

Application of Telecommunication Excise Tax to the Separate Charge for a Cell Phone Sold by a Mobile Telecommunications Service Provider

The issue raised is whether the gross receipts from the sales of cellphones, under the circumstances described below, by a mobile telecommunications service provider are included in the provider's gross receipts subject to the telecommunication excise tax imposed by Tax Law § 186-e. We conclude that the gross receipts from the sales of the cellphones are included in the provider's gross receipts subject to tax under § 186-e.¹

Facts

Company X has been in the business of providing wireless telecommunication service in New York for many years, including postpaid plans. Under the traditional postpaid plan, the customer enters into a service contract, generally for two years, to be billed for wireless service on a monthly basis. As a part of such postpaid plan, the customer receives a cellphone from the carrier at no cost or at a discounted price. The carrier recoups the cost of the cellphone through the monthly charge for service under the wireless service contract.

In March 2013, Company X began to offer postpaid wireless service without requiring the customer to enter into a service contract. Rather, customers agree to subscribe for service on a month-to-month basis. Importantly, customers no longer receive a free or reduced price device because the monthly cost of the service purchased does not include any embedded subsidy for the purchase of a cellphone. If a customer does not need to purchase a device from Company X, the customer selects a service plan on a month-to-month basis that includes a specified amount of voice, text and data. In order to confirm the customer's eligibility for service, Company X performs a credit check. To the extent that a customer's credit rating does not support the service level chosen, a service deposit may be required for a period of time, the amount of which depends on the customer's credit, payment history and service plan chosen. Subsequently, the customer is billed on a monthly basis for wireless service.

By way of example, the customer handset and service process typically works as follows. On a given day, a customer enters Company X's store and seeks to purchase a cellphone and sign-up for postpaid service. The customer would supply Company X with certain information including name and address and Company X would perform a credit check. Assuming the customer has satisfactory credit, no deposit would be required and service could commence on that day. The customer makes no payment until he or she receives the first bill, which is sent out soon after the customer signs up for service. The bill for each month's service thereafter will come out monthly.

With respect to the acquisition of a cellphone, if the postpaid customer purchases a device from Company X and fully pays for the cellphone on the date of purchase, there is no

¹ Tax Law § 186-e(2)(a) was amended by Part P of Chapter 59 of the Laws of 2016 applicable to sales made on or after May 1, 2015. See TSB-M-15(5)C. All references herein to Tax Law § 186-e will be to the version of that provision in effect prior to May 1, 2015.

reference to the cellphone purchase on the next service bill. The billing for the cellphone is separated from the billing for the service.

If, instead of fully paying for the device on the day in question, the customer purchases the device on the installment basis (at no interest), the customer would sign an agreement on that day. That agreement would reflect the particulars around the purchase of the device, such as the total purchase price of the device, the down payment and number of payments. In purchasing the cellphone on an installment basis, the customer enters into a sales contract with Company X's affiliate ("Affiliate"), as agent for Company X. As a matter of administrative convenience and cost savings, Company X includes the charge for the device on its invoice for cellular service. There is no difference in the price of the device if there is full payment at the time of purchase or if the purchase is on the installment basis. To the extent that the customer chooses to pay off the price of the device over time on an installment plan, the customer must enter into a wireless service plan and must maintain the service plan until the balance is paid off. If the customer terminates monthly service before paying off the balance on the installment purchase, then the remaining balance becomes due immediately. Unlike the situation where the customer pays in full for the device upfront, if the customer purchases the device on the installment basis, the customer's monthly bill for service will show the monthly charges for service and the monthly payment to be made for the device if there remains a balance due. The customer would be expected to pay the total of the service charges plus the installment charge on a monthly basis.

A customer can pay off the purchase price of the device at any time with no financing or prepayment penalty. In such cases, the installment plan would terminate with no further obligation to continue with Company X's wireless service. Conversely, a consumer that has his or her own phone can bring that phone to one of Company X's stores and initiate service under the same terms as the customer purchasing a device from Company X. A customer may purchase a device at Company X's stores without also purchasing any service from Company X as long as the customer pays the full purchase price for the cellphone at the time of the sale.

Any cellphone purchased from Company X is initially "locked" in the sense that it may be used only for service on Company X's network. The "lock" stays on for up to 40 days after purchase in order to avoid fraudulent purchases and theft of devices. According to Company X's terms and conditions, Company X will not unlock a phone, which requires the inputting of a proprietary code, unless the account is in good standing, and has been active on Company X's network for "at least 40 days on the requesting line." If the purchase of the cellphone was financed using Company X's equipment installment plan, the balance due must be paid in full. Company X maintains that there are other situations when it will unlock its cellphones, such as for military personnel deploying overseas or to allay a customer complaint.

Phones purchased for use on Company X's network use technology that does not function on many other carriers' networks. Petitioner acknowledges that even if the phone works on another carrier's system, some functionality of the device may be lost.

Analysis

Tax Law § 186-e(2)(a) imposes an excise tax on the sale of telecommunication services by a provider of telecommunication services on the gross receipt from "(4) mobile telecommunications service provided by a home service provider where the mobile

telecommunications customer's place of primary use is within this state." Under section 186-e(1)(g), "telecommunications services" includes any transmission of voice, image, data, information and paging, through microwave, radio wave or satellite, and services that are ancillary to the provision of telephone service and any equipment and services provided therewith." Company X does not dispute that it is a provider of mobile telecommunications services and that it is therefore liable for § 186-e tax on its gross receipt from the sale of mobile telecommunications services. See Tax Law §§ 186-e(1)(h), 1101(b)(24). Thus, the issue here is whether the charge for the cellphone should be included in § 186-e(1)(a)(1)'s definition of "gross receipt." Company X is the seller of the cellphones in all cases, as it makes outright sales itself, and makes installment sales of the devices through an affiliate that is acting as its agent.

Section 186-e(1)(a)(1) provides that "[g]ross receipt from the sale of mobile telecommunications service provided by a home service provider shall include 'charges for mobile telecommunications service' as described in [Tax Law § 1111(l)(1)], regardless of where the mobile telecommunications service originates, terminates or passes through." Tax Law § 1111(l)(1) defines "charges for a mobile telecommunications service" as "any charge by a home service provider to its mobile telecommunications customer for (A) commercial mobile radio service, and shall include property and services that are ancillary to the provision of commercial mobile radio service (such as dial tone, voice service, directory information, call forwarding, caller-identification and call-waiting), and (B) any service and property provided therewith." The property and services described in subparagraph (B) of § 1111(l)(1), but not the property and services described in subparagraph (A) of § 1111(l)(1), are subject to the disaggregation rules in § 186-e(2)(b)(4). The latter provision states that a carrier that is selling subparagraph (B) property and services along with mobile telecommunications service for one price may, under certain circumstances, exclude from the tax on mobile telecommunications services a portion of that total charge as attributable to the subparagraph (B) property, using the disaggregation rules set forth therein.

The cross reference in Tax Law § 186-e(1)(a)(1) to "charges for a mobile telecommunications service" in § 1111(l)(1) has the effect of separating the gross receipts received by a mobile telecommunication service provider into two categories. Subparagraph (A) of § 1111(l)(1) includes property and services that are integrally related to the provision of mobile telecommunication services, such as dial tone services, call forwarding, and property that is similarly integral to the mobile telecommunications service and thus part of the § 186-e tax base. See TSB-M-95(3)C [listing as "ancillary" and thus taxable under § 186-e "directory information, call forwarding, caller-identification and call-waiting and supplementary services," along with "equipment provided in connection with the provision of any telecommunications service (e.g., beepers, telephones, fax machines, modems, equipment used for data transmission, etc.)"]. These charges, being integral to the telecommunication process, are not made subject to the disaggregation rule in § 186-e(2)(b)(4) and, thus, are taxable as mobile telecommunications services under all circumstances. This means that the "any service and property provided therewith" language in subparagraph (B) must refer to otherwise nontaxable property and services that become taxable when bundled with mobile telecommunication services and sold for one price; under Tax Law § 186-e(2)(b)(4) the provider can disaggregate the bundle and exclude the portion of the charge attributable to the subparagraph (B) service and property.

The conclusion above that the “services and property provided therewith” language in subparagraph (B), and the disaggregation rules in § 186-e(2)(b)(4) made applicable to such property and services, were intended to apply only to otherwise nontaxable services or property is demonstrated by the last sentence in that paragraph: “Nothing herein shall be construed to exempt from tax any such service or property otherwise subject to tax under this section.” Section 1111(l)’s legislative history also supports this reading of the scope of subparagraph (B). See Memorandum of the Commissioner of Taxation and Finance Arthur Roth to Gov. Pataki, May 20, 2002, Bill Jacket to Chapter 85 of the Laws of 2002, at p. 12 of 20 (“Overall, this bill preserves the existing tax bases after the implementation of the uniform sourcing rule.”). See also *People ex rel. Schneiderman v. Sprint Nextel Corp.*, 26 N.Y.3d 98, 111 (2015) (explaining that Tax Law § 1111(l)(2), the largely parallel sales tax provision to § 186-e(2)(b)(4), provides “for the separate accounting of bundled services which are *non-taxable*” (emphasis added).

This understanding of the intended scope of § 186-e(2)(b)(4) leads us to the conclusion that its disaggregation rules do not apply to Petitioner’s separate charges for its cellphones. Under the facts here, it is apparent that a customer purchases a cellphone from Company X in order to use it on Company X’s network, including the facts that the cellphones are sold in a locked state and have only a limited ability to function on the networks of other carriers even when unlocked. Accordingly, the cellphones are “ancillary” to Company X’s mobile telecommunications service and thus qualify as subparagraph (A) property for purposes of Tax Law § 1111(l)(1). Because the cellphones are subparagraph (A) property, the disaggregation rules in § 186-e(2)(b)(4) do not apply to Petitioner’s sales of cellphones. Therefore, Company X’s separate charges for the cellphones are subject to § 186-e tax.

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