REQUEST LETTER

07-006
June 26, 2007

NAME
ADDRESS

Re: Request for Private Letter Ruling on Tax Base for Purposes of Calculating the Multi-channel Video or Audio Service Tax.

Dear Commissioners:

On behalf of COMPANY, this is a request for a private letter ruling concerning the proper calculation of the Multi-Channel video or Audio Service Tax. Utah Code Ann. §59-26-101 *et. Seq*.

The Multi-Channel Video or Audio Service Tax Act (the "Act"), effective July 1, 2004, imposes "a tax on the purchaser equal to 6.25% of amounts paid or charged for multi-channel video or audio service provided by a multi-channel video or audio service provider" in Utah. Utah Code Ann. §59-26-103. COMPANY is a "multi-channel video or audio service provider" because it is a cable operator pursuant to Utah Code Ann. § 59-26-102. As such, it is responsible for collecting the tax from the purchaser and remitting the tax collected to the Utah State Tax Commission, quarterly, on a tax return prescribed by the Tax Commission. See Utah Code Ann. § 59-26-104. In addition to charges for multi-channel services, COMPANY pays franchise fees to various local governments and passes the cost to purchasers in the respective municipalities or counties.

As discussed below, we believe that the franchise fee should not be included in the base from which the 6.25% calculation of the Multi-Channel Video or Audio Service Tax is drawn. There are no provisions in the plain language of the Act and the Tax Commission has not promulgated specific rules that would support inclusion of franchise fees in the tax base. Prior to the effective date of the Act, we discussed this issue with representatives from the Tax Commission on an informal basis, and we were told that the Tax Commission was undecided on how to implement the Act and that charges for franchise fees probably would not be taxable.

Not surprisingly, most of the cable operators in the State of Utah have similarly interpreted the Act, and have not included the amounts collected from purchasers for franchise fees as part of the tax base for purposes of calculating the tax due to the State under the Act. Because of this lack of clarity with regard to the statute, and because the Tax Commission has not otherwise addressed this question in rules or decisions, COMPANY respectfully requests a private letter ruling pursuant to Utah Code Ann. § 59-1-210 and Utah Admin. Code R861-1A-34, as to whether the amounts collected from purchasers for franchise fees become part of the tax base for purposes of calculating and remitting the tax to the State.

BACKGROUND ON FRANCHISE FEES

Franchise fees are imposed on cable operators by local governments, the primary justification being the need to regulate and receive compensation for the use of public rights-of-way. Pursuant to federal law, "franchise fees paid by a cable operator with respect to any cable system shall not exceed 5 percent of such cable operator's gross revenues derived in such period from the operation of the cable system to provide cable services" within the jurisdiction of the local government. 47 U.S.C. § 542(b). Franchise fees are broadly defined to include "any tax, fee, or assessment of any kind imposed by a franchising authority or other governmental entity on a cable operator or cable subscriber, or both, solely because of their status as such." 47 U.S.C. § 542(g)(1). The amount of the franchise fee may be identified as a separate line item on each regular bill and passed on to each subscriber. See 47 U.S.C. §542(c).

PLAIN LANGUAGE OF THE ACT

The Multi-Channel Video or Audio Service Tax Act imposes "a tax on the purchaser equal to 6.25% of amounts paid or charged for multi-channel video or audio service." Utah Code Ann. § 59-26-103. The clear language of the Act only levies the tax on the amount of services actually sold to purchasers. The definition of multi-channel video or audio service does not encompass franchise fees collected from purchasers or other incidental revenue sources. Utah Code Ann. § 59-26-108 states that the Tax Commission may adopt rules to implement and enforce the Act, however, the Tax Commission has not promulgated any rules that would support inclusion of franchise fees in the tax base.[1]

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1 S.B 223, which includes a tax credit beginning in 2008 for franchise fees against the Multi-Channel Video or Audio Service Tax the provider would otherwise be required to collect under the Act, supports the interpretation that the Utah Legislature did not intend for purchasers to pay a tax on franchise fees. The tax credit is equal to 50% of the amount of franchise fees the provider prays against the 6.25% tax the provider is required to collect from purchasers, and the provider must pass the tax credit through to its purchasers. The bill was introduced had a tax credit in an amount equal to the total franchise fees paid, but because of budget constraints, the tax credit was changed to 50% of the amount of franchise fees. This bill addresses a disparity between cable and satellite taxes in Utah. Purchasers of both services pay a 6.25% State excuse tax, and cable service providers (but not satellite providers) pay an additional 5% of their gross revenues as franchise fees.

Definitions in similar taxation statues vary from state to state, and there are no cases directly on point. Courts finding that collected franchise fees become part of the sales tax base have relied heavily on the specific language of the sate statues at issue. *See e.g., Tax appeal of Atchison Cablevision L.P., 936 P.2d 721 (Kan. 1997).* The Act, however, is silent on the treatment of franchise fees, and imposes a tax only on services sold. Furthermore, the Act grants rulemaking authority to the Tax Commission, but the Commission has not adopted rules. The only guidance is therefore the statutory language.

TREATMENT BY THE UTAH LEGISLATURE ON SIMILAR TAXES

Based on our research, the only other analogy we found was the Municipal Energy Sales and Use Tax Act, which provides that a municipality may levy a municipal energy sales and use tax on the sale or use of taxable energy within that municipality of up to 6% of the delivered value of the taxable energy. Utah Code Ann. § 10-1-304. For purposes of calculating this tax on the user of gas and electricity, the "delivered value" means "the fair market value of the taxable energy delivered for sale or use in the municipality" and does not include the State sales and use tax, the local sales and use tax, or the municipal energy sales and use tax. Utah Code Ann. § 10-1-303.[2]

CONCLUSION

In conclusion, we believe the Utah Legislature did not intend that a purchaser of multi-channel video or audio services be required to pay a tax on franchise fees paid to a local government. When the Act was adopted, the Utah Legislature had the ability to specify that should be included in the tax imposed by the Act. Pursuant to the Act, the Tax Commission has the authority to adopt administrative rules to implement and enforce the Act. The only guidance received from the Tax Commission was an informal statement that the Tax Commission was undecided on how to implement the Act, and that franchise fees probably would not be included in the tax base.

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2 The Utah Legislature included a requirement that the municipal energy sales and use tax ordinance provide a credit against the tax in the amount of a franchise fee paid if an energy supplier pays for a franchise fee to municipality pursuant to a franchise agreement in effect on July 1, 1997, the contractual franchise fee is passed through to a taxpayer as a separately itemized charge, and the energy supplier has accepted the franchise. Utah Code Ann. § 10-1-305.

If the Tax Commission finds that franchise fees should be included in the tax base, we believe the Tax Commission should construe the statutory language in favor the taxpayer, clarify the treatment of franchise fees, and apply the tax prospectively by adopting an effective date for purposes of future tax returns. Given the need for clarification in this area, a finding that service providers should have been remitting the tax on franchise fees collected from purchasers with an assessment for past occurrences would be an unreasonably harsh result. Because tax statues are penal in nature and because the consequences of finding that service providers should have been remitting the tax on franchise fees for past occurrences would be an unreasonably harsh result, we urge the Tax Commission under these circumstances to enforce the tax prospectively.

Finally, COMPANY respectfully requests that the Tax Commission treat this request for a private letter ruling as confidential pursuant to Utah Code Ann. Xx21 59-1-210 and Utah Admin Code R861-1A-12. Specifically, COMPANY requests that the information contained herein not be published and that the Tax Commission not identify the requesting party. Prior to any attempt at public disclosure of the information contained in this letter request or the identify of the requesting party, COMPANY requests that the Tax Commission notify COMPANY and provide it with an opportunity to protect its interests in preventing the information from disclosure.

Should you have any questions regarding this request for a private letter ruling, please contact the undersigned counsel. We look forward to your response.

Sincerely,

NAME

cc: Marc B Johnson
2ND NAME
3RD NAME

RESPONSE

April 4, 2008

NAME
ADDRESS

Re: Private Letter Ruling Request 07-006
Treatment of Franchise Fees Relative to the Base for Assessing Multi-Channel Video and Audio Service Taxes

Dear NAME:

You have requested a determination on behalf of your client COMPANY as to whether franchise fees paid to various local governments should be included in the base for which the Multi-channel Video or Audio Service Tax ("MCVAST" or "Tax") isassessed. These franchise fees are imposed on cable operators by local governments for use of public rights of way

pursuant to federal law. In your letter, you take the position that absent any specific administrative rules or other statutory authority, there is no provision to include the franchise fee as part of the base for imposing the tax. You add a request, that should the Commission find the tax includes the franchise fee, the ruling be applied prospectively.

Subsequent to your letter, we spoke directly on this matter and in respect to SB 96. In these conversations you reiterated your position. You also represented that you have discussed this with other cable providers, and that most or all of these firms, including your client, had not been collecting the tax, based on the reasons set forth in your letter.

Based on the analysis that follows, we find that the franchise fee is to be included in the amounts charged by COMPANY, on which the 6.25% is imposed. We find further, however, for reasons cited below, that this portion of the tax is to be collected prospectively from the first full calendar quarter following the date this Ruling is issued.

ANALYSIS

Utah Code § 59-26-103 imposes "… a tax on the purchaser equal to 6.25% of amounts paid or charged for multi-channel video or audio service provided by a multi-channel video or audio service provider: 1) within the state; and (2) to the extent provided by federal law."

Currently, the phrase "amount paid or charged for multi-channel video or audio service" is not defined by either Utah Code or a Tax Commission Ruling. However, similar language to this statute is found in the sales tax statutes defining whether similar charges should be included in the tax base for purposes of assessing sales tax. UCA § 59-12-102(72) defines purchase price to include among other things "… a tax imposed on the seller." In addition, this same section provides that purchase price does not include "… a tax or fee legally imposed directly on the consumer." Id. at (b)(ii)(G) and (c)(ii)(C), respectively.

The amounts included in the base (including taxes imposed on a seller) are representative of the types of business expenses incurred by a seller that are necessary for conducting its business activities. It is assumed that all of these costs are taken into consideration by the seller when calculating the amount to charge a customer for the sale of a product or service.

Additionally, your request letter references Senate Bill 223 from the 2007 General Session of the State Legislature that provides a non-refundable credit for 50% of the franchise fees paid. The amount of this credit must be passed onto its customers. This does not have any applicability as to whether the fees are included in the tax base. In fact, under the new code section allowing this credit:

> A tax under this chapter on amounts paid or charged for multi-channel video or audio services may not be reduced as a result of the amount of a multi-channel video or audio service provider passes through to its customers within this state under this Subsection (4).

UCA § 59-26-104.5.

Sections 59-26-102 and 103 do not specifically define or clarify the tax implications for either multi-channel audio or video service. We also recognize that the MCVAST Act under Chapter 26 is not the same as the Sales and Use Tax Act under Chapter 12. However, we interpret the provisions of § 59-12-102(72)(b)(ii)(G) wherein "**a tax imposed on the seller**" (emphasis added) is included in the purchase/sales price to include the same elements as the amount charged for multi-channel video or audio service under § 59-26-103. Just as the sales tax includes the tax imposed on the seller as part of the purchase price, the MCVAST tax includes the franchise fee imposed on the service provider. (We distinguish this situation from a hypothetical where a sales tax on COMPANY'S customer might be collected and remitted by COMPANY. In that situation, COMPANY would not include the sales tax, which is imposed directly on the customer, as part of the MCVAST base.)

It also follows that the amount charged by the multi-channel video or audio service provider for their respective services, includes various overhead charges, which include similar items as for purchase/sales prices. The franchise fee charged to the multi-channel video or audio service provider should be treated as another overhead charge to incorporate as part of the total charge for the services, and therefore, should be included in the tax base for the multi-channel video or audio service. In other words, the franchise fee, which is imposed on, and remitted by COMPANY, is then passed through to its customer as an expense to be reimbursed (not a tax to be collected). As such, the pass-through is considered part of the "amounts charged."

RULING

Absent specific legislative language to contrary, we conclude that the 6.25% imposed under the Act should be calculated on the base price and franchise fee combined as the total amount charged. We believe this to be an accurate and justifiable interpretation.

However, because the statute could arguably be viewed within the context of the interpretation set forth in your letter, and the fact that COMPANY, as well as other providers, have not been collecting or remitting the tax based on this interpretation, we will make our ruling prospective from the first full calendar quarter following the date this letter is issued.

Our conclusions are based on the facts as you have represented. Should any of the actual facts be different, or should conditions change in the future, our ruling may be changed accordingly. If you or your client have further questions, please do not hesitate to contact us.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/cms