STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PAY TV OF GREATER NEW YORK, INC.	:	DETERMINATION DTA NO. 805298
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1982 through May 31, 1985.	:	

Petitioner, Pay TV of Greater New York, Inc., c/o Brian Cooper, President, 123 East 91st Street, New York, New York 10028, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1982 through May 31, 1985.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on June 19, 1992 at 11:45 A.M., with all briefs to be submitted by December 4, 1992. Petitioner filed its briefs on August 6, 1992 and December 4, 1992. The Division of Taxation filed its brief on September 24, 1992. Petitioner appeared by Greenberger & Forman (Robert W. Forman, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether the expenses incurred by petitioner for repairs performed by Cooper Cable Company, Inc. are exempt from sales and use taxes as a repair and maintenance service rendered without charge to a customer.

II. Whether the Division of Taxation properly assessed sales and use taxes on the total amount paid for administrative and repair services where petitioner failed to present invoices which separated taxable and nontaxable items.

III. Whether penalties and interest in excess of the minimum, which were imposed against

petitioner, should be waived.

FINDINGS OF FACT

During the period in issue, petitioner, Pay TV of Greater New York, Inc. ("Pay TV"), was in the business of selling TV signals which were transmitted by microwave to subscribers who wished to have the service. In practice, signals were received by an antenna which was located at the top of an apartment building and then transmitted by cable to a decoder box in a subscriber's apartment.

In a letter dated June 12, 1985 the Division of Taxation ("Division") advised petitioner that its returns had been scheduled for a field examination. The letter requested that petitioner make available all of its books and records pertaining to its sales tax liability for the period June 1, 1982 through May 31, 1985 including journals, ledgers, sales invoices, purchase invoices, cash register tapes and exemption certificates. The Division also requested copies of petitioner's Federal income tax returns for the years 1982, 1983 and 1984.

In the course of the audit, petitioner cooperated with the auditor and provided the Division with everything requested. The Division reviewed the documents and concluded that petitioner's records were adequate to conduct a field audit.

At the conclusion of the audit, the Division determined that tax was due in the amount of $2,286.00 arising from petitioner's purchases of fixtures and equipment. The amount of tax due on petitioner's purchases of fixtures and equipment was not challenged at the hearing.

The Division ascertained that petitioner made payments to a firm known as Cooper Cable Co., Inc. ("Cooper Cable"). During the first part of the audit period, petitioner paid Cooper Cable $3.00 a month for the first decoder box in a home and a $1.50 a month for each additional decoder box. In April 1983, petitioner began paying Cooper Cable $4.00 for the first decoder box in a subscriber's home and $2.00 for each additional decoder box. There is no evidence that Cooper Cable ever provided an itemized invoice to Pay TV which allocated the monthly charge to the service being rendered.

The auditor examined petitioner's Federal income tax returns and found that the

following items were listed in the cost of goods sold section: programming and transmission costs, service costs and installation costs. Petitioner's accountant advised the auditor that the service costs were incurred in order to repair and service the decoder boxes. The Division accepted this explanation of the nature of the charge and concluded that the expense was subject to sales and use taxes.

The Division observed that if the decoder box was not working properly, petitioner would have it fixed at no cost to the customer. The Division did not consider the expense incurred to repair the boxes as a nontaxable warranty because petitioner's customers did not purchase the equipment. Rather, it was viewed as a payment for the repair of equipment that was owned by Pay TV. Neither Pay TV nor Cooper Cable represented to the auditor that they manufactured the cable boxes.

In order to determine the amount of tax due on the charges by Cooper Cable, the Division multiplied the number of decoder boxes by the rate charged by Cooper Cable to determine the total cost of the service. The auditor was able to determine the number of boxes from an examination of petitioner's general ledger, accounts receivable and sales records. The total cost of the service was then multiplied by the applicable sales and use tax rate to determine the amount of tax asserted to be due.

The Division also concluded that penalties should be imposed because of the absence of reasonable cause.

During the audit, the Division found that customers paid Pay TV for installing cable service and that Pay TV collected sales tax on this charge. Other than the monthly payment to Cooper Cable and the tax due on expense purchases, the auditor felt that petitioner was in substantial compliance with the tax laws.

On the basis of the foregoing audit, the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated August 20, 1985, which assessed sales and use taxes for the period June 1, 1982 through May 31, 1985 in the amount of $186,941.68, plus penalty of $35,890.28 and interest of $34,203.60, for a total amount due of $257,035.36.

Prior to the years in issue, petitioner was in the master antenna business. The opportunity to engage in this business arose because, when a building was constructed in petitioner's area, the owner of the building usually installed a master antenna system. The system consisted of a television antenna which was connected to a cable which ran into each apartment. Petitioner charged an annual fee of $2.00 per year per apartment in order to service the master antenna system. This business was lucrative because the master antenna system infrequently, if ever, needed repairs.

In the late 1970's Home Box Office ("HBO") approached petitioner with a service which petitioner could offer to its subscribers. HBO told petitioner that with the new service customers could be charged about $10.00 a month for viewing movies and sports. Further, petitioner could deliver the programming through the master antenna system then in place. Subsequently, petitioner agreed to begin distributing HBO.

In order to distribute its programming, HBO broadcast a microwave signal from the Empire State Building in New York City. The signal was received by a special microwave service antenna that was attached to each regular television antenna which had been placed on the rooftops of buildings. The HBO signal was then transmitted to those subscribers who agreed to accept the HBO service through an unused or open channel in the master antenna system. The customers who agreed to take the HBO service for a monthly fee were provided with a device which allowed them, and not others, in the building to receive the HBO broadcast.

When petitioner began distributing HBO it was not necessary to add additional wiring to the building. Petitioner was required to simply set up a microwave antenna and input the signal into the existing master antenna system.

When petitioner had the master antenna business only, it dealt exclusively with the landlord. It began dealing with the individual subscribers when it started offering HBO.

Initially, petitioner needed to secure the landlord's permission to put HBO into the building. In order to obtain permission, petitioner either paid the landlord a commission or

offered to service the master antenna for free or at a reduced rate. After petitioner had the landlord's permission, it solicited orders from the residents of the building.

Depending on the type of building and which channel was open, petitioner installed a box, known as a trap, which allowed the customers to switch from regular viewing to HBO viewing. The box or trap always remained petitioner's property.

Petitioner did not have a significant increase in maintenance after it began distributing HBO.

Generally, petitioner provided HBO service and master antenna service only to buildings that had more than 100 apartments. Petitioner felt that it was not economical to supply its service to buildings with fewer apartments.

By 1981 or 1982, the HBO business had become a substantial portion of the master antenna business. As a result, petitioner began considering a public stock offering to raise capital to expand the market and promote the service in a broader area in New York. The parties who were working with petitioner on the contemplated public stock offering wanted a way for investors to know that the costs of doing business were going to be stable and that the proceeds of the public offering would be invested in expanding the business rather than spending it on the existing business.

Petitioner felt that it could demonstrate to investors that it could control its costs through the use of a related company known as Cooper Cable Company, Inc. ("Cooper Cable").[1] In exchange for a fixed rate for operating expenses each month, Cooper Cable agreed to provide the company services including general administrative staff, installation staff, and telephone receptionists. Petitioner thought that its contract with Cooper Cable, which was not reduced to writing, made the prospects of a

public offering much better because anyone who invested money would know that petitioner could control its costs.

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[1]The sole shareholders of Cooper Cable were the principal shareholders of Pay TV.

Cooper Cable employed a field staff of from six to twelve people, depending on the volume of work, who were engaged as installers, servicemen and disconnect people. The field staff included one or two technicians who were involved in what was referred to as MATV repair and maintenance. The latter people were able to do the repair work and fine tuning when it was required. Other than labor costs, Cooper Cable incurred costs for parts and materials.

The general ledger of Cooper Cable shows that Cooper Cable incurred a total salary expense of $1,018,258.50 for the period ending March 31, 1985. This amount was divided into four categories - executive, office, shop and sales. The shop category was for the technical staff who performed installation, disconnections and repairs. The total amount attributed to shop was $120,011.77.

Petitioner's contract with its subscribers provided, in part, as follows:

> "No Warranties on Our Equipment. Since we are not selling or leasing Our Equipment to you, we make no warranties, expressed or implied, about Our Equipment nor about the quality of the television reception that can be obtained on your television set. We will, however, repair or replace at no charge to you any of Our EQUIPMENT THAT IN OUR JUDGEMENT FAILS TO OPERATE PROPERLY BECAUSE OF ORDINARY WEAR AND TEAR (that is, a failure because the equipment wore out or broke down by itself). We will not be responsible for the condition or repair of your television set or for the quality of the television signal that can be received at your premises because of location, terrain, buildings, any kind of interference or any other conditions beyond our control."[2]

The $3.00 a month charge that Pay TV remitted to Cooper Cable included the expense for disconnecting sets and mailing bills and other literature for Pay TV. The expense also included the cost of answering and making phone calls to customers.

The U.S. corporation income tax returns of Pay TV and Cooper Cable for the fiscal year ended March 31, 1985 report, among other things, the following deductions:

Deduction	Pay TV	Cooper Cable
postage	$ 5,041.00	$ 71,641.00
telephone	4,746.00	87,861.00

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[2] The paragraph quoted above was from a contract used by an entity which succeeded petitioner. However, testimony at the hearing establishes that the contract between petitioner and its subscribers contained the same wording as the contract quoted above.

insurance	-0-	205,492.00

At the hearing petitioner's witness estimated that based on his experience with Pay TV, repair costs would constitute 15 to 20 cents a month.

CONCLUSIONS OF LAW

A. Initially, it is petitioner's position that the monthly charge paid by petitioner to Cooper Cable is exempt from sales and use tax pursuant to 20 NYCRR 527.5(d)(1) and 527.5(d)(4) as a warranty. Petitioner also relies upon Matter of Castomatic, Division of Arwood Corp. (State Tax Commission, February 11, 1983) and 20 NYCRR 541.1(g) to support its position.

In response, the Division submits that since petitioner is neither the manufacturer nor vendor of the decoder box, 20 NYCRR 527.5(d)(1) is inapplicable. The Division also argues that 20 NYCRR 541.1(g) does not apply since petitioner is not a contractor.

B. During the period in issue, Tax Law § 1105(c)(3) imposed a tax on the service of maintaining, servicing, or repairing tangible personal property, unless the property was held for sale in the regular course of business. However, the Commissioner's regulations provide that repair and maintenance services are not taxable when they are rendered without charge to the customer (20 NYCRR 527.5[d][1]).

C. In this case, petitioner is not directly providing any repair service. Rather, petitioner has contracted with a third party to provide the repair service. The section of the regulations cited by petitioner provides as follows:

> "Where a manufacturer reimburses a vendor or repairman performing warranty work, the reimbursement is not taxable, as it was for resale." (20 NYCRR 527.5[d][4].)

Here, the Division has accurately noted that petitioner is not the manufacturer of the item being repaired. Therefore, petitioner's attempt to rely upon 20 NYCRR 527.5(d)(4) to characterize the charge as nontaxable warranty work is rejected. Similarly, since petitioner does not manufacture the decoder boxes, its reliance upon Matter of Castomatic, Division of Arwood Corp. (State Tax Commn., April 14, 1983) is also misplaced.

It is noted that petitioner's contention that the foregoing approach is too literal is without merit. The language of a regulation is to be construed according to its ordinary meaning (Matter of Leisure Vue v. Commr. of Taxation & Fin., 172 AD2d 872, 568 NYS2d 175). Further, petitioner's reliance upon 20 NYCRR 541.1(g) is rejected. Petitioner was not a contractor and therefore this section is inapplicable.

The applicable regulation is 20 NYCRR 527.5(c)(1) which provides, "[t]he purchase of a maintenance or service contract is a taxable transaction." On the basis of this regulation and Tax Law § 1105(c)(3), it is concluded that at least a portion of the payment at issue was subject to tax.

D. Petitioner next argues that only a small fraction of the monthly charge was subject to tax. In response, the Division submits that since Cooper Cable did not separately invoice petitioner for taxable and nontaxable services, the entire fee was subject to tax.

E. In this case, petitioner's accountant advised the Division that the $3.00 per month charge was for the repair of property. In addition, there was no evidence that there were invoices between petitioner and Cooper Cable which itemized the services provided. Under these circumstances, the Division rationally concluded that the full amounts of the charges in issue were taxable (see, Matter of Dynamic Telephone Answering Systems v. State Tax Commn., 135 AD2d 978, 522 NYS2d 386, lv denied 71 NY2d 801, 527 NYS2d 767; Matter of La Cascade, Inc. v. State Tax Commn., 91 AD2d 784, 458 NYS2d 80).

Petitioner has presented credible testimony and records from Cooper Cable to establish that only a small portion of the $3.00 monthly fee was used to repair equipment. Such evidence is pertinent because the Division should use a "fair sales price" as a basis for the asserted liability (see, Matter of WEBR, Inc. v. State Tax Commn., 58 AD2d 471, 397 NYS2d 200). However, there must be a basis in the record for determining the taxable portion of the receipt (see, Matter of Dynamic Telephone Answering Systems v. State Tax Commn., supra).

As noted, petitioner presented testimonial evidence, based on the experience of Pay TV, that, of the bill of $3.00 per month, 15 to 20 cents per month was for repairs. Although the

testimony was credible, it was not sufficient in the absence of supporting documentary evidence from Pay TV to establish the taxable portion of the charge (see, Matter of Dynamic Telephone Answering Systems v. State Tax Commn., supra).

The other evidence presented by petitioner was the general ledger of Cooper Cable to show that $120,011.77 of the total labor expense of $1,018,258.50, or approximately 11.8 percent, was attributable to employees who perform installation, disconnections and repairs. It is concluded that the foregoing evidence is also not sufficient to allocate the taxable and nontaxable portion of the receipt. The record does not show whether Cooper Cable had other customers besides Pay TV and, if so, what the nature of the business of these other customers was. Without this information, it can not be said that the percentage of workers in the shop department of Cooper Cable necessarily reflects the percentage of the $3.00 monthly charge attributable to repairs.

F. Before concluding on this point, it is observed that the requirement that taxable and nontaxable items be separately stated on an invoice is not a mere technicality. The failure to follow this procedure makes it impossible on audit to determine whether the proper amount of tax is being collected.

G. Petitioner's last argument is that the penalty should be waived. In support of this position, petitioner asserts that its filing and payment history show a good faith attempt to comply with the law and that even though the bulk of petitioner's revenues were exempt from tax, it regularly filed returns and paid the amounts due. Petitioner contends that its accountant took the position, in good faith, that its charge was not taxable and the good faith constitutes reasonable cause not to impose penalties.

In response, the Division submits that petitioner has not shown reasonable cause to cancel penalties because it has not presented any reason why the accountant considered the service costs to be nontaxable.

H. In order to establish reasonable cause for the remission of penalties, petitioner has relied on the asserted good faith of its accountant. It is well established that reliance on a tax

advisor does not necessarily constitute reasonable cause for the remission of penalties (see, Matter of Auerbach v. State Tax Commn., 142 AD2d 390, 536 NYS2d 557; Matter of LT & B Realty v. State Tax Commn., 141 AD2d 185, 535 NYS2d 121).

In this case, petitioner's accountant told the Division that the $3.00 monthly fee was for repairs. Although petitioner has shown that this explanation is not completely accurate, the question remains why, if this is what the accountant believed, tax was not collected on these amounts. The failure to collect tax under these circumstances preclude a finding that petitioner's failure to pay tax was due to reasonable cause.

I. The petition of Pay TV of Greater New York, Inc. is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated August 20, 1985, is sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York
June 3, 1993

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE