

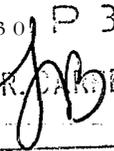
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STATE OF

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

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BY ROIA. D.R. DAKENTER



Supreme Court No. 79702-1

CLERK

COMMUNITY TELECABLE OF SEATTLE, INC.,
COMCAST OF WASHINGTON I, INC., AND
COMCAST OF WASHINGTON IV, INC.,

Petitioners,

v.

CITY OF SEATTLE,

Respondent.

DECLARATION OF SUZANNE HARMES

Randy Gainer, WSBA No. 11823
Dirk Giseburt, WSBA No. 13949
Davis Wright Tremaine LLP
Attorneys for Petitioners

2600 Century Square
1504 Fourth Avenue
Seattle, Washington 98101-1688
(206) 622-3150 Phone
(206) 628-7699 Fax

1. I am the Tax Audit Manager of Comcast Cable Communications, Inc. I make this statement from personal knowledge and from Comcast's records.

2. On October 16, 2007, I received from the State of Washington, Department of Revenue, Audit Division reports titled "Auditor's Detail of Differences and Instructions to Taxpayer" ("Auditor's reports") regarding the Department's audits of each of the following Comcast subsidiaries: Community Telecable of Seattle, Inc.; Comcast of Washington I, Inc.; and Comcast of Washington IV, Inc.

3. A true copy of the Auditor's report for Community Telecable of Seattle, Inc. is attached and incorporated by reference in this declaration as Exhibit 1. A true copy of the Auditor's report for Comcast of Washington I, Inc. is attached and incorporated by reference in this declaration as Exhibit 2. A true copy of the Auditor's report for Comcast of Washington IV, Inc. is attached and incorporated by reference in this declaration as Exhibit 3.

I declare under the penalty of perjury of the laws of the State of Washington that the foregoing is true and correct.

Suzanne Harmes

Executed at Englewood, Colorado on November 29, 2007.

Certificate of Service

I hereby certify that on this ____flay of November, 2007, I caused to be served by first class mail, postage prepaid, a true and correct copy of the Declaration of Suzanne Harmes filed in connection with the above-referenced matter upon the following counsel of record at the following addresses:

Kent C. Meyer
600 Fourth Avenue, Fourth Floor
P.O. Box 94769
Seattle, WA 98124-4769

Robert L. Mahon
Perkins Coie LLP
1201 Third Avenue, Suite #4800
Seattle, WA 98101-3099

Jon Brian Davis
Sutherland, Asbill & Brennan, LLP
1275 Pennsylvania Avenue, NW
Washington, D.C. 20004-2415

A copy of the above-referenced document was also sent by first-class mail, postage prepaid to the following:

The Honorable Rob McKenna
Attorney General of the State of Washington
1125 Washington Street S.E.
P. O. Box 40100
Olympia, WA 98504-0100

Dated this 30th day of November, 2007.

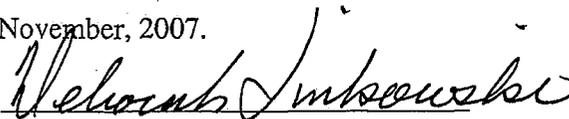

Deborah Linkowski

EXHIBIT 1



STATE OF WASHINGTON
DEPARTMENT OF REVENUE

AUDITOR'S DETAIL-OF-DIFFERENCES- -
AND INSTRUCTIONS TO TAXPAYER

Community Telecable of Seattle Inc
Registration Number 578 080 387

Your records have been audited for the period of January 1, 1999 through December 31, 2001. The tax adjustments are summarized in Schedule 1 and supported by Schedules 2 through 6.

RCW 82.32.050(3) bars the Department from issuing an assessment of additional taxes due more than four years after the close of the tax year, except where a taxpayer has executed a written waiver of such limitation.

A Statute of Limitations Non-Claim Period Waiver Agreement covering the period of January 1, 1999 through December 31, 2001 was signed by Maya Crawford, your Tax Audits Manager. The agreement extends the statutory period through October 31, 2007.

Business Activities

Community Telecable of Seattle Inc is a cable TV operator and Internet service provider. You sell television programming and Internet service to subscribers in Washington for which you charge a monthly fee. You also rent and sell converters, remote controls, and modems. In addition, you sell advertising on your cable system network.

It should also be noted that only 3.81 percent of the income recorded in general ledger cost centers 103059 and 103063 has been allocated to Community Telecable of Seattle Inc. The remaining percentage has been allocated between Comcast of Bellevue Inc, Comcast of Washington I Inc, and Comcast of Washington II Inc in accordance with your income allocation per your excise tax return worksheets. In 2002 all your income recorded in cost center 103059 was allocated to Comcast of Washington II Inc and all your income recorded in cost center 103063 was allocated to Comcast of Washington I Inc in accordance with your income allocation per your excise tax returns.

Comcast of Bellevue Inc, Comcast of Washington I Inc and Comcast of Washington II Inc have been audited in conjunction with Community Telecable of Seattle Inc.

Community Telecable of Seattle Inc is a subsidiary of Comcast. This audit was done in conjunction with other Comcast subsidiaries and partnerships. Please refer to Workpaper H for a listing of these subsidiaries and partnerships.

Audit Scope

The scope of the audit includes the determination of your tax liability through the use of various accounting records that relate to your business activities. In the course of the audit the following accounting records were examined: general ledgers; profit and loss statements; and excise tax returns with supporting workpapers.

Only a few copies of customer billing, price lists were made available. No audit trail detailing how the customer billings tie into the general ledger accounts were made available. Please refer to the exhibits for copies of the customer billings and price lists provided.

Qualified to Excise Tax Return

This audit is qualified to the extent that it includes taxes reportable on the excise tax return only. Amounts reportable on other tax returns or by other means are not included in this report, and the Department of Revenue reserves the right to verify any other liability within the statute of limitations period. This audit is further qualified in that it only includes tax adjustments relating to your income. A separate partial audit has been performed to assert any deferred sales tax and/or use tax liability that may be due on your purchases.

References

The instructions provided in this report address the application of the Revised Code of Washington (RCW); the Washington Administrative Code (WAC); the Washington Tax Decisions (WTD); and/or the Excise Tax Advisories (ETA) to the audit schedules. They constitute "specific written instructions" within the meaning of RCW 82.32.090. All authoritative references are available at the Department's Internet web site: <http://dor.wa.gov>.

The following abbreviations may also be used in this report: business and occupation tax (B&O); and Regional Transit Authority (RTA).

Schedule 2 - Radio and TV Broadcasting B&O Tax Due on Unreported Advertising Revenue

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Radio and Television Broadcasting B&O tax classification on gross income derived from advertising revenues.

Your advertising revenue and shopping channel revenue per your general ledgers and profit and loss statements have been compared to those amounts reported on your excise tax returns. Refer to Workpaper A for the computation of the taxable amounts.

This schedule asserts tax on any underreported amounts.

Schedule 3 - Service and Other Activities B&O Tax Due on Unreported Service Income

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Service and Other Activities B&O tax classification on the gross income derived from charges made for installation and monthly service fees.

Your Internet subscription fees are also subject to the service and other activities B&O tax.

In, addition, your digital converter revenue from your G/L account 3151.0000.3007 is subject to the service and other activities B&O tax. You provide your customers with one set-top digital receiver (converter) with your sales to them of a digital cable TV package. You charge your customers_ a single. package price for the bundled cable TV services and the use of the set-top receiver that you provide to them. Because you do not make a separate charge on your billing to your customers for a rental of the digital receiver the entire package price is subject to the service and other activities B&O tax. Please refer to the discussion of "Areas of Disagreement" below.

This schedule asserts the service and other activities B&O tax on any underreported amounts.

Schedule 4A - Retailing B&O Tax Credit Due on Overreported Retail Sales

Schedule 4B - Retail Sales Tax Due on Unreported Retail Sales

Sales and rentals of tangible personal property to consumers are retail sales.

Your revenue subject to the Retailing B&O and Retail Sales Taxes, per your profit and loss statements, has been compared to those amounts reported on your excise tax returns. Refer to Workpapers C and D for a computation of the taxable amounts.

Schedule 4A and 4B assert the retailing B&O. and retail sales tax on any unreported revenue from the sales of cable TV guides, equipment, equipment rentals and Internet installation charges.

Please note that while your digital converter revenue from your G/L account 3151.0000.3007 has been excluded from tax for retailing B&O tax purposes, it has been included in determining your retail sales tax liability. This is because you have collected the retail sales tax on the amount of . your digital package price that you have internally allocated to your digital converter revenue account.

Pursuant to RCW 82.08.050 and WAC 458-20-217, retail sales tax shall be deemed held in trust by the seller until paid to the Department of Revenue. Any seller who appropriates or converts the tax collected to his/her own use or to any use other than the payment of the tax shall be guilty of a gross misdemeanor.

Please refer to the discussion of "Areas of Disagreement" below.

Schedule 5 - Retail Sales Tax Due on Non-Taxed Purchases of Digital Converters

This schedule asserts the retail sales tax on your non-taxed purchases of digital converters (receivers) from T C I Materials Management, Inc, an affiliate of Comcast. These purchases were delivered from T C I Material Management's Auburn, Washington warehouse. Please refer to Workpapers E through G.

You provide your customers with one set-top digital converter receiver with your sales to them of a digital cable TV package. You charge your customers a single package price for the bundled cable TV services and the use of the set-top receiver that you provide to them.

A digital set-top converter is required to receive digital cable services such as pay per view programming, on demand programming, digital music channels, the interactive programming guide and premium channels.

- You internally allocate a small portion of this package price, generally around \$1.50, to digital converter revenue G/L account 3151.0000.3007 charge your customer sales tax on this internally allocated amount.

You may also rent, for a separate charge, digital set-top converters for additional television sets on which your customer would like to receive digital services. Generally, you charge between \$4.70 for an additional standard set-top converter to \$6.50 for an advanced digital set-top converter.

You are subject to the retail sales tax or use tax on your purchases of digital converters that you use to provide digital cable TV services unless you separately state on your billing the rental charges for the digital converters.

For purposes of this audit we deemed that all your purchases of digital converters were subject to the sales tax because you were unable to segregate those that you rented from those that you installed as part of the digital cable TV services package. If you can provide additional information that segregates the units you rented from the units you provided as part of a digital TV package then an adjustment may be made to this audit.

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Service and Other Activities B&O tax classification on the gross income derived from charges made for installation and monthly service fees.

It also states that persons engaging in the business of subscriber television are subject to retail sales of use tax on all purchases of tangible personal property utilized or required in providing service to subscribers.

Please refer to the discussions of "Areas of Disagreement below.

Schedule 6 - Litter Tax Due on Sales of Cable Guides

RCW 82.19.010 and WAC 458-20-243 levy a litter tax upon manufacturers, wholesalers, and retailers of certain products that are sold in Washington State or shipped into Washington. The measure of the tax is on the gross proceeds of sales of the products listed in WAC 458-20-243 and is to be reported under the Litter Tax classification. Among the products subject to the tax are sales of newspapers and magazines.

WAC458-20-243 defines newspapers and magazines to include all daily and periodical publications. Your cable guides fall under this definition.

This schedule asserts the litter tax on your sales of cable guides.

Future Reporting Instructions

In the future you should pay sales tax or use tax on your purchases of digital converters, modems, remotes, etc. that are provided as part of the bundled digital cable TV package, or Internet service. You should not internally allocate a portion of the price to digital converter rentals or charge your customer sales tax on any portion of the bundled services. Any billings for

the bundled services will be taxable under the Service and Other Business Activities tax classification of the B&O tax.

If you elect to charge a separate amount on your customer billing for the rental of a digital receiver, modem or remote control unit the charge must be a reasonable rental value.

Your purchase price of digital set-top receivers averaged around \$250 per unit for the audit period. Based on this purchase price a rental of \$1.50 per month, as is currently internally allocated to your digital converter revenue account, may not represent a reasonable rental value.

WAC 458-20-211 Section (7) provides that if rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalization value the lessor of the particular type of property is generally using in rate setting.

Generally when the department imputes a fair rental value it takes into account such things as the annual amount of depreciation taken, the borrowing cost of funds, property taxes, insurance, maintenance, plus a profit percentage based on expected rate of return on the funds invested.

Disagreement with Audit Adjustments

Maya Crawford and Suzanne Harmes, your Tax Audits Managers, have expressed their disagreement with the tax adjustments with respect to the digital converters subjected to the sales tax in Schedule 5. In addition, they believe that you should receive a refund for any sales tax paid to T C I Materials Management on your taxed purchases of digital converters. They also disagree with the service and other activities B&O tax assessed on this income that you allocated to your digital converter revenue G/L account 3151.0000.3007.

As stated above, you charge your customer a single price for your digital cable TV packages on your customer billings. These packages include a tier of digital cable TV programming, Comcast on Demand, PPV (Pay per View) access, digital music channels, an interactive programming guide, one or more digital receivers and remotes, and certain digital cable packages include access to premium channels. See the examples of your price lists and customer billing in the exhibits.

You internally allocate a small amount of this package price to your digital converter revenue account 3151.0000.3007. In addition, even though you do not separately state this charge on your customer billing you charge your customer sales tax on the internally allocated amount.

You may also rent digital set top receivers for a separate charge for additional television sets or on an A La Carte basis.

For purposes of this audit we deemed that all your purchases of digital converters were subject to the sales tax because you were unable to segregate those units that you rented from those that you installed as part of the digital cable TV services package. If you can provide additional information that segregates the units you rented from those units provided as part of a digital TV package then an adjustment may be made to this audit.

In addition, you rent addressable and non-addressable analog converters. You rent these converters for a separate charge and charge sales tax on that amount the amount of the rentals.

These amounts have therefore been included in the retailing B&O and retail sales tax calculation and are not part of this issue that is in dispute.

WAC 458-20-227-Subscriber Television Services provides: -

(1) DEFINITIONS. The following definitions apply to this section.

(a) "Subscriber television" refers to all businesses providing television programming to consumers for a fee. It includes, but is not limited to, cable television and satellite television. Subscriber television often transmits to its customer's special channels offering a variety of programming such as movies, sporting events, children's entertainment, news and other informational services.

(b) "Fee" includes the amount paid by the subscriber to receive the subscription television service. Generally, the fee consists of an amount for installation and a monthly charge for maintenance or service.

(2) Business and Occupation Tax. Persons engaging in the business of subscriber television are subject to the business and occupation tax as follows:

(a) Gross income derived from the charge made for installation and the monthly rental or service fee is subject to tax under the classification service and other activities B&O. (See WAC 458- 20-224.)

(b) Gross income derived from advertising revenues is subject to tax under the classification radio and television broadcasting. (See WAC 458-20-241.)

(c) No deductions from gross income may be taken for affiliate fees, video service fees, satellite fees, copyright fees, or any other amounts paid to other firms for special programming provided to subscribers.

(3) Use Tax. Persons engaging in the business of subscriber television are subject to retail sales tax or use tax on all purchases of tangible personal property utilized or required in providing service to subscribers. (See WAC 458-20-178.)

Suzanne Harmes has stated in her letter dated December 14, 2006 that in Comcast's view you are engaged in two separate businesses, providing cable video service and renting ("retailing") certain equipment related to this service.

She indicates that the Board of Tax Appeals has already supported her position in the case of Tele-Vue Systems, Inc v. State, BTA Docket No. 96-11.

I disagree with her conclusion in how it relates to digital package prices billed on your customer billings. The Board of Tax Appeals (BTA docket No. 96-11) ruled:

Where a person engaged in the business of providing services also provides its customers with equipment for use in conjunction with the service, the service provider is engaged in the business of leasing personal property separate from the provision of the services where (1) the agreement between the parties is designated as an outright lease or rental, without reservations; (2) the customer has exclusive use, possession, and control of the equipment even to the exclusion of the service provider (as opposed to a mere license to use the equipment, or some lessor right); and (3) the service provider separately states the charges for the leased equipment.

The Board of Tax Appeals recognized that Tele-View began separately itemizing charges for descrambler units on its bills to cable service customers on September 1, 1993. It therefore held that descrambler purchases beginning September 1, 1993 were purchased for resale and that the rental income was subject to the retailing B&O and retail sales taxes:

In the current situation, there is no separate line item on the customer's billing for the first set top receiver included as part of the digital programming package. Instead, only a cable package price is listed which includes a tier of cable TV programming, premium channels, On Demand TV, Pay per View, digital music channels, an interactive programming guide and a digital set-top receiver (converter).

Suzanne Harmes also indicates that the FCC, which regulates cable television service and rates, specifically requires operators to un-bundle the equipment business from the video service business. She refers to 47 Code of Federal Regulations (C.F.R.) Section 76.923(b).

In reviewing sections 76.922 and 76.923 it appears that the C.F.R. 76.922 regulates the maximum amount that may be charged to subscribers for basic and cable programming service tiers. C.F.R. 76.923 regulates the maximum that may be charged to subscribers for equipment. As long as the combined rate that you charge in your digital cable TV packages do not exceed the maximum amounts allowed for the programming, you are in compliance with these regulations.

Suzanne Harmes states that the "package" prices also stated on the price lists, and reflected on monthly bills, can constitute nothing more than a summary of the separate prices, since the FCC requires that customers rent this equipment for a separate charge.

In reviewing the price list the cable package prices do not equal the combination of the prices of the individual items included in the cable package, therefore it is not a summary of the separate prices. In addition, if the FCC requires that customers rent the equipment for a separate charge you have not complied with this section since you have not itemized these charges on your customer billings.

Disagreement with Future Reporting Instructions

Suzanne Harmes has also expressed her disagreement with the future reporting instructions above. She indicates that she believes that the discounted amount that they charge sales tax on for the digital receivers included in the digital package represents a fair rental value. She quotes paragraph (j) of C.F.R. 76.923 as her basis.

C.F.R. 76.923 (j) provides:

A cable operator may offer equipment or installation at charges below those determined under paragraphs (e) through (g) of this section, as long as those offerings are reasonable in scope in relation to the operator's overall offerings in the Equipment Basket and not unreasonably discriminatory. Operators may not recover the cost of a promotional offering by increasing charges for other Equipment Basket elements, or by increasing programming service rates above the maximum monthly charge per subscriber prescribed by these rules. As part of a general cut-of-service showing, an operator may include the cost of promotions in its general system overhead costs.

This paragraph basically provides that you may not lower the rate charged for one piece of equipment and recover the costs by raising the rate charged for another piece of equipment above

the maximum allowable rate for that piece of equipment. This would be unreasonable discriminatory. Or in the alternative, you may not lower the rate charged for one piece of equipment and recover the costs by raising the rate charged for cable programming above the maximum rate allowable under section 76.922. It should be noted that the maximum monthly rate allowable for equipment is based on the average purchase price of the unit plus the yearly monthly maintenance costs and dividing this sum by 12.

With an average purchase price during the audit period of \$250 this would indicate that you were allowed to charge a rate on your digital converter rentals in excess of \$20.00 a month.

While we are not advocating that you charge your customers \$20.00 a month for the rental of these converters, we feel that \$1.50 a month charge on a \$250 item is not a reasonable rental value. We do not believe that C.F.R. 76.923 is controlling in the matter of what a reasonable rental value should be.

WAC 458-20-211 Section (7) provides that if rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalization value the lessor of the particular type of property is generally using in rate setting.

Generally when the department imputes a fair rental value it takes into account such things as the annual amount of depreciation taken, the borrowing cost of funds, property taxes, insurance, maintenance, plus a profit percentage based on expected rate of return on the funds invested.

Closing Comments

A telephone conference was held to discuss the tax adjustments on February 8, 2007. Attending the conference were Maya Crawford and Suzanne Harmes, your Tax Audit Managers, representing Comcast and Mark Charette, Field Audit Manager, and Donald Adamson, Revenue Auditor, representing the Department of Revenue. The various areas of disagreement were discussed with no resolution reached with regards to these issues.

A separate phone conference call was held on September 17, 2007, and in addition to those parties noted above in attendance were Mike Bryan of Comcast, Dirk Giseburt of Davis Wright Tremaine LLP, and Scott Garrison, Regional Audit Manager, Department of Revenue. The areas of disagreement were discussed and again no consensus or agreement regarding the audit findings could be reached.

If there are any questions regarding these adjustments or if additional information is needed, contact either Donald Adamson, Revenue Auditor, telephone number (360) 725-7541; or Mark Charette, Field Audit Manager, telephone number (360) 725-7539; prior to the due date shown on the assessment. Copies of all authoritative references cited in this report may be downloaded from the Depailinent's Internet web site: <http://dor.wa.gov>.

RCW 82.32.050 and RCW 82.32.090 impose interest and a 5 percent assessment penalty, respectively, on the tax due before any payments are made.

HB 2671 modifies the assessment penalty effective July 1, 2006. The 5 percent assessment penalty will only be applied if the tax that is found to be due was substantially underpaid and if the amount of underpaid tax is at least \$1,000. The law defines "substantially underpaid" to

Community Telecable of Seattle Inc

Registration Number 578 080 387

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mean that the taxpayer has paid less than 80 percent of the amount of tax determined to be due by the Department.

Full payment of the tax, interest, and penalty (if imposed) must be made by the due date to avoid additional interest and penalties. The penalty imposed will be a total of 15 percent of the tax due if payment is not made by the due date.

The procedures to file a petition for review are contained in WAC 458-20-100. The petition must be filed with the Department of Revenue within 30 days after the date the departmental action occurred. If the petition for review is requesting a refund of taxes paid, it must be filed within four years after the close of the year in which the taxes were paid.

The instructions in this report constitute "specific written instructions" within the meaning of RCW 82.32.090. Failure to follow the instructions may subject the taxpayer to the additional 10 percent penalty.

The Department thanks you for your assistance and cooperation.

October 3, 2007

Donald Adamson, Revenue Auditor

EXHIBIT 2



STATE OF WASHINGTON
DEPARTMENT OF REVENUE

AUDITOR'S- DETAIL OF DIFFERENCES- -
AND INSTRUCTIONS TO TAXPAYER

Comcast of Washington **I Inc**
dba **Viacom** Cablevision
Registration Number 578 078 636

Your records have been audited for the period of January 1, 1999 through December 31, 2002. The tax adjustments are summarized in Schedule 1 and supported by Schedules 2 through 6.

RCW 82.32.050(3) bars the Department from issuing an assessment of additional taxes due more than four years after the close of the tax year, except where a taxpayer has executed a written waiver of such limitation.

A Statute of Limitations Non-Claim Period Waiver Agreement covering the period of January 1, 1999 through December 31, 2002 was signed by Maya Crawford, Tax Audit Manager. The agreement extends the statutory period through October 31, 2007.

Business Activities

Comcast of Washington I Inc is a cable TV operator and Internet service provider. You sell television programming and Internet service to subscribers in Washington for which you charge a monthly fee. You also rent and sell converters, remote controls, and modems. In addition, you sell advertising on your cable system.

It should also be noted that only 41.76 percent of the income recorded in general ledger cost centers 103059 and 103063 has been allocated to Comcast of Washington I Inc for the period January 1, 1999 through December 31, 2001. The remaining percentage has been allocated between Comcast of Bellevue Inc, Community Telecable of Seattle Inc, and Comcast of Washington II Inc in accordance with your income allocation per your Combined Excise Tax Return worksheets. In 2002 all your income recorded in cost center 103059 was allocated to Comcast of Washington II Inc and all your income recorded in cost center 103063 was allocated to Comcast of Washington I Inc in accordance with your income allocation per your Combined Excise Tax Returns.

Comcast of Bellevue Inc, Community Telecable of Seattle Inc, and Comcast of Washington II Inc have been audited in conjunction with Comcast of Washington I Inc.

Comcast of Washington I Inc is a subsidiary of Comcast. This audit was done in conjunction with other Comcast subsidiaries and partnerships. Please refer to Workpaper H for a listing of these subsidiaries and partnerships.

Audit Scope

The scope of the audit includes the determination of your tax liability through the use of various accounting records that relate to your business activities. In the course of the audit the following

accounting records were examined: general ledgers; profit and loss statements; and state excise tax returns with supporting workpapers.

· Only a few copies of customer billing, price lists were made available. No audit trail detailing how the customer billings tie into the general ledger accounts were made available. Please refer to the exhibits for copies of the customer billings and price lists provided.

Qualified to Excise Tax Return

This audit is qualified to the extent that it includes taxes reportable on the excise tax return only. Amounts reportable on other tax returns or by other means are not included in this report, and the Department of Revenue reserves the right to verify any other liability within the statute of limitations period. This audit is further qualified in that it only includes tax adjustments relating to your income. A separate partial audit has been performed to assert any deferred sales tax and/or use tax liability that may be due on your purchases.

References

The instructions provided in this report address the application of the Revised Code of Washington (RCW); the Washington Administrative Code (WAC); the Washington Tax Decisions (WTD); and/or the Excise Tax Advisories (ETA) to the audit schedules. They constitute "specific written instructions" within the meaning of RCW 82.32.090. All authoritative references are available at the Department's Internet web site: <http://dor.wa.gov>.

The following abbreviations may also be used in this report: business and occupation tax.(B&O); and Regional Transit Authority (RTA).

Schedule 2 - Radio and TV Broadcasting Tax Credit Due on Overreported Advertising Revenue

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Radio and Television Broadcasting B&O tax classification on gross income derived from advertising revenues.

Your advertising revenue and shopping channel revenue per your general ledgers and profit and loss statements for January 1, 1999 through November 17, 2002, plus an estimate of this revenue for November 18, 2002 through December 31, 2002, have been compared to those amounts reported on your excise tax returns. Refer to Workpaper A for the computation of the taxable amounts.

This schedule allows you credit for any overreported amounts. The overreported differences identified on this schedule for 2002 resulted primarily because of clerical errors you made. You calculated, the amount of Service and Other Activities (Service) B&O tax classification due. Instead of taking this tax and backing into the taxable amount to report for service B&O tax purposes you took this tax and backed into an amount to report under the Radio and Television Broadcasting B&O tax classification.

Method of Estimating Revenue for November 18, 2002 through December 31, 2002

Suzanne Harmes, Tax Audit Manager has indicated that your general ledgers and profit and loss statements did not include your income for the period November 18, 2002 through December 31,

2002. Prior to November 18, 2002 this entity was owned by AT&T Broadband. On November 18, 2002 AT&T Broadband merged with Comcast. Because your actual revenue for the period November 18, 2002 through December 31, 2002 Was not available, we estimated your revenue for this period. Your income, per your general ledgers and profit and loss statements for January 1, 2002 through November 17, 2002, was divided by 321, the number of days in that time period. The resulting quotient was then multiplied by 44, the number of days from November 18, 2002 through December 31, 2002 to estimate your revenue for this period.

Schedule 3 - Service and Other Activities B&O Tax Due on Unreported Service Income

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Service and Other Activities (Service) B&O tax classification on the gross income derived from charges made for installation and monthly service fees.

In addition, Internet subscription fees are also subject to the service B&O tax.

Your revenue subject to the service B&O tax, per your profit and loss statements for January 1, 1999 through November 17, 2002, plus an estimate of this revenue for November 18, 2002 through December 31, 2002, has been compared to those amounts reported on your excise tax returns. Refer to Workpaper B for the computation of the taxable amounts.

This schedule asserts tax on any underreported amounts. The underreported differences identified on this schedule for 2002 resulted primarily because of clerical errors you made. You calculated the amount of radio and TV broadcasting tax due. Instead of taking this tax and backing into the taxable amount to report for radio and TV broadcasting tax purposes you took this tax and backed into an amount to report under the Service B&O tax classification.

As indicated in the discussion in Schedule 2, your profit and loss statements did not include your income for the period November 18, 2002 through December 31, 2002. Because actual revenue figures were not available, your revenue had to be estimated for this period.

In addition, your digital converter revenue from your G/L account 3151.0000.3007 has been subjected to the service B&O tax. You provide your customers with one set-top digital receiver (converter) with your sales to them of a digital cable TV package. You charge your customers a single package price for the bundled cable TV services and the use of the set-top receiver that you provide to them. Because you do not make a separate charge on your billing to your customers for a rental of the digital receiver, the entire package price is subject to the service B&O tax. Please refer to the discussion of "Areas of Disagreement" below.

Schedule 4A - Retailing B&O Tax Credit Due on Overreported Retail Sales

Schedule 413 - Retail Sales Tax Due on Unreported Retail Sales

Sales and rentals of tangible personal property to consumers are retail sales.

Your revenue subject to the retailing B&O and retail sales taxes, per your profit and loss statements for January 1, 1999 through November 17, 2002, plus an estimate of this revenue for November 18, 2002 through December 31, 2002, has been compared to those amounts reported on your excise tax returns. Refer to Workpapers C and D for a computation of the taxable amounts.

Schedules 4A and 4B assert the retailing B&O and retail sales tax on any unreported revenue from the sales of cable TV guides, equipment, equipment rentals and Internet installation . charges.

As indicated in the discussion of Schedule 2, your profit and loss statements did not include your income for the period November 18, 2002 through December 31, 2002. Because actual revenue figures were not available, your revenue had to be estimated for this period.

Please note that while your digital converter revenue from your G/L account 3151.0000.3007 has been excluded from tax for retailing B&O tax purposes, it has been included in determining your retail sales tax liability. This is because you have collected the retail sales tax on the amount of your digital package price that you have internally allocated to your digital converter revenue account.

Pursuant to RCW 82.08.050 and WAC 458-20-217, retail sales tax shall be deemed held in trust by the seller until paid to the Department of Revenue. Any seller who appropriates or converts the tax collected to his/her own use or to any use other than the payment of the tax shall be guilty of a gross misdemeanor.

Please refer to the discussion of "Areas of Disagreement" below.

Schedule .5 - Retail Sales Tax Due on Non-Taxed Purchases of Digital Converters

This schedule asserts the retail sales tax on your non-taxed purchases of digital converters (receivers) from T C I Materials Management Inc, an affiliate of Comcast. These purchases were delivered from T C I Material Management's Auburn, Washington warehouse. Please refer to Workpapers E through G.

You provide your customers with one set-top digital converter receiver with your sales to them of a digital cable TV package. You charge your customers a single package price for the bundled cable TV services and the use of the set-top receiver that you provide to them.

A digital set-top converter is required to receive digital cable services such as pay per view programming, on demand programming, digital music channels, the interactive programming guide and premium channels.

You internally allocate a small portion of this package price, generally around \$1.50, to digital converter revenue G/L account 3151.0000.3007 charge your customer sales tax on this internally allocated amount.

You may also rent, for a separate charge, digital set-top converters for additional television sets on which your customer would like to receive digital services. Generally, you charge between \$4.70 for an additional standard set-top converter to \$6.50 for an advanced digital set-top converter.

You are subject to the retail sales tax or use tax on your purchases of digital converters that you use to provide digital cable TV services unless you separately state on your billing the rental charges for the digital converters.

For purposes of this audit we deemed that all your purchases of digital converters were subject to the sales tax because you were unable to segregate those that you rented from those that you installed as part of the digital cable TV services package. If you can provide additional

information that segregates the units you rented from the units you provided as part of a digital TV package then an adjustment may be made to this audit.

WAC 458-20-227 states that persons providing subscriber television services are subject to tax - under the Service and Other Activities (Service) B&O tax classification on the gross income derived from charges made for installation and monthly service fees.

It also states that persons engaging in the business of subscriber television are subject to retail sales or use tax on all purchases of tangible personal property utilized or required in providing service to subscribers.

Please refer to the discussions of "Areas of Disagreement below.

Schedule 6 - Litter Tax Due on Sales of Cable Guides

RCW 82.19.010 and WAC 458-20-243 levy a litter tax upon manufacturers, wholesalers, and retailers of certain products that are sold in Washington State or shipped into Washington. The measure of the tax is on the gross proceeds of sales of the products listed in WAC 458-20-243 and is to be reported under the Litter Tax classification. Among the products subject to the tax are sales of newspapers and magazines.

WAC458-20-243 defines newspapers and magazines to include all daily and periodical publications. Your cable guides fall under this definition.

This schedule asserts the litter tax on your sales of cable guides.

Future Reporting Instructions

In the future you should pay sales tax or use tax on your purchases of digital converters, modems, remotes, etc. that are provided as part of the bundled digital cable TV package, or Internet service. You should not internally allocate a portion of the price to digital converter rentals or charge your customer sales tax on any portion of the bundled services. Any billings for the bundled services will be taxable under the Service and Other Activities B&O classification of the B&O tax.

If you elect to charge a separate amount on your customer billing for the rental of a digital receiver, modem or remote control unit the charge must be a reasonable rental value.

Your purchase price of digital set-top receivers averaged around \$250 per unit for the audit period. Based on this purchase price a rental of \$1.50 per month, as is currently internally allocated to your digital converter revenue account, may not represent a reasonable rental value.

WAC 458-20-211 Section (7) provides that if rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalization value the lessor of the particular type of property is generally using in rate setting.

Generally when the Department imputes a fair rental value it takes into account such things as the annual amount of depreciation taken, the borrowing cost of funds, property taxes, insurance, maintenance, plus a profit percentage based on expected rate of return on the funds invested.

Areas of Disagreement

Disagreement with Audit Adjustments

Maya Crawford and Suzanne Harmes, Tax Audit Managers, have expressed their disagreement with the tax adjustments with respect to the digital converters subjected to the sales tax in Schedule 5. In addition, they believe that you should receive a refund for any sales tax paid to T C I Materials Management on your taxed purchases of digital converters. They also disagree with the service and other activities B&O tax assessed on this income that you allocated to your digital converter revenue G/L account 3151.0000.3007.

As stated above, you charge your customer a single price for your digital cable TV packages on your customer billings. These packages include a tier of digital cable TV programming, Comcast on Demand, PPV (Pay per View) access, digital music channels, an interactive programming guide, one or more digital receivers and remotes, and certain digital cable packages include access to premium channels. See the examples of your price lists and customer billing in Exhibits A through D.

You internally allocate a small amount of this package price to your digital converter revenue account 3151.0000.3007. In addition, even though you do not separately state this charge on your customer billing you charge your customer sales tax on the internally allocated amount.

You may also rent digital set top receivers for a separate charge for additional television sets or on an A La Carte basis.

For purposes of this audit we deemed that all your purchases of digital converters were subject to the sales tax because you were unable to segregate those that you rented from those units that you installed as part of the digital cable TV services package. If you can provide additional information that segregates the units you rented from those units provided as part of a digital TV package then an adjustment may be made to this audit.

In addition, you rent addressable and non-addressable analog converters. You rent these converters for a separate charge and charge sales tax on that amount, the amount of the rentals. These amounts have therefore been included in the retailing B&O and retail sales tax calculation and are not part of this issue that is in dispute.

WAC 458-20-227 Subscriber Television Services provides:

(1) Definitions. The following definitions apply to this section.

(a) "Subscriber television" refers to all businesses providing television programming to consumers for a fee. It includes, but is not limited to, cable television and satellite television. Subscriber television often transmits to its customer's special channels offering a variety of programming such as movies, sporting events, children's entertainment, news and other informational services.

(b) "Fee" includes the amount paid by the subscriber to receive the subscription television service. Generally, the fee consists of an amount for installation and a monthly charge for maintenance or service.

(2) B&O Tax. Persons engaging in the business of subscriber television are subject to the B&O tax as follows:

(a) Gross income derived from the charge made for installation and the monthly rental or service fee is subject to tax under the service and other activities B&O tax. (See WAC 458- 20-224.)

(b) Gross income derived from advertising revenues is subject to tax under the radio and television broadcasting tax. (See WAC 458-20-241.)

(c) No deductions from gross income may be taken for affiliate fees, video service fees, satellite fees, copyright fees, or any other amounts paid to other firms for special programming provided to subscribers.

(3) Use Tax. Persons engaging in the business of subscriber television are subject to retail sales tax or use tax on all purchases of tangible personal property utilized or required in providing service to subscribers. (See WAC 458-20-178.)

Suzanne Harmes has stated in her letter dated December 14, 2006 that in Comcast's view you are engaged in two separate businesses, providing cable video service and renting ("retailing B&O") certain equipment related to this service.

She indicates that the Board of Tax Appeals has already supported her position in the case of Tele-Vue Systems, Inc v. State, BTA Docket No. 96-11.

The auditor disagrees with her conclusion in how it relates to digital package prices billed on your customer billings. The Board of Tax Appeals (BTA docket No. 96-11) ruled:

Where a person engaged in the business of providing services also provides its customers with equipment for use in conjunction with the service, the service provider is engaged in the business of leasing personal property separate from the provision of the services where (1) the agreement between the parties is designated as an outright lease or rental, without reservations; (2) the customer has exclusive use, possession, and control of the equipment even to the exclusion of the service provider (as opposed to a mere license to use the equipment, or some lessor right); and (3) the service provider separately states the charges for the leased equipment.

The Board of Tax Appeals recognized that Tele-Vue began separately itemizing charges for descrambler units on its bills to cable service customers on September 1, 1993. It therefore held that descrambler purchases beginning September 1, 1993 were purchased for resale and that the rental income was subject to the retailing B&O and retail sales taxes.

In this instance, there is no separate line item on the customer's billing for the first set top receiver included as part of the digital programming package. Instead, only a cable package price is listed which includes a tier of cable TV programming, premium channels, On Demand TV, Pay per View, digital music channels, an interactive programming guide and a digital set-top receiver (converter).

Suzanne Harmes also indicates that the FCC, which regulates cable television service and rates, specifically requires operators to un-bundle the equipment business from the video service business. She refers to 47 Code of Federal Regulations (C.F.R.) Section 76.923(b).

In reviewing sections 76.922 and 76.923 it appears that the C.F.R 76.922 regulates the maximum amount that may be charged to subscribers for basic and cable programming service tiers. C.F. R. 76.923 regulates the maximum that may be charged to subscribers for equipment. As long as the combined rate that you charge in your digital cable TV packages does not exceed the maximum amounts allowed for the programming, you are in compliance with these regulations.

Suzanne Harmes states that the "package" prices also stated on the price lists, and reflected on monthly bills, can constitute nothing more than a summary of the separate prices, since the FCC requires that customers rent this equipment _fora separate charge.

In reviewing the price list the cable package prices do not equal the combination of the prices of the individual items included in the cable package, therefore it is not a summary of the separate prices. In addition, if the FCC requires that customers rent the equipment for a separate charge you have not complied with this section since you have not itemized these charges on your customer billings.

Disagreement with Future Reporting Instructions

Suzanne Harmes has also expressed her disagreement with the future reporting instructions above. She indicates that she believes that the discounted amount that they charge sales tax on for the digital receivers included in the digital package represents a fair rental value. She quotes paragraph (j) of C.F.R. 76.923 as her basis.

C.F.R.76.923 (j) provides:

A cable operator may offer equipment or installation at charges below those determined under paragraphs (e) through (g) of this section, as long as those offerings are reasonable in scope in relation to the operator's overall offerings in the Equipment Basket and not unreasonably discriminatory. Operators may not recover the cost of a promotional offering by increasing charges for other Equipment Basket elements, or by increasing programming service rates above the maximum monthly charge per subscriber prescribed by these rules. As part of a general cost-of-service showing, an operator may include the cost of promotions in its general system overhead costs.

This paragraph basically provides that you may not lower the rate charged for one piece of equipment and recover the costs by raising the rate charged for another piece of equipment above the maximum allowable rate for that piece of equipment. This would be unreasonable discriminatory. Or in the alternative, you may not lower the rate charged for one piece of equipment and recover the costs by raising the rate charged for cable programming above the maximum rate allowable under section 76.922. It should be noted that the maximum monthly rate allowable for equipment is based on the average purchase price of the unit plus the yearly monthly maintenance costs and dividing this sum by 12.

With an average purchase price during the audit period of \$250 this would indicate that you were allowed to charge a rate on your digital converter rentals in excess of \$20.00 a month.

While we are not advocating that you charge your customers \$20.00 a month for the rental of these converters, we feel that \$1.50 a month charge on a \$250 item is not a reasonable rental value. We do not believe that C.F.R. 76.923 is controlling in the matter of what a reasonable rental value should be.

WAC 458-20-211 Section (7) provides that if rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalization value the lessor of the particular type of property is generally using in rate setting.

Generally when the Department imputes a fair rental value it takes into account such things as the annual amount of depreciation taken, the borrowing cost of funds, property taxes, insurance, maintenance, plus a profit percentage based on expected rate of return on the funds invested.

Closing Comments

A telephone conference was held to discuss the tax adjustments on February 8, 2007. Attending the conference were Maya Crawford and Suzanne Harmes, Tax Audit Managers representing Comcast; Mark Charette, Field Audit Manager; and Donald Adamson, Revenue Auditor representing the Department of Revenue. The various areas of disagreement were discussed with no resolution reached with regards to these issues.

A separate phone conference call was held on September 17, 2007, and in addition to those parties noted above in attendance were Mr. Mike Bryan of Comcast; Mr. Dirk Giseburt of Davis Wright Tremaine LLP; and Mr. Scott Garrison, Regional Audit Manager of the Department of Revenue. The areas of disagreement were discussed and again no consensus or agreement regarding the audit findings could be reached. .

If there are any questions regarding these adjustments or if additional information is needed, contact either Donald Adamson, Revenue Auditor, telephone number (360) 725-7541; or Mark Charette, Field Audit Manager, telephone number (360) 725-7539; prior to the due date shown on the assessment. Copies of all authoritative references cited in this report may be downloaded from the Department's Internet web site: <http://dor.wa.gov>.

RCW 82.32.050 and RCW 82.32.090 impose interest and a 5 percent assessment penalty, respectively, on the tax due before any payments are made.

HB 2671 modifies the assessment penalty effective July 1, 2006. The 5 percent assessment penalty will only be applied if the tax that is found to be due was substantially underpaid and if the amount of underpaid tax is at least \$1,000. The law defines "substantially underpaid" to mean that the taxpayer has paid less than 80 percent of the amount of tax determined to be due by the Department.

Full payment of the tax, interest, and penalty (if imposed) must be made by the due date to avoid additional interest and penalties. The penalty imposed will be a total of 15 percent of the tax due if payment is not made by the due date.

The procedures to file a petition for review are contained in WAC 458-20-100. The petition must be filed with the Department of Revenue within 30 days after the date the departmental action occurred. If the petition for review is requesting a refund of taxes paid, it must be filed within four years after the close of the year in which the taxes were paid.

The instructions in this report constitute "specific written instructions" within the meaning of RCW 82.32.090. Failure to follow the instructions may subject the taxpayer to the additional 10 percent penalty.

The Department thanks you for your assistance and cooperation.

EXHIBIT 3

STATE OF WASHINGTON
DEPARTMENT OF REVENUE

AUDITOR'S DETAIL OF DIFFERENCES
AND INSTRUCTIONS TO TAXPAYER

Comcast of Washington IV Inc
dba Paccom
Registration Number 601 031 297

Your records have been audited for the period of January 1, 1999 through December 31, 2002. The tax adjustments are summarized in Schedule 1 and supported by Schedules 2 through 6.

RCW 82.32.050(3) bars the Department from issuing an assessment of additional taxes due more than four years after the close of the tax year, except where a taxpayer has executed a written waiver of such limitation.

A Statute of Limitations Non-Claim Period Waiver Agreement covering the period of January 1, 1999 through December 31, 2002 was signed by Maya Crawford, Tax Audit Manager. The agreement extends the statutory period through October 31, 2007.

Business Activities

Comcast of Washington IV Inc is a cable TV operator and Internet service provider. You sell television programming and Internet service to subscribers in Washington for which you charge a monthly fee. You also rent and sell converters, remote controls, and modems. In addition, you sell advertising on your cable system.

Comcast of Washington W Inc is a subsidiary of Comcast. This audit was done in conjunction with other Comcast subsidiaries and partnerships. Please Refer to Workpaper M for a listing of these subsidiaries and partnerships.

Audit Scope

The scope of the audit includes the determination of your tax liability through the use of various accounting records that relate to your business activities. In the course of the audit the following accounting records were examined: general ledgers; profit and loss statements; and state excise tax returns with supporting workpapers.

Only a few copies of customer billing, price lists were made available. No audit trail detailing how the customer billings tie into the general ledger accounts were made available. Please refer to Exhibits A through D for copies of the customer billings and price lists provided.

Qualified to Excise Tax Return

This audit is qualified to the extent that it includes taxes reportable on the excise tax return only. Amounts reportable on other tax returns or by other means are not included in this report, and the Department of Revenue reserves the right to verify any other liability within the statute of limitations period. This audit is further qualified in that it only includes tax adjustments relating

to your income. A separate partial audit has been performed to assert any deferred sales tax and/or use tax liability that may be due on your purchases.

References

The instructions provided in this report address the application of the Revised Code of Washington (RCW); the Washington Administrative Code (WAC); the Washington Tax Decisions (WTD); and/or the Excise Tax Advisories (ETA) to the audit schedules. They constitute "specific written instructions" within the meaning of RCW 82.32.090. All authoritative references are available at the Department's Internet web site: <http://dor.wa.gov>.

The following abbreviations may also be used in this report: business and occupation tax (B&O); and Regional Transit Authority (RTA).

Schedule 2 - Radio and TV Broadcasting Tax Credit Due on Overreported Advertising Revenue

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Radio and Television Broadcasting B&O tax classification on gross income derived from advertising revenues.

Your advertising revenue and shopping channel revenue per your general ledgers and profit and loss statements for January 1, 1999 through November 17, 2002, plus an estimate of this revenue for November 18, 2002 through December 31, 2002, have been compared to those amounts reported on your excise tax returns. Refer to Workpaper A for the computation of the taxable amounts.

This schedule allows you credit for any overreported amounts. The overreported differences identified on this schedule for 2002 resulted primarily because of clerical errors you made. You calculated the amount of service and other activities (Service) B&O tax due. Instead of taking this tax and backing into the taxable amount to report for Service B&O tax purposes you took this tax and backed into an amount to report under the Radio and Television Broadcasting B&O tax classification.

Method of Estimating Revenue for November 18, 2002 through December 31, 2002

Suzanne Harmes, Tax Audit Manager has indicated that your general ledgers and profit and loss statements did not include your income for the period November 18, 2002 through December 31, 2002. Prior to November 18, 2002 this entity was owned by AT&T Broadband. On November 18, 2002 AT&T Broadband merged with Comcast. Because your actual revenue for the period November 18, 2002 through December 31, 2002 was not available, we estimated your revenue for this period. Your income, per your general ledgers and profit and loss statements for January 1, 2002 through November 17, 2002, was divided by 321, the number of days in that time period. The resulting quotient was then multiplied by 44, the number of days from November 18, 2002 through December 31, 2002 to estimate your revenue for this period.

Schedule 3 - Service and Other Activities B&O Tax Due on Unreported Service Income

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Service and Other Activities (Service) B&O tax classification on the gross income derived from charges made for installation and monthly service fees.

In addition, Internet subscription fees are also subject to the service B&O tax.

Your revenue subject to the service B&O tax, per your profit and loss statements for January 1, 1999 through November 17, 2002, plus an estimate of this revenue for November 18, 2002, through December 31, 2002, has been "compared to those amounts reported on your excise tax returns. Refer to Workpaper B for the computation of the taxable amounts.

This schedule asserts tax on any underreported amounts. The underreported differences identified on this schedule for 2002 resulted primarily because of clerical errors you made. You calculated the amount of radio and TV broadcasting tax due. Instead of taking this tax and backing into the taxable amount to report for radio and TV broadcasting tax purposes you took this tax and backed into an amount to report under the Service B&O tax classification.

As indicated in the discussion in Schedule 2, your profit and loss statements did not include your income for the period November 18, 2002 through December 31, 2002. Because actual revenue figures were not available, your revenue had to be estimated for this period.

In addition, your digital converter revenue from your G/L account 3151.0000.3007 has been subjected to the service B&O tax. You provide your customers with one set-top digital receiver (converter) with your sales to them of a digital cable TV package. You charge your customers a single package price for the bundled cable TV services and the use of the set-top receiver that you provide to them. Because you do not make a separate charge on your billing to your customers for a rental of the digital receiver the entire package price is subject to the service B&O tax. Please refer to the discussion of "Areas of Disagreement" below.

Schedule 4A - Retailing B&O Tax Credit Due on Overreported Retail Sales

Schedules 4B through 4P - Retail Sales Tax Due on Unreported Retail Sales - Various Locations

Sales and rentals of tangible personal property to consumers are retail sales.

Your revenue subject to the retailing B&O and retail sales taxes, per your profit and loss statements for January 1, 1999 through November 17, 2002, plus an estimate of this revenue for November 18, 2002 through December 31, 2002, has been compared to those amounts reported on your excise tax returns. Refer to Workpaper C for a computation of the taxable amounts.

Schedule 4A asserts the retailing B&O tax on any unreported revenue from the sales of cable TV guides, equipment, equipment rentals, and Internet installation charges. Schedules 4B through 4P assert the retail sales tax on any unreported revenue from these sales for each of the various locations. Unreported retail sales for 2002 were assessed at the pool code rate set out in Schedule 4P.

Refer to Workpaper D for a recap of the retail sales reported for each location for each month for 1999 through 2001.

As indicated in the discussion of Schedule 2, your profit and loss statements did not include your income for the period November 18, 2002 through December 31, 2002. Because actual revenue figures were not available, your revenue had to be estimated for this period.

Please note that while your digital converter revenue from your G/L account 3151.0000.3007 has been excluded from tax for retailing B&O tax purposes, it has been included in determining your retail sales tax liability. This is because you have collected the retail sales tax on the amount of your digital package price that you have internally allocated to your digitalconverter revenue account.

Pursuant to RCW 82.08.050 and WAC 458-20-217, retail sales tax shall be deemed held in trust by the seller until paid to the Department of Revenue. Any seller who appropriates or converts the tax collected to his/her own use or to any use other than the payment of the tax shall be guilty of a gross misdemeanor.

Please refer to the discussion of "Areas of Disagreement" below.

Schedule 5 - Retail Sales Tax Due on Non-Taxed Purchases of Digital Converters

This schedule asserts the retail sales tax on your non-taxed purchases of digital converters (receivers) from T C I Materials Management Inc an affiliate of Comcast. These purchases were delivered from T C I Material Management's Auburn, Washington warehouse. Please refer to Workpapers E through L.

You provide your customers with one set-top digital converter receiver with your sales to them of a digital cable TV package. You charge your customers a single package price for the bundled cable TV services and the use of the set-top receiver that you provide to them.

A digital set-top converter is required to receive digital cable services such as pay per view programming, on demand programming, digital music channels, the interactive programming guide and premium channels.

You internally allocate a small portion of this package price, generally around \$1.50, to digital converter revenue G/L account 3151.0000.3007 charge your customer sales tax on this internally allocated amount.

You may also rent, for a separate charge, digital set-top converters for additional television sets on which your customer would like to receive digital services. Generally, you charge between \$4.70 for an additional standard set-top converter to \$6.50 for an advanced digital set-top converter.

You are subject to the retail sales tax or use tax on your purchases of digital converters that you use to provide digital cable TV services unless you separately state on your billing the rental charges for the digital converters.

For purposes of this audit we deemed that all your purchases of digital converters were subject to the sales tax because you were unable to segregate those that you rented from those that you installed as part of the digital cable TV services package. If you can provide additional information that segregates the units you rented from the units you provided as part of a digital TV package then an adjustment may be made to this audit.

WAC 458-20-227 states that persons providing subscriber television services are subject to tax under the Service and Other Activities (Service) B&O tax classification on the gross income derived from charges made for installation and monthly service fees.

It also states that persons engaging in the business of subscriber television are subject to retail sales of use tax on all purchases of tangible personal property utilized or required in providing service to subscribers.

Please refer to the discussions of "Areas of Disagreement below.

Schedule 6 - Litter Tax Due on Sales of Cable Guides

RCW 82.19.010 and WAC 458-20-243 levy a litter tax upon manufacturers, wholesalers, and retailers of certain products that are sold in Washington State or shipped into Washington. The measure of the tax is on the gross proceeds of sales of the products listed in WAC 458-20-243 and is to be reported under the Litter Tax classification. Among the products subject to the tax are sales of newspapers and magazines.

WAC458-20-243 defines newspapers and magazines to include all daily and periodical publications. Your cable guides fall under this definition.

This schedule asserts the litter tax on your sales of cable guides.

Future Reporting Instructions

In the future you should pay sales tax or use tax on your purchases of digital converters, modems, remotes, etc. that are provided as part of the bundled digital cable TV package, or Internet service. You should not internally allocate a portion of the price to digital converter rentals or charge your customer sales tax on any portion of the bundled services. Any billings for the bundled services will be taxable under the Service B&O tax classification.

If you elect to charge a separate amount on your customer billing for the rental of a digital receiver, modem or remote control unit the charge must be a reasonable rental value.

Your purchase price of digital set-top receivers averaged around \$250 per unit for the audit period. Based on this purchase price a rental of \$1.50 per month, as is currently internally allocated to your digital converter revenue account, may not represent a reasonable rental value.

WAC 458-20-211 Section (7) provides that if rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalization value the lessor of the particular type of property is generally using in rate setting.

Generally when the Department imputes a fair rental value it takes into account such things as the annual amount of depreciation taken, the borrowing cost of funds, property taxes, insurance, maintenance, plus a profit percentage based on expected rate of return on the funds invested.

Areas of Disagreement

Disagreement with Audit Adjustments

Maya Crawford and Suzanne Harmes, Tax Audit Managers, have expressed their disagreement with the tax adjustments with respect to the digital converters subjected to the sales tax in Schedule 5. In addition, they believe that you should receive a refund for any sales tax paid to T C I Materials Management on your taxed purchases of digital converters. They also disagree

with the service B&O tax assessed on this income that you allocated to your digital converter revenue G/L account 3151.0000.3007.

As stated above, you charge your customer a single price for your digital cable TV packages on your customer billings. These packages include a tier of digital cable TV programming, Comcast on Demand, PPV (Pay per View) access, digital music channels, an interactive programming guide, one or more digital receivers and remotes, and certain digital cable packages include access to premium channels. See the examples of your price lists and customer billing in Exhibits A through D.

You internally allocate a small amount of this package price to your digital converter revenue account 3151.0000.3007. In addition, even though you do not separately state this charge on your customer billing you charge your customer sales tax on the internally allocated amount.

You may also rent digital set top receivers for a separate charge for additional television sets or on an A La Carte basis.

For purposes of this audit we deemed that all your purchases of digital converters were subject to the sales tax because you were unable to segregate those that you rented from those units that you installed as part of the digital cable TV services package. If you can provide additional information that segregates the units you rented from those units provided as part of a digital TV package then an adjustment may be made to this audit.

In addition, you rent addressable and non-addressable analog converters. You rent these converters for a separate charge and charge sales tax on that amount the amount of the rentals. These amounts have therefore been included in the retailing B&O and retail sales tax calculation and are not part of this issue that is in dispute.

WAC 458-20-227 Subscriber Television Services provides:

(1) Definitions. The following definitions apply to this section.

(a) "Subscriber television" refers to all businesses providing television programming to consumers for a fee. It includes, but is not limited to, cable television and satellite television. Subscriber television often transmits to its customer's special channels offering a variety of programming such as movies, sporting events, children's entertainment, news and other informational services.

(b) "Fee" includes the amount paid by the subscriber to receive the subscription television service. Generally, the fee consists of an amount for installation and a monthly charge for maintenance or service.

(2) B&O Tax. Persons engaging in the business of subscriber television are subject to the B&O tax as follows:

(a) Gross income derived from the charge made for installation and the monthly rental or service fee is subject to tax under the classification service and other activities. (See WAC 458- 20-224.)

(b) Gross income derived from advertising revenues is subject to tax under the classification radio and television broadcasting. (See WAC 458-20-241.)

(c) No deductions from gross income may be taken for affiliate fees, video service fees, satellite fees, copyright fees, or any other amounts paid to other firms for special programming provided to subscribers.

(3) Use Tax. Persons engaging in the business of subscriber television are subject to retail sales tax or use tax on all purchases of tangible personal property utilized or required in providing service to subscribers. (See WAC 458-20-178.)

Suzanne Harmes, Tax Audit Manager has stated in her letter dated December 14, 2006 that in Comcast's view you are engaged in two separate businesses, providing cable video service and renting ("retailing B&O") certain equipment related to this service.

She indicates that the Board of Tax Appeals has already supported her position in the case of Tele-Vue Systems, Inc v. State, BTA Docket No. 96-11.

The auditor disagrees with her conclusion in how it relates to digital package prices billed on your customer billings. The Board of Tax Appeals (BTA docket No. 96-11) ruled:

Where a person engaged in the business of providing services also provides its customers with equipment for use in conjunction with the service, the service provider is engaged in the business of leasing personal property separate from the provision of the services where (1) the agreement between the parties is designated as an outright lease or rental, without reservations; (2) the customer has exclusive use, possession, and control of the equipment even to the exclusion of the service provider (as opposed to a mere license to use the equipment, or some lessor right); and (3) the service provider separately states the charges for the leased equipment.

The Board of Tax Appeals recognized that Tele-Vue began separately itemizing charges for descrambler units on its bills to cable service customers on September 1, 1993. It therefore held that descrambler purchases beginning September 1, 1993 were purchased for resale and that the rental income was subject to the retailing B&O and retail sales taxes.

In this instance, there is no separate line item on the customer's billing for the first set top receiver included as part of the digital programming package. Instead, only a cable package price is listed which includes a tier of cable TV programming, premium channels, On Demand TV, Pay per View, digital music channels, an interactive programming guide and a digital set-top receiver (converter).

Suzanne Harmes, Tax Audit Manager also indicates that the FCC, which regulates cable television service and rates, specifically requires operators to un-bundle the equipment business from the video service business. She refers to 47 Code of Federal Regulations (C.F.R.) Section 76.923(b).

In reviewing sections 76.922 and 76.923 it appears that the C.F.R 76.922 regulates the maximum amount that may be charged to subscribers for basic and cable programming service tiers. C.F. R. 76.923 regulates the maximum that may be charged to subscribers for equipment. As long as the combined rate that you charge in your digital cable TV packages does not exceed the maximum amounts allowed for the programming, you are in compliance with these regulations.

Suzanne Harmes, Tax Audit Manager states that the "package" prices also stated on the price lists, and reflected on monthly bills, can constitute nothing more than a summary of the separate prices, since the FCC requires that customers rent this equipment for a separate charge.

In reviewing the price list the cable package prices do not equal the combination of the prices of the individual items included in the cable package, therefore it is not a summary of the separate prices. In addition, if the FCC requires that customers rent the equipment for a separate charge you have not complied with this section since you have not itemized these charges on your customer billings.

Disagreement with Future Reporting Instructions

Suzanne Harnes, Tax Audit Manager has also expressed her disagreement with the future reporting instructions above. She indicates that she believes that the discounted amount that they charge sales tax on for the digital receivers included in the digital package represents a fair rental value. She quotes paragraph (j) of C.F.R. 76.923 as her basis.

C.F.R.76.923 (j) provides:

A cable operator may offer equipment or installation at charges below those determined under paragraphs (e) through (g) of this section, as long as those offerings are reasonable in scope in relation to the operator's overall offerings in the Equipment Basket and not unreasonably discriminatory. Operators may not recover the cost of a promotional offering by increasing charges for other Equipment Basket elements, or by increasing programming service rates above the maximum monthly charge per subscriber prescribed by these rules. As part of a general cost-of-service showing, an operator may include the cost of promotions in its general system overhead costs.

This paragraph basically provides that you may not lower the rate charged for one piece of equipment and recover the costs by raising the rate charged for another piece of equipment above the maximum allowable rate for that piece of equipment. This would be unreasonable discriminatory. Or in the alternative, you may not lower the rate charged for one piece of equipment and recover the costs by raising the rate charged for cable programming above the maximum rate allowable under section 76.922. It should be noted that the maximum monthly rate allowable for equipment is based on the average purchase price of the unit plus the yearly monthly maintenance costs and dividing this sum by 12.

With an average purchase price during the audit period of \$250 this would indicate that you were allowed to charge a rate on your digital converter rentals in excess of \$20.00 a month.

While we are not advocating that you charge your customers \$20.00 a month for the rental of these converters, we feel that \$1.50 a month charge on a \$250 item is not a reasonable rental value. We do not believe that C.F.R. 76.923 is controlling in the matter of what a reasonable rental value should be.

WAC 458-20-211 Section (7) provides that if rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalization value the lessor of the particular type of property is generally using in rate setting.

Generally when the Department imputes a fair rental value it takes into account such things as the annual amount of depreciation taken, the borrowing cost of funds, property taxes, insurance, maintenance, plus a profit percentage based on expected rate of return on the funds invested.

Closing Comments

A telephone conference was held to discuss the tax adjustments on February 8, 2007. Attending the conference were Maya Crawford and Suzanne Harmes, Tax Audit Managers representing Comcast; Mark Charette, Field Audit Manager; and Donald Adamson, Revenue Auditor representing the Department of Revenue. The various areas of disagreement were discussed with no resolution reached with regards to these issues.

A separate phone conference call was held on September 17, 2007, and in addition to those parties noted above in attendance were Mr. Mike Bryan of Comcast, Mr. Dirk Giseburt of Davis Wright Tremaine LLP, and Mr. Scott Garrison, Regional Audit Manager of the Department of Revenue. The areas of disagreement were discussed and again no consensus or agreement regarding the audit findings could be reached.

If there are any questions regarding these adjustments or if additional information is needed, contact either Donald Adamson, Revenue Auditor, telephone number (360) 725-7541; or Mark Charette, Field Audit Manager, telephone number (360) 725-7539; prior to the due date shown on the assessment. Copies of all authoritative references cited in this report may be downloaded from the Department's Internet web site: <http://dor.wa.gov> .

RCW 82.32.050 and RCW 82.32.090 impose interest and a 5 percent assessment penalty, respectively, on the tax due before any payments are made.

HB 2671 modifies the assessment penalty effective July 1, 2006. The 5 percent assessment penalty will only be applied if the tax that is found to be due was substantially underpaid and if the amount of underpaid tax is at least \$1,000. The law defines "substantially underpaid" to mean that the taxpayer has paid less than 80 percent of the amount of tax determined to be due by the Department.

Full payment of the tax, interest, and penalty (if imposed) must be made by the due date to avoid additional interest and penalties. The penalty imposed will be a total of 15 percent of the tax due if payment is not made by the due date.

The procedures to file a petition for review are contained in WAC 458-20-100. The petition must be filed with the Department of Revenue within 30 days after the date the departmental action occurred. If the petition for review is requesting a refund of taxes paid, it must be filed within four years after the close of the year in which the taxes were paid.

The instructions in this report constitute "specific written instructions" within the meaning of RCW 82.32.090. Failure to follow the instructions may subject the taxpayer to the additional 10 percent penalty.

The Department thanks you for your assistance and cooperation.