Assembly did not enact, in contravention of "the paramount principle" of statutory construction that requires statutes to be interpreted "as written." *Miller & Rhoads Bldg, L.L.C. v. City of Richmond*, 292 Va. 537,542, 790 S.E.2d 484, 486 (2016).

37. An opinion of the Virginia Attorney General made clear over 20 years ago that *Virginia Code* § 58.1-609(2) is not confined to retail ISPs. In response to a query by Senator (now Justice) William Mims, the Attorney General opined that the statute applies to wholesale ISPs. Focusing on the category of "amplification, transmission and distribution equipment," the Attorney General concluded that the General Assembly "intended a broad, rather than restrictive application of the term." The broad language encompasses wholesale ISPs. The Attorney General opined:

Simply stated, the question is whether the entity seeking an exemption must use the equipment to provide direct Internet service to end users or whether it is sufficient for the entity to use the equipment to enable others to provide the same service. It is my opinion that the definitions and exemption are sufficiently broad to include both the entity using equipment to provide Internet access service directly to end users and the entity using equipment to enable other entities to provide such service to end users.

Va. Atty. Gen. Op. 00-005 (Mar. 15, 2000) at 2.

38. The Fairfax County Circuit Court agreed in *Cisco Sys. v. Thorsen*, 68 Va. Cir. 385 (Fairfax Cty. 2005). Section 58.1-609.6(2), the Cisco court concluded, "places the exemption on what is to be exempted and does not differentiate as to who may take the exemption." The Commissioner's attempt to limit the exemption to retail ISPs, it held, "is inconsistent with the current law" and "cannot be sustained." *Id*. at 391.

39. *Cisco* found persuasive that the General Assembly had been on notice of the Attorney General's opinion for five years at the time of that decision and had not amended the statute. That the General Assembly's acquiescence now spans 20 years cements its conclusion. As the Supreme Court has held: "The legislature is presumed to have had knowledge of the Attorney General's interpretation of the statutes, and its failure to make corrective amendments evinces legislative acquiescence in the Attorney General's view." *Beck v. Shelton*, 267 Va. 482, 492, 593 S.E.2d 195, 200 (2004), quoting *Browning-Ferris, Inc. v. Commonwealth*, 225 Va. 157, 161-62, 300 S.E.2d 603, 605-06 (1983). Consequently, it does not matter whether Shentel PCS was a retail or wholesale ISP.

40. The Commissioner's position is also wrong as a matter of fact because Shentel PCS was a retail ISP. Shentel provided Internet access directly to end-user customers. Retail subscribers used their mobile phones to connect directly to Shentel PCS's wireless network and access the Internet.

41. That Shentel PCS provided Internet service under the Sprint brand is of no moment. Nothing precludes a company from being a retail ISP because it does business under a brand name other than its own. Retail franchisees typically operate under their franchisor's name. Think of McDonalds restaurants. A customer buying a hamburger at a McDonalds may be unaware that he is not buying a hamburger from the McDonalds Corporation, but that does not mean the franchisee is not a retail purveyor of hamburgers.

42. Likewise of no moment is the fact Sprint held the FCC spectrum licenses for the radio frequencies Shentel PCS used. Nothing in § 58.1-609.2(6) limits the exemptions to entities that hold a spectrum license.

43. Form is not elevated over substance in the classification of parties and transactions for tax laws. *County of York v. Peninsula Airport Com.*, 235 Va. 477,481, 369 S.2d 665, 667 (1988) (appeal concerning whether airport commission qualifies as tax exempt noting the political subdivision: "The County asks us to elevate form over substance. We decline to do so."). The substantive reality is Shentel PCS operated as a retail ISP, and thus the equipment is tax exempt even under the Department's erroneous reading of *Virginia Code* § 58.1-609.6(2).

C. Services

44. The service charges for which Lucent seeks a refund in this lawsuit are exempt from sales tax under *Virginia Code* § 58.1-609.5. That statute exempts, among other things, "an amount separately charged for labor or services rendered in installing, applying, remodeling or repairing property sold."

45. The service charges also are exempt even if considered part of the equipment's purchase price under the "true object test." Under that test, a service charge is treated as part of the purchase price of a good if the service is an integral part of the acquisition of the good. 23 Va. Admin. Code § 10-210-4040(0). In that circumstance, the service charge shares the good's status and is exempt if the good is exempt. *LZM, Inc. v. Dep 't of Taxation*, 269 Va. 105,110,606 S.E.2d 797, 800 (2005); 23 Va. Admin. Code § 10-210-4040(0).

D. Interest

46. Lucent has agreed to pass onto Shentel PCS all the refunded tax. Trial Day 1 Tr. at 189:21-190:5; PX-27; Trial Day 1 Tr. at 122:2-123:2. Lucent consequently is entitled to interest on the refunded amounts pursuant to *Virginia Code* § 58. I-1833(A).

ACCORDINGLY, Lucent is awarded a refund in the principal amount of $1,469.698.66 plus prejudgment interest. The parties are directed to confer on the interest calculation and present a final order that includes interest consistent with these findings.

Respectfully submitted,

ALCATEL-LUCENT USA INC.

Related Documents: 19-6020-204

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