

INTERNAL REVENUE SERVICE
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06-22-1999

In re:

Legend:

Taxpayer =

Dear

This responds to your February 10, 1999, letter on behalf of your client, Taxpayer, in which you request rulings as to the following:

(1) Whether the communications excise tax imposed by § 4251 of the Internal Revenue Code applies to amounts paid to Taxpayer for its "telecommunications based processing transactions and software download services" (the Services).

(2) Whether amounts paid by Taxpayer to purchase "bulk telecommunication services" from communications providers are subject to the § 4251 tax.

Taxpayer has represented the following. Taxpayer produces a variety of hardware and software for data communication and electronic commerce via third party gateways and routers between merchants' point-of-service transaction terminals (POS) and financial service providers. Taxpayer offers the Services to its subscribers. By using the Services, merchants can access Taxpayer's customers, the financial service providers, for determination of credit information.

Taxpayer purchases bulk communication capacity from a communications provider, which it uses in providing the Services to its customers. Taxpayer uses the phrase "bulk communications services" to describe the large amount of communications time purchased by Taxpayer.

To use Taxpayer's system for access to the financial service provider's host systems, a merchant's POS dials a toll-free 800 number (Connection 1). The call is immediately routed to and answered by Taxpayer's modem hardware. Thereafter, Taxpayer connects the merchant's POS system with the financial service provider's host computers (Connection 2). Data from the financial service providers is thereafter transmitted along the same route back to the merchant's POS system. A similar process occurs for software downloads to the POS terminals from the financial service provider's host systems.

Connection 1 is made over local or toll telephone lines. Taxpayer purchases the 800 number service from a long distance carrier and the carrier collects the communications excise tax from Taxpayer. Connection 2 occurs using a "private network over dedicated lines" and once the call enters Taxpayer's modem network, it is sent over the internet and is capable of transmitting data only. Because of encryption hardware, only Taxpayer's customers have access to Taxpayer's network. Further, the network system does not permit intercommunication among subscribers.

Section 4251 imposes a tax on amounts paid for communications services; the term communications services means local telephone service, toll telephone service, and teletypewriter exchange service. Section 4251(a)(2) provides that the tax is paid by the person paying for the service. Under § 4291, the person receiving the payment for the service is responsible for collecting the tax from the person making the payment.

Section 4252(a) defines local telephone service as: (1) the access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system, and (2) any facility or service provided in connection with a service described in (1). The term local telephone service does not include any service which is a toll telephone service or a private communication service.

Section 4252(b) defines toll telephone service as: (1) a telephonic quality communication for which (A) there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication and (B) the charge is paid within the United States, and (2) a service which entitles the subscriber, upon payment of a periodic charge

(determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radio telephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

Section 4252(c) defines teletypewriter exchange service as the access from a teletypewriter or other data station to the teletypewriter exchange system of which such station is a part, and the privilege of intercommunication by such station with substantially all persons having teletypewriter or other data stations constituting a part of the same teletypewriter exchange system, to which the subscriber is entitled upon payment of a charge or charges (whether such charge or charges are determined as a flat periodic amount, on the basis of distance and elapsed transmission time, or in some other manner). The term teletypewriter exchange service does not include any service which is local telephone service.

Revenue Ruling 74-402, 1974-2 C.B. 362, holds that amounts paid for a switched digital data communication service which provides high speed transmission of computer and other data messages between the subscriber's offices at various locations, but does not permit intercommunication with other subscribers to the service, are not subject to the tax on communications services.

Revenue Ruling 79-245, 1979-2 C.B. 380, holds that amounts paid to the local telephone company for the local telephone service that is used with teleprocessing equipment is subject to the tax on communications services.

Local telephone service, toll telephone service, and teletypewriter exchange service, as defined in § 4252, all provide the privilege of intercommunication between substantially all persons constituting a part of the respective system. In the case at hand, Taxpayer does not provide local, toll, or teletypewriter exchange service to its customers because the Services do not permit intercommunication with other subscribers to the Service. Additionally, although Taxpayer uses communications services in providing the Services, it does not resell those services as such to its customers. As in Rev. Rul. 79-245, the communications services purchased by Taxpayer provide Taxpayer with the privilege of voice quality communication with substantially all persons in the system; it is immaterial whether Taxpayer chooses to exercise that privilege.

Accordingly, based on the representations made:

(1) Amounts paid to Taxpayer for the Services are not subject to the communications excise tax imposed by § 4251. Consequently, Taxpayer has no collection obligation under § 4291 with respect to these amounts.

(2) Amounts paid by Taxpayer to purchase bulk telecommunications services are subject to the communications excise tax imposed by § 4251.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it shall not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special Industries)

By:

Ruth Hoffman
Senior Technical Reviewer, Branch 8

Enclosures (2):

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