February 2007

State Tax Return

Volume 14 Number 2

Couch Potatoes Commiserate Remotely: Recent Ohio Supreme Court Decision Increases The Cost Of Cable TV Service With Tax

Kasey T. Ingram
Columbus
(614) 281-3922

If you like to watch television, you may be troubled by the Ohio Supreme Court's recent decision in *Time Warner Operations, Inc. v. Wilkins*, 857 N.E.2d 590 (Ohio 2006). More importantly, if you provide non-taxable services in Ohio accompanied by tangible personal property, this opinion may impact your business.

Despite the Court's rejection of the taxpayer's view of the essence of the transaction, taxpayers are cautioned not to conclude that eliminating the separate charge for the tangible component would improve the tax treatment. Bundling taxable elements with nontaxable elements may cause the entire transaction to be subjected to tax, or the taxpayer may have an overwhelming burden to prove the value to be treated as nontaxable. Sometimes it seems you just can't win.

Time Warner Operations, Inc. and Time Warner Entertainment (collectively, "Time Warner") provide cable television service to viewers throughout Ohio. Any customer who desires more than basic cable service must utilize a converter box provided by Time Warner. A fee is charged for the converter box, and the fee is listed separately on the monthly bill. The consumer does not choose to have a converter box; rather, the consumer chooses to have greater viewing options which require a converter box.

Ohio's Tax Commissioner assessed Time Warner for failing to collect sales tax from consumers on the charges for converter boxes. Time Warner appealed to the Ohio Board of Tax Appeals ("BTA"). The BTA reversed the Tax Commissioner and held that the converter box rentals were not within the definition of a taxable retail sale because the boxes were used directly in the rendition of a public utility service. The Tax Commissioner appealed to the Ohio Supreme Court, which reversed the BTA and affirmed the Commissioner's assessment.

The Court concluded that Time Warner should have collected sales tax on the charges for converter boxes. The Court first found that the BTA incorrectly applied the utility exemption available under section 5739.02(B)(42) of the Ohio Revised Code. The Court found that the utility exemption applied only to purchases *by* utility providers, not to sales made by utility providers to others. Thus, the utility exemption did not apply to charges made by Time Warner to its customers for the converter boxes.

After finding that the utility exemption did not apply, the Court then rejected Time Warner's argument that the converter boxes were not taxable because Ohio does not impose sales tax on cable services. The Court noted that there was no dispute regarding the application of sales tax to the provision of cable services. The Court found, however, that Time Warner's rental of the converter boxes was a taxable sale of tangible personal property and not a sale of cable services. As a result, the Court reversed the BTA and held that sales tax applied to Time Warner's charges for converter boxes to its consumers.

Two justices dissented, arguing that the converter box was an "essential component of the cable service" purchased by consumers who chose more than the basic programming package. Because the converter box ultimately benefited Time Warner by allowing it to provide a more expansive service, the converter box should not be subject to sales tax. The dissent's argument, consistent with Time Warner's, is essentially that the transfer of the converter box is an inseparable part of the sale of the cable service and not a separate sale of tangible personal property. The majority opinion focuses, however, on how Time Warner billed the customers rather than on what the customers sought to purchase. This effectively leads to a determination by the majority of two separate sales.

The majority opinion results in a higher cost for premium cable service in Ohio, a result that seems inconsistent with the Ohio General Assembly's decision not to make cable services subject to sales tax. Even more disturbing, the Court seemed to go out of its way to find a taxable transaction. Instead of looking at the purpose or object of the transaction, the Court focused on the individual aspects of the bill.■

This article is reprinted from the *State Tax Return,* a Jones Day monthly newsletter reporting on recent developments in state and local tax. Requests for a subscription to the *State Tax Return* or permission to reproduce this publication, in whole or in part, or comments and suggestions should be sent to Susan Ervien (214/969-3694 or shervien@jonesday.com) in Jones Day's Dallas Office, 2727 N. Harwood, Dallas, Texas 75201.

©Jones Day 2007. All Rights Reserved. No portion of the article may be reproduced or used without express permission. Because of its generality, the information contained herein should not be construed as legal advice on any specific facts and circumstances. The contents are intended for general information purposes only.