SUPREME COURT OF IOWA

AOL LLC v. Iowa Department of Revenue

No. 07-1792 · No. No. 07-1792 · Decided August 21, 2009

SUMMARY

The Supreme Court of Iowa considered whether Iowa could impose sales tax on internet services provided by AOL to Iowa customers. The court held that the Iowa Department of Revenue's rule requiring both the origination and termination points of a communication to be within Iowa applied to internet services, and that AOL's services were interstate because authentication and essential communications occurred through AOL's Virginia data centers. The court vacated the Court of Appeals decision and affirmed the district court judgment in favor of AOL.

CASE DETAILS

COURT	Supreme Court of Iowa
WRITING FOR THE COURT	Appel, Justice
JURISDICTION	Iowa
DECIDED	August 21, 2009
DOCKET	No. 07-1792
DISPOSITION	vacated
PROCEDURAL POSTURE	The Iowa Department of Revenue sought further review of the Iowa Court of Appeals' decision affirming the district court's reversal of the Department's determination that AOL's Iowa internet services were subject to state sales tax.
STANDARD OF REVIEW	Under the Iowa Administrative Procedure Act, an agency's interpretation of law receives deference only when interpretive authority has clearly been vested in the agency; otherwise, statutory interpretation is reviewed for correction of errors at law and de novo. Agency interpretations are invalid if irrational, illogical, or wholly unjustifiable. Agency factual determinations are upheld if supported by substantial evidence, while application of law to established facts may be reversed if irrational, illogical, or wholly unjustifiable.
PRECEDENTIAL VALUE	Published Iowa Supreme Court opinion
PARTIES	Iowa Department of Revenue v. AOL LLC

TOPICS

sales and use tax · judicial review of agency action · administrative law · statutory interpretation · appellate procedure

PRACTICE AREAS

state and local tax · administrative law · appellate procedure

QUESTIONS PRESENTED

1. Whether the definition of communication service provided "in this state" in Iowa Administrative Code rule 18.20(1)(b) applies to the internet-service provision in rule 18.20(5).
2. Whether, under the undisputed facts and the applicable administrative rules, AOL provided taxable intrastate communication services in Iowa.

HOLDINGS

1. The definition in rule 18.20(1)(b) applies fully when determining whether internet services under rule 18.20(5) are subject to Iowa sales tax. The Department could not treat rule 18.20(5) as a stand-alone provision and avoid the generally applicable definition.
2. AOL's services were interstate rather than intrastate communication services under rule 18.20(1)(b), because the transmission and receipt of information did not occur wholly within Iowa. The Iowa access point and local modem hotel did not themselves constitute a taxable intrastate communication service.

KEY QUOTATIONS

> *"An agency simply cannot assert a "King's X" defense when unambiguous definitions prove too tight or too loose."* (9)

> *"There is simply no "play in the joints" of the rule sufficient to allow the department to escape the rule's plain meaning and overall structure."* (10)

> *"Under these undisputed facts, it cannot be maintained that AOL's communication service is intrastate when, without the Virginia connection, the user gets nothing."* (11)

FACTUAL BACKGROUND

AOL provided Iowa customers with internet access, email, instant messaging, and other online content. Iowa customers dialed a local Iowa telephone number, but the connection was routed through AOL's data centers in Virginia, where the customer's account was authenticated before any AOL service or content became available. All information sent to or from AOL users was routed through Virginia, and no service could be provided to Iowa users if the Virginia computer system was disconnected.

PROCEDURAL HISTORY

The Department assessed sales tax on AOL's Iowa communication-service sales for July 1, 1995, through December 31, 2000. An administrative law judge concluded the services were untaxable interstate services, but the Department's director reversed that decision. The Iowa District Court for Polk County reversed the agency decision, the Iowa Court of Appeals affirmed, and the Iowa Supreme Court granted further review, vacated the Court of Appeals decision, and affirmed the district court judgment.

DISPOSITION

vacated

CASES CITED

- Prodigy Servs. Corp., Inc. v. Johnson, 125 S.W.3d 413 (Tenn. Ct. App. 2003)
- Auen v. Alcoholic Beverages Division, 679 N.W.2d 586, 589-90 (Iowa 2004)
- Ranniger v. Iowa Department of Revenue & Finance, 746 N.W.2d 267, 268, 270 (Iowa 2008)
- Marovec v. PMX Industries, 693 N.W.2d 779, 785 (Iowa 2005)
- Qwest Corp. v. State ex rel. Wyoming Department of Revenue, 130 P.3d 507, 515 (Wyo. 2006)