**DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: October 14, 2004
Decision: MTHO #149 & 150
Tax Collector: Towns of Gilbert and Paradise Valley
Hearing Dates: June 8 and 9, 2004

## DISCUSSION

### Introduction

On August 22, 2003, ***Taxpayer***, Inc. ("Taxpayer") filed a protest of a denial by the Town of Gilbert of a refund request filed by the Taxpayer. After review, the Town of Gilbert concluded the protest was in proper form but was not timely filed. On August 28, 2003, the Taxpayer filed a protest of a denial by the Town of Paradise Valley of a refund request by the Taxpayer. After review, the Town of Paradise Valley concluded on September 18, 2003, that the protest was in proper form but was not timely filed. On November 7, 2003, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the Taxpayer to respond to the timeliness issue. On November 18, 2003, the Taxpayer filed a response to the timeliness issue raised by the Towns of Gilbert and Paradise Valley (Collectively, hereafter referred to as ("Towns")). On November 24, 2003 the Hearing Officer ordered the Towns to respond to the protests by January 8, 2004.

On December 8, 2003, the Towns requested an extension until January 30, 2004 to file a response to the protests. On December 9, 2003, the Hearing Officer granted the extension until January 30, 2004. On January 29, 2004, the Towns requested another extension until February 4, 2004. On February 2, 2004, the Hearing Officer granted the extension until February 4, 2004. The Towns filed a response to the protests on February 4, 2004. A conference call was held on March 3, 2004 at which time the Towns and the Taxpayer agreed to discuss how to proceed with the "People's Choice" issue. On March 6, 2004, the Hearing Officer scheduled another conference call for March 30, 2004. On March 30, 2004 another conference call was held at which time the Towns and Taxpayer agreed to discuss evidentiary issues and hearing dates. On March 30, 2004, the Hearing Officer scheduled another conference call for April 13, 2004. A conference call was held on April 13, 2004 at which time the parties agreed to file stipulated facts on or before June 1, 2004; have another conference call on June 2, 2004; and, commence the hearing on June 8, 2004. On May 27, 2004, the Hearing Officer issued a letter clarifying the scope of the hearing. A conference call was held on June 2, 2004 at which time the parties agreed to file stipulated facts and witness lists on or before June 4, 2004; commence the hearing on June 8, 2004; and, have oral arguments on the "People's Choice" issue on June 9, 2004. Both parties appeared and presented evidence at the June 8, 2004 hearing and provided oral arguments on the "People's Choice" issue on June 9, 2004. On June 10, 2004 the Hearing Officer indicated the parties would file simultaneous closing briefs on July 30, 2004 and simultaneous reply briefs on August 27, 2004. On July 29, 2004, the Towns requested an unopposed extension for initial briefs until August 6, 2004. On July 30, 2004, the Hearing Officer granted the extension. Both

parties filed simultaneous closing briefs and reply briefs on August 6, 2004 and August 27, 2004, respectively.

As part of the parties' joint prehearing statement, the parties submitted the following uncontested material facts and uncontested legal issues:

## A. Uncontested Material Facts

The parties agree that the following are material and uncontested facts:

1. The Cities and Towns have imposed a local privilege license tax on cable services for over twenty years.
2. Since its inception in 1987, the Model City Tax Code ("MCTC") has provided for taxation of telecommunications services, defined to include cable services.
3. The State of Arizona has never imposed a state privilege license tax on cable services.
4. ***Taxpayer***, Inc. ("***Taxpayer***") provides cable television service to subscribers who pay fees to receive cable programming.
5. Pursuant to license agreements with the Town of Paradise Valley and the Town of Gilbert (collectively "the Towns") and federal law, ***Taxpayer*** transmits its programming and advertising to its customers via a cable system that occupies paths traversing various rights of way on, over and under various roads and thoroughfares maintained by the Towns.
6. The ***Taxpayer*** cable system in the Phoenix area has a transmission capacity of 750 MHz.
7. Today, in the Phoenix metropolitan area, ***Taxpayer*** provides a total of 24 channels in its "limited basic tier."

8. ***Taxpayer***'s "expanded basic" level of service, which is offered throughout the Phoenix metropolitan area, includes an additional 52 channels.
9. ***Taxpayer*** also offers digital cable service throughout the Phoenix metropolitan area.
10. Cable television employs coaxial cable and fiber optic cable as the primary transmission technology.
11. ***Taxpayer*** is required to carry many local television stations as part of the Federal Communications commission ("FCC") "must-carry" rules.
12. ***Taxpayer*** is subject to the Cable Communications Policy Act of 1984.
13. On January 17, 2003, ***Taxpayer*** filed refund claims in numerous cities and towns including the municipalities and towns in this matter.
14. Gilbert formerly responded to ***Taxpayer***'s refund request on July 9, 2003, and Paradise Valley formally responded on July 15, 2003.

**B. Uncontested Legal Issues**

1. The federal Cable Act does not prohibit cities and towns from imposing a local privilege tax on cable services.
2. The Gilbert Municipal Code and the Paradise Valley Municipal Code tax codes provide for taxation of telecommunications services, defined to include cable services.

**<u>Towns Position</u>**

The Towns indicated that the Taxpayer provided both interstate and intrastate telecommunications services to its customers in the Towns. Further, the Towns asserted the Taxpayer did not segregate, separately bill or separately report income derived from its interstate and intrastate telecommunications services. In fact, the Taxpayer "bundled" its services and charges, and reported and remitted the transaction privilege tax based upon the gross income received from customers within the Towns. According to the Towns, the Model City Tax Code

("MCTC") expressly authorizes and imposes a transaction privilege tax upon income derived from the provision of telecommunications services, including cable television services, within a city or town. The Towns also note that ARS Section 42-6004 (A) (2) precludes imposition by the Towns or other municipalities of a transaction privilege tax on "interstate telecommunications services." The Towns asserted that the MCTC neither expressly nor implicitly exempts nor excludes cable television services from the municipal transaction privilege tax base for "telecommunications services." The Towns indicated that MCTC Section 470 (a) ("Section 470 (a)") imposes a transaction privilege tax on "any person engaging or continuing in the business of providing telecommunication services to consumers within the City." Further, MTHO Section 400 (c) ("Section 400 (c)") provides that "it shall be presumed that all gross income is subject to the tax until the contrary is established by the taxpayer."

The Towns argued that when a taxpayer engages in both taxable and non-taxable activities, it is incumbent upon the taxpayer to segregate and separately invoice and report its taxable and non-taxable revenues. In this case, the Taxpayer did not identify its income from intrastate telecommunications services on its customer invoices and did not report its income to the Towns in a manner which would allow imposition of the municipal transaction privilege tax only on income derived from the intrastate component of its operations. Accordingly, the Towns argued that the Taxpayer's gross income from telecommunications services is subject to the transaction privilege tax.

In response to the Taxpayer's argument that the MCTC does not distinguish between the two categories, the Towns assert that the Taxpayer is the one that invoked the distinction between "interstate" and "intrastate" components because of the mistaken notion that all of its revenues will be exempt if the majority of its revenues can be classified as derived from "interstate" activities. Further, the Towns noted that the state legislature has recognized there is a category of intrastate telecommunication services by cable television systems. ARS Section 42-506 (A) provides that or state transaction privilege tax purposes, "intrastate telecommunication services by a cable television system" are not to be included within the "telecommunications" tax classification. According to the Towns, there is no such exemption at the municipal level. The Towns also argued that the Taxpayer's attempt to draw distinction between a tax "exemption" and a "prohibition" on taxation is simply a false dichotomy. The Towns asserted that ARS Section 42-6004 is instructively entitled: "Exemption from municipal tax."

In response to the Taxpayer, the Towns argued that there is no reason for the Towns to make a distinction between interstate and intrastate activities for purposes of the imposition of the municipal licensing fee measured by the taxpayer's gross revenues. The Towns further argued that even if the Taxpayer cannot segregate its activities and revenues with mathematical precision, it does not follow that this exempts the Taxpayers from the presumption of taxability of all revenues.

The Towns argued that the case-determinative issue in this proceeding was neither presented nor addressed by the Court in People's Choice. The Towns asserted that the law is crystal clear that a court decision does not constitute controlling precedent with respect to issues not presented to the court or which were not ultimately addressed in the court's opinion. Further, the Towns indicated that those matters which the court's language may have touched casually,

inadvertently, or unnecessarily addressed is dicta with no precedential value. Finally, the Towns argued that the holding in People's Choice has no relevance in this case because of the factual distinctions.

The Towns argued that the Taxpayer's reliance on People's Choice TV Corp., Inc. v. City of Tucson, 202 Ariz. 401, 46 P.3d 412 (2002) is mistaken. According to the Towns, neither the narrow issue presented in People's Choice nor the particular business under examination is involved in this case. The Towns asserted that the pivotal issue in this case – the requirement of segregation and separate reporting – was neither raised nor addressed in the People's Choice decision. In addition, the Towns noted the statutory/code presumption of taxability appears nowhere in the decision. According to the Towns, the only issue presented in People's Choice was whether a microwave system which utilized some in-state equipment could properly be classified as intrastate in nature so that all of its revenues were subject to the transaction privilege tax by the City of Tucson. In that case, the microwave system essentially relayed uninterrupted, unedited out-of-state sourced signals to in-state consumers (with little local infrastructure, no local franchise, and minimal regulation) is "primarily" engaged in interstate telecommunications activities and, if it must be labeled one or the other, logically should be labeled "interstate." The City asserted that if the City of Tucson raised the allocation and separation reporting, both the question presented for decision and the result might have been different.

The Towns argued the Taxpayer's interpretation of the People's Choice decision is simply wrong. According to the Towns, the court in People's Choice was only asked to classify the microwave transmission services in that case as "interstate" or "intrastate." The propriety and/or necessity of segregation and separate reporting of both on interstate and intrastate component were found to be present was not at issue and was not decided. The Towns believed that if that issue was presented, the court would have declared the interstate component of People's Choice's review to be non-taxable and the intrastate component to be taxable. According to the Towns, it was not until 2002 that the Taxpayer first suggested that any part of its revenues were non-taxable, thus giving rise for the first time of the issue of segregation of revenue and elevating the significance of the Taxpayer's failure to segregate and separately report. Further, the Towns argued that the consequence of the lack of such records is that the Taxpayer cannot qualify for the benefit flowing from a proper segregation of revenues into taxable and non-taxable components.

The Towns acknowledged that the People's Choice decision suggests that A.R.S. Section 42-5064 (A) "specifically exempts cable and microwave television systems from intrastate taxation …" Id. At 404, 46 P.3d at 415. However, the Towns asserted this was not an element of the holding of "People's Choice", and it is demonstrably incorrect. First, ARS Section 42-5064 (A) does not specifically or expressly exempt cable or even microwave television systems from intrastate taxation. Further, there was no "cable system" involved in the People's Choice case, and the court had no reason (or basis) to speculate as the application of the interstate telecommunications services exemption statute to a different circumstance, involving a different technology, and a different type of telecommunications service system. The Towns argued that Taxpayer's cable television system is so distinct from the microwave system at issue in People's Choice that the People's Choice decision would be of little assistance in determining the

propriety of a claimed exemption for the intrastate component of the Taxpayer's revenues, even if the Taxpayer had properly segregated those revenues.

According to the Towns, some of the most important factual distinctions between the Taxpayers cable television system and the microwave system operated by People's Choice are as follows:

1. The Taxpayer offers local programming including locally produced commercials that are delivered to consumers through a massive cable network, and through plant, property and equipment located in Arizona;

2. Unlike the microwave system operated in People's Choice, the Taxpayer delivers its transmissions through cables physically occupying the streets and right-of-way of the Towns;

3. Unlike the microwave system operated in People's Choice, the Taxpayer's technology allows for both interruption of programming and insertion of advertising and emergency alerts;

4. Unlike the microwave system operated in People's Choice, the Taxpayer modifies the programming signals it receives prior to transmissions into subscribers' homes by inserting advertising and other locally-generated materials;

5. People's Choice premised its case on the fact that it neither produced nor inserted in the transmissions to its customers, any locally produced programming;

6. While both microwave and cable technologies are used to deliver video programming to subscribers, they do so in very different ways;

7. The Taxpayer could not provide its services without intensive local activities carried out by thousands of local employees and contractors. The Taxpayer has lines in every residential street within the Towns;

8. Unlike microwave providers, the Taxpayer is large and requires a local cable license; and,

9. Unlike the small staff of microwave provided, the Taxpayer had 2,200 local employees.

The Towns asserted that the People's Choice decision is in no sense determinative of this case as it simply did not address the key factual and legal issues involved in this proceeding. The Towns argued that since the Taxpayer failed to segregate and separately invoice the intrastate and interstate revenues, all of the income is subject to the tax. Based on all the above, the Towns requested the Taxpayer's request for a refund be denied.

According to the Towns, the Taxpayer has requested a refund of transaction privilege taxes paid to the Towns for the periods extending from June 1, 1998 to September 30, 1998, and from December, 1998 through November, 2002. The Towns asserted the refund claims for 1994-1998

are time barred as they were filed after the four year limitation period had expired. The Towns argued that the statutory limitation period is four years from when a return was "required to be filed" or four years from when the "return is filed," whichever is later. According to the Towns, the Taxpayer's returns were "required to be filed" each month during the tax period from 1994 through 1998, and no returns were filed subsequently.

The Towns argued that the Taxpayer's refund claim for the tax period January 1, 1994 to September 30, 1998 is barred by the Statute of Limitations. The Towns indicated that ARS Section 42-1106 (c) makes it clear that if a refund claim is not timely filed, that "failure … is a bar against the recovery of taxes by the taxpayer." That section provides that the deadline to file a refund claim coincides with the four-year period within which the Arizona Department of Revenue ("DOR") may make an assessment under ARS Section 42-1104. As a result, the deadline for the Taxpayer to file a refund claim was the later of when the tax return or report was due in the first instance, or when a report or return was in fact filed. According to the Towns, the Taxpayer filed returns on a timely basis for each of the months for the entire period. The Towns acknowledged that the Taxpayer did not report income in the municipal telecommunications category, however, the Towns asserted it does not follow that therefore the Taxpayer did not file returns at all. The Towns disagree with the Taxpayer's argument that its January, 2001 payment of the audit assessment "should be considered" a return. The Towns also disputed the Taxpayer's alternative argument that if the payment was not a return then the Taxpayer never filed a return "under the telecommunications classification" and, therefore there is no limitation period for its refund claims. The Towns again asserted that the Taxpayer did file returns for the 1994 – 1998 period. As a result of the above, the Towns argued the Taxpayer's refund claim for 1994-1998 is barred.

The Towns asserted the Taxpayer's claim for attorney fees and costs is meritless and beyond the scope of this proceeding. First, the Towns argued the Taxpayer should not prevail on its refund requests and therefore has no basis to assert a claim for recovery of fees or costs. Even if the Taxpayer were the prevailing party, the Towns argued no award of fees or costs would be appropriate because the Towns' position is more than substantially "justified". The Towns' position was based on long-standing tax law principles while the Taxpayer's position is based on <u>dicta</u> in the <u>People's Choice</u> case. The Towns also argued that they had the right to preserve their position for further proceedings before the Tax Court and, ultimately, the Supreme Court, if clarification/limitation of the <u>People's Choice</u> decision is necessary. Lastly, the Towns asserted it is neither necessary nor appropriate for the Hearing Officer to address the claim for fees and costs as MCTC Section 578 (c) provides that any taxpayer claim for fees and costs shall be presented to and determined by the Taxpayer Problem Resolution Officer after the conclusion of any administrative hearing.

**<u>Taxpayer Position</u>**

According to the Taxpayer, <u>People's Choice</u> instructs that no city or town may tax the revenues of a telecommunications business whose programming is primarily interstate in origin. The Taxpayer asserted the record is clear that the Taxpayer is such a business and that the Towns should have granted the Taxpayer's refund request. The Taxpayer argued that the Court in <u>People's Choice</u> concluded that ARS Section 6004 (A) (2) prohibits cities and towns from

imposing a tax on a "business" or "system" that offers programming that originates primarily from outside of Arizona. According to the Taxpayer, People's Choice offered both local and interstate programming in every package offered to subscribers. However, the court, without conducting a package-by-package or channel-by-channel analysis ruled that because the business or "system" as a whole offered programming that was primarily interstate in origin, no city or town could tax it. The Taxpayer asserted the Court construed ARS Section 42-6004 (A) (2) as a prohibition, not an exemption, thus demanding a liberal construction in favor of the taxpayer.

The Taxpayer argued that the taxability turns on the programming content's origin is confirmed by the earlier Cable Plus Co., L.P. v. Ariz. Dept of Revenue, 197 Ariz 507, 4 P.3d 1050, (Ct. App. 2000) which was cited with approval in Peoples' Choice. According to the Taxpayer, the Court specifically rejected the State's argument that Cable Plus somehow converted satellite-delivered programming into an intrastate telecommunications activity by processing locally the satellite signals and re-transmitting the signals to its customers through local equipment and wires. The Taxpayer asserts the hearing testimony demonstrated the majority of Taxpayer's programming content originates outside of Arizona. The testimony supported that 90 percent of Taxpayer's subscribers receive at least expanded basic service, which includes limited basic service (a total of 76 channels). Of these 76 channels, 52 channels contain 97 percent interstate content and the other 24 channels contain in excess of 60 percent content that is overwhelmingly interstate in origin. Further, the Taxpayer indicated the digital tiers programming for the digital tiers is overwhelmingly interstate in origin. Accordingly, the Taxpayer concluded the undisputed evidence shows that the content of the entire "system" is, in fact, overwhelmingly interstate in origin.

While the Towns offered distinctions between People's Choice microwave system and the Taxpayer's system, the Taxpayer argued the distinctions don't appear in People's Choice. The Taxpayer asserted a system's programming content does not shift to intrastate as it lays more miles of fiber; when it installs more extensive, expensive equipment; when it hires more employees; or as it serves more communities.

In response to the Town's argument regarding records to decipher what portion of the business was intrastate, the Taxpayer asserted it had no obligation to keep books and records of separate intrastate business. The Taxpayer listed six reasons the intrastate business classification did not exist: People's Choice applied a "primarily" interstate test to prohibit tax on the revenues of the taxpayer's entire "business" or "system". The only taxable business category created by the MCTC, and the only category upon which the Taxpayer paid tax in the first instance, is the business of "providing telecommunications services" to consumers within the Towns under MCTC Section 470. The Towns have never adopted a tax on a separate business category of "providing intrastate telecommunications services;" none of the reports for he cable licenses require the Taxpayer to make to the Towns contemplates a separate business of intrastate services; the records demanded by the Towns are not only unnecessary to process the Taxpayer's claims, they are impossible to create; the Towns attempt to change the tax codes after the fact to require records for interstate and intrastate revenues violates the Taxpayer's constitutional right to due process of law; and , the Towns' suggestion at the hearing that the Taxpayer must re-design its program offerings to segregate into a separate tier those channels that are exclusively intrastate in character raises serious freedom of speech concerns.

The Taxpayer asserts the Towns "case-dispositive" issue is simply wrong. The Taxpayer argued The Supreme Court's clear and plain "majority origin" test conflicts squarely with a segregation requirement, so the test cannot be dismissed as mere dicta. Even if the Supreme Court's "majority origin" test could be discarded as dicta, the Taxpayer argued the Towns could not deny a refund for alleged failure to "segregate" where the Towns' own tax codes adopted neither an intrastate telecommunications classification nor a deduction or exemption for interstate telecommunications. According to the Taxpayer, the Towns imposed a tax on all cable "telecommunications", regardless of origin, just as Tucson did in People's Choice. The Taxpayer asserted that borderless tax violates state law by purporting to tax interstate telecommunications revenue. The Taxpayer argued that the "majority origin" test is not dicta but is the holding in People's Choice. Further, the Court's reasoning turned not on any unique attributes of microwave television services, but on the common, predominantly interstate origin of both cable and microwave programming content. The Taxpayer also noted that the same Towns that now claim that the opinion does not apply to cable television informed the Court, through their amicus brief, that its ruling would affect cable television directly.

The Taxpayer opined that the People's Choice "majority origin" test allows no tax on the remaining minority pieces of the "business" or "system". The Taxpayer argued that even if the Towns were correct that after People's Choice some hypothetical minority intrastate "component" of the Taxpayer's programming could be taxed, the Towns are wrong because they have never imposed such a tax or defined how a business should measure the intrastate portion of its revenues. According to the Taxpayer, the principle that controls in this refund proceeding is as follows: (a) Except as provided in Section_-565, the period with in which a claim for credit may be filed, or refund allowed or made if no claim is filed, shall be as provided in A.R.S. Sections 42-1106 and 42-1118.

In construing tax statues, it is the rule that the act must be certain, clear and unambiguous as to the subject of taxation, and doubtful tax statutes are given a strict construction against the taxing power.

Here, MCTC Section 470 (a) imposed a tax on the "gross income from the business activity upon every person engaging on continuing in the business of providing telecommunication services to consumers within this City." The Taxpayer asserted that the tax code did not differentiate between programming that originates within or outside of Arizona. As a result, the Taxpayer concluded their billing and record keeping complied perfectly with the requirements of MCTC Section 470. Further, the Taxpayer agreed that the record established conclusively that all of the Taxpayer's subscriber revenues fall under MCTC Section 470 and that imposing the tax on the Taxpayer violates state law b3ecdause the majority of the Taxpayer's programming content originates out of state. According to the Taxpayer, it is clear from the court's decision in People's Choice that People's Choice had both local and out-of-state programming:

> The facts giving rise to this appeal are undisputed. From 1992 to 1996, PCTV provided microwave television services to its customers in Tucson and the surrounding area. To do so, PCTV received *both local and out-of-state programs* at its facility outside Tucson and then transmitted the programs to its customers

> using microwave frequencies. The customers, in turn, received these transmissions through microwave antennae provided and installed by PCTC for a fee. PCTV offered its customers various programming packages at different monthly fees, and *all packages contained both local and out-of-state programs.* PCTV also charged an additional fee for each pay-per-view program its customers ordered.

The Taxpayer filed refund claims for transaction privilege taxes and interest that it paid on January 29, 2001 under an audit assessment issued on December 15, 2000 by the Department of Revenue ("DOR") for the period January 1, 1994 through September 30, 1998. The Taxpayer argued that the Towns incorrectly asserted that these refund claims are stale. MCTC Section 560 (a) provides as follows:

> (a) Except as provided in Section _-565, the period within which a claim for credit may be filed, or refund allowed or made if no claim is filed, shall be as provided in A.R.S Section 42-1106 and 42-1118.

ARS Section 42-1106 incorporates by reference the statue of limitations period within which DOR may make an assessment, as specified in ARS Section 42-1104 ("Section 1104"). Section 1104 required the Taxpayer to file its refund claim "within four years after the report on return is required to be filed or within four years after the report or return is filed, whichever period expires later." The taxpayer asserted that its refund claims at issue relate to taxes that were never owed (per People's Choice) and that the Taxpayer only paid to comply with the Towns' erroneous December 15, 2000 audit assessment. As a result, the Taxpayer argued that the payment made on January 29, 2001 should be considered the Taxpayer's return. Accordingly, the Taxpayer concluded the January 17, 2003 refund claim was timely filed within the four-year limitations period. The Taxpayer indicated they only seek a refund of back taxes paid as the result of an audit, and shortly before the court held those taxes unlawful. The Taxpayer argued that it would be a harsh and inequitable result to allow the Towns to keep what they wrongfully took.

The Taxpayer asserted that if the January 29, 2001 payment did not constitute a "return", then no return has yet been filed for the Town of Gilbert for the majority of the audit period at issue. According to the Taxpayer, they did not begin filing transaction privilege tax returns under the telecommunication classification for the Town of Gilbert until May 1998 and each of the returns filed between May 1998 and September 1998 underreported the tax allegedly due by more than 25 percent. As a result, the Taxpayer concluded the Statute of Limitations has not begun to run for the periods in which no returns were filed and the six-year statute of limitations applies to those returns filed between May 1998 and September 1998.

ARS Section 42-2064 and MCTC Section 578 authorize reimbursement for reasonable fees and other costs if the taxpayer is the prevailing party in an administrative proceeding. MCTC Section 578 provides the taxpayer is considered a prevailing party if both of the following are true:

> (1) the Tax Collector's position was not substantially justified; and

(2) the Taxpayer prevails as to the most significant issue or set of issues.

The Taxpayer requested the Hearing Officer issue the following findings relating to the Taxpayer's application for fees and costs:

1. The Towns' position was not substantially justified;
2. ***Taxpayer*** prevailed as to the most significant issue or set of issues;
3. During the course of the proceeding ***Taxpayer*** did not unduly and unreasonably protract the final resolution of the matter; and
4. ***Taxpayer*** did not prevail due to an intervening change in the applicable law between the filing of the refund claim and the issuance of the Hearing Officer's ruling.

The Taxpayer asserted its refund claims for payments made in January 2001 are timely. The Taxpayer indicated a request for a refund of back taxes paid was as the result of an audit and shortly before the court held those taxes unlawful. The Taxpayer argued that it would be illogical and inequitable not to treat the Taxpayer's January 29, 2001 payment as a "return" under and within the meaning of ARS Section 42-1104 (A). Based on all the above, the Taxpayer requested the Hearing Officer to order the Towns to grant the refunds requested and to issue finding supporting the Taxpayer's request for fees and costs.

## ANALYSIS

People's Choice

In reviewing the People's Choice decision, we find the Court determined that People's Choice offered customers programming packages that contained both local and out-of-state programs. It is also clear that the Court determined that ARS Section 42-6004 (A) (2) prohibited cities and towns from taxing interstate telecommunications services. We find it is clear that the Court concluded that the interstate and intrastate revenues of People's Choice were prohibited pursuant to ARS Section 42-6004 (A) (2) from transaction privilege tax because People's Choice primarily provided interstate programming. We also find that the Court didn't limit its holding to microwave television systems and that it's holding applied to cable television systems. While the Court didn't define what it meant by "primarily", we find the evidence in this case, supports a conclusion that the Taxpayer "primarily" provided interstate programming. Based on the evidence, we conclude that approximately 90 percent of the programming content originates outside of Arizona. We reached this conclusion by taking a weighted average of the percentages (97 percent and 60 percent) for the 52 channels of the limited basic service and for the 24 other channels of the limited basic service. This results in a weighted average of approximately 86 percent which we rounded up to 90 percent to reflect the remaining digital channels are overwhelmingly interstate in origin. While we recognize the difficulty of arriving at a precise number for interstate/intrastate programming, it is clear to the Hearing Officer that the Taxpayer "primarily" provided interstate programming. Based on all the above, we conclude that pursuant to People's Choice the Taxpayer's revenues from its cable television system were not taxable during the refund periods. Does that mean the Towns are forever foreclosed from taxing intrastate revenues from the Taxpayer's cable television system? We think not. However, in order to do so, we believe the Towns need to clarify that MCTC Section 470 (a) only applies to

intrastate telecommunication services and to provide some reasonable guidelines on how to measure the percentage of intrastate revenues.

Statute of Limitations

There was no dispute that the refund request for the period from December 1998 through November 2002 was timely filed. The dispute was for the period June 1, 1994 through September 30, 1998. The parties both argued that the statutory limitation period was four years from when a return "required to be filed" or four years from when the "return was filed," whichever is later. The Taxpayer indicated that no transaction privilege tax returns for the Town of Gilbert was filed until May of 1998 and that the Taxpayer would have underreported tax allegedly due by more than 25 percent. For that reason, the Taxpayer argued the statute of limitations has not begun to run for the periods in which no tax returns were filed and a six year statute of limitations applies for the period in which returns were underreported by 25 percent. The Taxpayer's primary argument was that the payment made on January 29, 2001 for the Towns' December 15, 2000 audit assessment should be considered the "return". The Towns' argument was that the limitation period runs from when the Taxpayer's tax returns were initially due.

After review of the various arguments, we conclude that there was a six year statute of limitations for the period in which the Taxpayer filed returns that were underreported in excess of 25 percent. For those periods in which no returns were filed, we find the Taxpayer's January 29, 2001 payment would be the appropriate "return" filing date with a four year statute of limitations. As a result, the Taxpayer's January 17, 2003 refund claim is timely and the Taxpayer is entitled to a refund of excess taxes paid. However, there were no excess taxes paid for the audit period of January 1, 1994, until September 30, 1998. The audit assessment was made on December 15, 2000 and the Taxpayer had an opportunity to file an appeal of that audit assessment. The Taxpayer's failure to file an appeal made that audit assessment final and as a result there can be no excess taxes paid subject to refund. While the Taxpayer has argued that it would be harsh and inequitable to not refund these monies, we find it would be inequitable to competitors such as People's Choice that spent the time and money to appeal their assessment while the Taxpayer did nothing. As a result, we conclude the Taxpayer filed a timely refund request under the statute of limitations but there were no excess taxes paid for the audit period January 1, 1994 until September 30, 1998.

Reimbursement of Fees and Costs

We concur with the Towns and the Taxpayer that MCTC 578 (c), and ARS Section 42-2064 provide that any taxpayer claim for fees and costs shall be presented to and determined by the Taxpayer Problem Resolution Officer. While we are in agreement that the Hearing Officer does not make the determination on a claim for fees and costs, we do find it appropriate for the Hearing Officer to provide guidance that may be helpful to the Taxpayer Problem Resolution Officer's determination. Hopefully, it will also reduce the review time needed by the Taxpayer Problem Resolution Officer. Accordingly, based on the review of the record in this case, the Hearing Officer concludes as follows: the Taxpayer prevailed as to the most significant issue or set of issues; and while the Towns presented reasonable arguments, we find the arguments were

made because of the Towns desire to modify the People's Choice decision. With that said, we must conclude that the Town's position was not reasonable in light of People's Choice.

## FINDINGS OF FACT

1. On August 22, 2003, the Taxpayer filed a protest of a denial by the Town of Gilbert of a refund request filed by the Taxpayer.

2. On August 28, 2003, the Taxpayer filed a protest of a denial by the Town of Paradise Valley of a refund request filed by the Taxpayer.

3. After review, the Town of Gilbert concluded the protest was in proper form but was not timely filed.

4. After review, the Town of Paradise Valley concluded the protest was in proper form but was not timely filed.

5. On November 7, 2003, the Hearing Officer ordered the Taxpayer to respond to the timeliness issue.

6. On November 18, 2003, the Taxpayer responded to the timeliness issue raised by the Towns.

7. On November 24, 2003, the Hearing Officer ordered the Towns to respond to the protests on or before January 8, 2004.

8. On December 8, 2003, the Towns requested an extension until January 30, 2004 to file a response to the protests.

9. On December 9, 2003, the Hearing Officer granted the extension until January 30, 2004.

10. On January 29, 2004, the Towns requested another extension until February 4, 2004.

11. On February 2, 2004, the Hearing Officer granted the extension until February 4, 2004.

12. The Towns filed a response to the protests on February 4, 2004.

13. A conference call was held on March 3, 2004 at which time the Towns and the Taxpayer agreed to discuss how to proceed with the "People's Choice" issue.

14. On March 6, 2004, the Hearing Officer scheduled another conference call for March 30, 2004.

15. On March 30, 2004, another conference call was held at which time the Towns and Taxpayer agreed to discuss evidentiary issues and hearing dates.

16. On March 30, 2004, the Hearing Officer scheduled another conference call for April 13, 2004, ownerships.

17. A conference call was held on April 13, 2004 at which time the parties agreed to file stipulated facts on or before June 1, 2004; have another conference call on June 2, 2004; and, commence the hearing on June 8, 2004.

18. On May 27, 2004, the Hearing Officer issued a letter clarifying the scope of the hearing.

19. A conference call was held on June 2, 2004 at which time the parties agreed to file stipulated facts and witness lists on or before June 4, 2004; commence the hearing on June 8, 2004; and, have oral arguments on the "People's Choice" issue on June 9, 2004.

20. Both parties appeared and presented evidence at the June 8, 2004 hearing and provided oral arguments on the "People's Choice" issue on June 9, 2004.

21. On June 10, 2004, the Hearing Officer indicated the parties would file simultaneous closing briefs on July 30, 2004 and simultaneous reply briefs on August 27, 2004.

22. On July 29, 2004, the Towns requested an unopposed extension for initial briefs until August 6, 2004.

23. On July 30, 2004 the Hearing Officer granted the extension.

24. Both parties filed simultaneous closing briefs and reply briefs on August 6, 2004 and August 30, 2004, respectively.

25. The parties filed a joint prehearing statement which contained uncontested material facts and uncontested legal issues.

26. The Taxpayer has requested a refund of transaction privilege taxes paid to the Towns for the periods extending from June 1, 1994 to September 30, 1998 and from December 1998 through November 2002.

27. The Taxpayer provided both interstate and intrastate telecommunications services to its customers in the Towns during the refund periods.

28. The Taxpayer did not segregate, separately bill or separately report income derived from its interstate and intrastate telecommunications services.

29. The Taxpayer "bundled" its services and charges, and reported and remitted the transaction privilege tax based upon the gross income received from customers within the Towns.

30. Ninety percent of Taxpayer's subscribers receive expanded basic cable service, which includes limited basic service (a total of 76 channels).

31. Of the 76 channels, 52 channels contain 97 percent interstate content and the other 24 channels contain in excess of 60 percent interstate content that is overwhelmingly interstate in origin.

32. The digital tiers programming is overwhelmingly interstate in origin.

33. On January 29, 2001, the Taxpayer paid an audit assessment issued on December 15, 2000 by the DOR for the period January 1, 1994 through September 30, 1998.

34. The December 15, 2000 DOR audit assessment included assessments for the Towns.

35. The Taxpayer did not appeal the December 15, 2000 DOR audit assessment.

## CONCLUSIONS OF LAW

1. Pursuant to ARS Section 42-6056, the Municipal Tax Hearing Officer is to hear all reviews of petitions for hearing or redetermination under the Model City Tax Code.

2. The Taxpayer "primarily" provided interstate programming.

3. People's Choice applies to both microwave television systems and cable television systems.

4. Pursuant to People's Choice, the Taxpayer's revenues from its cable television system were not taxable during the refund periods.

5. The Taxpayer's refund request for the period December 1998 through November 2002 was timely filed.

6. The statutory limitation period for filing for a refund for the period June 1, 1999 through September 30, 1998 was either six years from the date a tax return was filed or four years from January 29, 2001.

7. The Taxpayer's refund request for the period June 1, 1994 through September 30, 1998 was timely filed.

8. The Taxpayer failed to file a timely appeal of the December 15, 2000 DOR audit assessment.

9. The Taxpayer's failure to file a timely appeal made the December 15, 2000 audit assessment final and is a result there can be no excess taxes paid subject to refund.

10. The Taxpayer's request for a refund from the Towns for the period December 1998 through November 2002 should be granted.

11. The Taxpayer's request for a refund from the Towns for the period June 1, 1994, through September 30, 1998, should be denied.

## **ORDER**

It is therefore ordered that the August 22, 2003, and August 28, 2003, protests filed by ***Taxpayer***, Inc. of a denial of refund requests by the Towns of Gilbert and Paradise Valley, respectively, is granted in part and denied in part consistent with the Discussion, Findings of Fact, and Conclusion of Law contained herein.

It is further ordered that the Towns of Gilbert and Paradise Valley shall grant the refund requests filed by ***Taxpayer***, Inc. for the period December 1998 through November 2002.

It is furthered ordered that the Towns of Gilbert and Paradise Valley shall not grant the refund requests by ***Taxpayer***, Inc. for the period June 1, 1994, through September 30, 1998.

It is further ordered that this Decision shall be effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer