

OHIO BOARD OF TAX APPEALS

Time Warner Entertainment,)
)
 Appellant,) CASE NO. 2003-R-1810¹
)
 vs.) (SALES TAX)
)
) DECISION AND ORDER
 Thomas M. Zaino,)
 Tax Commissioner of Ohio,) **Reversed on Appeal 12/13/06 Ohio Supreme Court**
)
 Appellee.) **111 Ohio St.3d 559, 2006-Ohio-6210**

APPEARANCES:

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Entered September 16, 2005

Ms. Margulies, Mr. Eberhart, and Mr. Dunlap concur.

This matter is before the Board of Tax Appeals upon a notice of appeal filed by Time Warner Entertainment (“TWE”) on November 21, 2003. TWE appeals from a final determination of the Tax Commissioner, in which the commissioner affirmed, as adjusted, a previously issued sales tax assessment, assessment no. 7010402491, for the period July 1, 1992

through December 31, 1996. The original assessment of \$4,810,656.81 was modified to include \$2,233,684.53 in tax and \$1,076,880.01 in interest. The commissioner also canceled the penalties.

The two items at issue in this matter involve the taxability of revenue collected by TWE from its customers for converter boxes and remote control units. TWE contends that the revenue from these items is exempt from sales tax. TWE submits that it is a public utility for purposes of sales tax, and these items are used directly in providing its services. The Tax Commissioner, on the other hand, claims that these items qualify as taxable retail sales in Ohio because TWE's customer is the consumer, not TWE.

The following facts are uncontroverted. TWE provides cable television services to private residences and businesses in the Columbus, Akron, and Canton, Ohio areas. During the audit period, TWE offered four levels of service. The basic service included twenty-six channels. The standard service offered thirty additional channels. The premium service offered eight to ten channels, including movie channels. Then, TWE also offered pay-per-view. These four levels of service totaled approximately eighty channels.

TWE would receive cable signals at its "head-end" facility, either through an antenna or by satellite. The signal would be processed and then transported via either fiber optics or coaxial cables and amplifiers to a distribution plant with coaxial taps in the local neighborhoods. From the coaxial taps, TWE would install a coaxial service drop in the customer's home. Inside the customer's home, the cable was either connected directly to the

¹ There is a companion case to this one, docketed as *Time Warner Operations, Inc. v. Zaino*, BTA No. 2003-R-1811. It involves the same issues as found in the present appeal, but for a different geographic region.

customer's television set or to a converter box. If the customer owned a cable-ready television and ordered only the basic level of service, the cable could be connected directly to the television. However, if the customer's television was not cable ready or the customer chose any of the enhanced levels of service, then a converter box was required to acquire the cable services.²

A converter box is a broad-band, multi-channel receiver that allows the customer to receive and tune specific tiers of service. It has a key pad on top and controls the television and VCR, and changes volume and channels. The converter box also unscrambles distorted signals based upon the level of service the customer orders. Each converter box is unique to TWE because it is controlled from its head-end facility. Therefore, a converter box would not be used for any other purpose.

In addition to converter boxes, TWE also provided the customer with a remote control unit. This is a hand-held device that transmits signals to the converter box. The remote control unit would have been either connected to the converter box by a cord or wireless. It would have essentially the same key pad as found on a converter box. Therefore, with this remote control unit, the customer could access the cable television services, change channels, and control volume.

Prior to the enactment of the Cable Act of 1992, TWE did not charge separately for installation, cable television services, and equipment, with the exception of the wireless

² The Tax Commissioner acknowledged that a converter box would be necessary for the customer to receive TWE's services if the television was not cable ready or for enhanced cable services. S.T. 2.

remote control unit. The wireless remote control unit had advanced technology and provided greater services, including a clock, an alarm, and parental controls.

After the Cable Act of 1992, TWE was required to “unbundle” the cost of its services in its customer billings, and separately state the charges for installation, cable television services, additional outlets, and equipment, including the converter boxes and remote control units. However, after the act became effective there was no change in services or the means of distributing those services.

Prior to the Cable Act of 1992, TWE did not charge its customers sales tax on any of its services or equipment. Even though the Cable Act of 1992 did not address sales taxes, TWE collected and remitted sales taxes on ten percent of its revenue from remote control units based upon a case regarding another cable television operator. Then, in March of 1996, TWE began collecting and remitting sales taxes on all of its converter box and remote control unit revenue based upon an information release from the Ohio Department of Taxation in November 1995.

Following an audit, TWE filed a petition for reassessment. The Tax Commissioner issued his final determination rejecting TWE’s objections on September 29, 2003. It is from this decision that TWE now appeals.

The matter is submitted to the board on the appellant’s notice of appeal, the statutory transcript (“S.T.”), the record of the December 14, 2004 hearing (“H.R.”) before this board, and briefs of counsel. At the hearing, both TWE and the Tax Commissioner appeared and were represented by counsel. TWE presented the testimony of Randy Hall, vice president of engineering for Time Warner, Steven A. Bertsch, vice president of finance for the

Columbus, Ohio division of Time Warner, Todd E. Watkins, vice president of finance and controller for the Cincinnati, Ohio division of Time Warner, and Jim Golly, vice president of divisional tax services for Time Warner. The Tax Commissioner presented no additional evidence other than cross-examination of the witnesses.

We begin our review by observing that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121, 123. Consequently, it is incumbent upon a taxpayer challenging a determination of the Tax Commissioner to rebut that presumption. *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135, 143; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138, 142. Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213, 215. When no competent and/or probative evidence is developed and properly presented to the board to establish that the commissioner's determination is "clearly unreasonable or unlawful," the determination is presumed to be correct. *Alcan Aluminum*, at 123.

R.C. 5739.02 levies an excise tax on each retail sale made in the state of Ohio.

R.C. 5739.01(E) further provided:

"Retail sale' and 'sales at retail' include all sales except those in which the purpose of the consumer is:

"(2) To incorporate the thing transferred as a material or a part, ****, to use or consume the thing transferred **** directly in the rendition of a public utility service ****."

R.C. 5739.01(P) defined “used directly in the rendition of a public utility service” as:

“‘Used directly in the rendition of a public utility service’ means that property which is to be incorporated into and will become a part of the consumer's production, transmission, transportation, or distribution system and which retains its classification as tangible personal property after such incorporation ***.”

In determining whether this exception applies, there is a three-step process of review: (1) whether the taxpayer is a regulated public utility service; (2) whether it was rendering a public utility service; and (3) whether the item was used directly in rendering the public utility service. *Inland Refuse Transfer Co., v. Limbach* (1990), 53 Ohio St.3d 10; *Manfredi Motor Transit Co. v. Limbach* (1988), 35 Ohio St.3d 73; *Warner Cable Communications, Inc. v. Limbach* (1990), 67 Ohio App.3d 458; and *Continental Cablevision of Ohio, Inc. v. Tracy* (July 10, 1998), BTA Nos. 1996-K-6 and 1996-K-518, unreported.

Statutory definitions given to “public utility” in other chapters of the Revised Code are not dispositive in the application of R.C. Chapter 5701, et seq; those definitions are relevant solely to the statutory chapters in which they are located. *Vernon v. Warner Amex Cable Communications, Inc.* (1986), 25 Ohio St.3d 177; *Warner Cable Communications, Inc.*, supra.

To constitute a “public utility,”

“the devotion to public use must be of such character that the product and service are available to the public generally and indiscriminately ***.”

Warner Cable Communications, Inc., supra, at 463.

A “wide brush” has been used to paint the public utility exception. *Continental Cablevision of Ohio, Inc.*, supra, at 54.

In *Warner Cable Communications, Inc.* and *Continental Cablevision of Ohio, Inc.*, supra, the Tenth District Court of Appeals and the Board of Tax Appeals both applied the public utility exception to cable television services. Therefore, this board finds that TWE is also a public utility within the meaning of R.C. Chapter 5739 and was providing public utility services during the audit period. The first two prongs of the test are met, so the final inquiry is whether TWE used the items directly in rendering the public utility service.

The evidence clearly demonstrated that in most cases, cable television services could not be rendered without the use of the converter boxes. Even the Tax Commissioner acknowledged this fact. Therefore, the board finds that the converter boxes are essential in the distribution of cable television services, and as a result, the revenue from the converter boxes is exempt from sales tax.

As to the remote control units, the evidence shows that cable television services were able to be accessed by TWE’s customers with converter boxes alone and without the assistance of remote control units. Although they are more convenient, the board finds that the remote control units were not essential in providing customers with continuous cable television services. Therefore, the revenue from the remote control units is not exempt from sales tax.

The Tax Commissioner argues that TWE’s customers are the actual consumers of the converter boxes and remote control units, and since they do not qualify as a public utility, the exemption for sales tax should be denied under R.C. 5739.01(B). TWE, however,

submits that since the items are used directly in rendering a public utility service, which would then not be taxable, R.C. 5739.01(B) is not applicable. We agree that this section of the statute does not apply, and we need not address such argument.

The pertinent analysis is whether or not the subject items were used directly in rendering a public utility service. Inasmuch as we have determined that the converter boxes were used directly in rendering a public utility service, they are not taxable. However, because we have concluded that the remote control units are not necessary for the furnishing of cable television service, the revenue from the remote control units remains taxable.

Based upon all of the foregoing, the Board of Tax Appeals orders that the Tax Commissioner's final determination must be, and the same hereby is, affirmed in part, and reversed in part.

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