NATIONAL
GOVERNORS
ASSOCIATION
1908 - 2008

Testimony of the National Governors Association

David C. Quam, Director of Federal Relations

Before the House Judiciary Committee

Subcommittee on Commercial and Administrative Law

U.S. House of Representatives

Hearing on H.R. 3679, the "State Video Tax Fairness Act of 2007

February 14, 2008

Chairwoman Sanchez, Ranking Member Cannon, and members of the Subcommittee, thank you for inviting the National Governors Association (NGA) to testify today.

My name is David Quam, and I am the Director of Federal Relations for NGA. I am pleased to be here on behalf of the nation's governors to discuss the organization's perspective on H.R. 3679, the "State Video Tax Fairness Act of 2007."

NGA opposes H.R. 3679 because decisions about state and local taxes must be made by state and local elected officials – not the federal government. The ability of states to structure their revenue systems is a core element of sovereignty that must be respected. If H.R. 3679 were to become law, it would effectively remove the authority of states to craft common-sense solutions that modernize existing state and local tax systems. If Congress is truly interested in encouraging states to reform taxes on multichannel video services, it should remove federal barriers to reform rather than imposing new restrictions.

Although the U.S. Constitution grants Congress broad authority to regulate interstate commerce, the federal government, historically, has been reluctant to interfere with states' ability to raise and regulate their own revenues. State tax sovereignty is a basic tenet of our federalist system and is fundamental to the inherent political independence and viability of states. For this reason governors generally oppose any federal legislation that would interfere with states' sovereign ability to craft and manage their own revenue systems.

The problem H.R. 3679 purportedly seeks to address -- inequality in the taxation of multichannel video services -- stems from the long-standing tax treatment of cable television and satellite services. Historically, cable services have been required to obtain franchises from local governments to operate and provide multichannel video services in specific areas. Franchise fees, which cover the costs of using local rights-of-way and provide compensation for the franchise, are capped by the federal government at 5 percent of gross receipts. Revenues from franchise agreements typically flow into the general funds of local governments and support a wide range of government operations and services.

In contrast, federal law prohibits local governments from imposing taxes or fees on multichannel video services delivered by direct broadcast satellite (DBS) providers. Federal law does, however, allow states to tax such services and distribute a portion of the proceeds to local governments. This prohibition on local government taxation was enacted as part of several 1996 telecommunications reforms to spur growth of DBS services and increase competition for incumbent cable service providers. Today DirecTV and Echostar, the two predominate providers of DBS services, serve more than 30 million subscribers and earn $25 billion in annual revenue.

The differing federal treatment of cable and satellite services has resulted in a variety of state and local tax scenarios: 47 states authorize local governments to impose franchise fees on cable services; 29 states tax DBS services; 24 states impose a sales tax on video services provided by cable companies; and 18 states allow local governments to impose sales taxes on cable video services.

Recently, several states worked within the framework of existing federal restrictions to modernize their tax systems and create parity in the tax treatment of multichannel video providers. Specifically, some states have used their authority to impose taxes on satellite services to craft a new tax on both DBS and cable services. The tax replaces traditional local franchise fees in return for the states redistributing a portion of the taxes to local governments to compensate for lost local revenues. This is the case in North Carolina where in 2006 the state legislature replaced the authority of local governments to charge franchise taxes on cable service providers with a 7 percent state sales tax on gross receipts of both cable and DBS providers. The state uses a portion of the proceeds to compensate local governments that formerly collected franchise fees and provides revenues on a formula basis to non-franchise localities.

Alternatively, some states have chosen to retain the local franchise system, while imposing a new tax on all multichannel video providers. To help equalize the payments of satellite and cable providers, the state allows a cable provider to credit a portion of the franchise fees it pays against the state tax. This is the system in Utah, where the state imposes a 6.25 percent sales tax on all multichannel video services, but allows cable providers to credit 50 percent of its franchise fees against the tax. These different approaches to taxing multichannel video services reflect the fiscal and political realities of individual states and their local governments and have withstood constitutional challenges in both state and federal court. (See *DirecTV, inc, et al. v. Treesh*, No. 3:05-CV-00024 (2007), and *DirecTV, inc, et al. v. Treesh*, No. 05-CI-01623 (2007) ; and *DirecTV, Inc. v. Tolson*, No. 07-1250 (4th Cir., Jan. 10, 2008)).

H.R. 3697 would disrupt state efforts to streamline and modernize their tax systems by imposing yet another restriction on the authority of states to develop and manage their own systems of taxation. H.R. 3697 would prohibit a state from imposing a discriminatory tax on any provider multichannel video service regardless of the technology used to provide the service. The bill defines a discriminatory tax as, “any form of direct or indirect tax that results in different net State charges being imposed on substantially equivalent multichannel video programming services.” The terms “net State charge” and “substantially equivalent” are not defined. It is unclear how the net charge would be calculated or what type of taxes and charges it would include. This uncertainty would generate increased litigation, discourage state efforts to create tax parity, and together with the existing federal prohibition on local taxation of satellite services, further entrench established tax disparities between multichannel video providers.

Conclusion:

Governors remain steadfast in their insistence that decisions regarding state and local taxation should remain with state and local officials. The independent and sovereign authority of states to develop their own revenue systems is a basic tenet of self government and our federal system. Governors also support and promote competition and encourage the development of tax and regulatory frameworks that are technology neutral, level the playing field for all competitors and provide necessary revenues to promote the public interest and support government services. Governors oppose H.R. 3697 because it unnecessarily interferes with state and local efforts to craft reasonable and constitutional tax systems that reflect market realities and serve the interests of state and local governments and consumers.