Testimony of Howard J. Symons
on behalf of the
National Cable & Telecommunications Association

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

before the
U.S. House Judiciary Subcommittee
on Commercial and Administrative Law
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Madam Chairwoman and members of the Subcommittee, my name is Howard Symons, and I am here on behalf of the National Cable & Telecommunication Association. NCTA represents cable operators serving more than 90 percent of the nation's cable TV households and more than 200 cable program networks. The cable industry is also the nation's largest broadband provider of high speed Internet access after investing more than $110 billion to build out a two-way interactive network with fiber optic technology. Cable companies also provide state-of-the-art digital telephone service to millions of American consumers. I am a partner at the law firm of Mintz Levin, and have represented the cable industry on regulatory and related tax policy matters before Congress and the FCC for almost 20 years.

Thank you for inviting NCTA to testify today about H.R. 3679.

NCTA strongly opposes H.R. 3679. It represents an unjustified interference into efforts being undertaken by state legislatures to equalize the tax burden between cable operators and providers of direct broadcast satellite service (DBS) so that consumers may have a tax-neutral choice of video providers.

In 1996, Congress insulated the then-fledgling DBS industry from the administrative burden of complying with local taxes and fees, but preserved the ability of states to impose taxes and fees on satellite providers on a centralized basis. Cable companies have no similar

insulation, and pay local taxes and fees not borne by DBS. Today, in 44 states, cable operators pay higher taxes and fees in the aggregate statewide than their DBS counterparts. Ultimately, those taxes are paid by cable's customers. DBS is now a multibillion dollar industry, and the two DBS operators are the second and third largest multichannel video providers, larger than every cable operator except Comcast. Six states have determined that this situation is unfair to cable customers. These states have enacted legislation that equalizes the tax burden between cable and DBS providers, taking into account all taxes and fees that both providers pay at the state as well as the local level.

The DBS industry, seeking to preserve its tax advantage, unsuccessfully opposed the legislation in those six states. DBS's subsequent court challenges have likewise been unsuccessful, except in one local trial court. Unable to prevail in state legislatures or in Federal court, the DBS industry has come to Congress asking you to substitute your judgment for the judgment of state legislatures. We do not believe that such a radical step is necessary or appropriate. The DBS industry has ample opportunity to argue against tax parity in each state legislature that considers the issue. It simply prefers not to do so. State governments should be the final arbiters of the tax structure in their own states as long as that judgment is exercised within constitutional bounds, as it has been with respect to the tax parity issue.

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Background On Section 602 And Its Effect On Taxing Multichannel Video Providers

In the 1996 Telecommunications Act ("Act") Congress exempted DBS operators from the obligation to "collect[] or remit[]" taxes or fees to local governments, believing such an obligation would be an administrative burden for the nascent DBS industry.[1/] A "tax or fee" is

[1/] Pub. L. No. 104-104, § 602, 47 U.S.C. § 152nt.

defined in section 602 of the Act to include taxes and fees imposed by local taxing jurisdictions, including "franchise fees."[2/]

The plain language of section 602 of the Act exempts DBS only from the administrative burden of collecting and remitting local taxes and fees. Congress did *not* exempt the DBS industry from having to *pay* taxes that benefit local governments. To the contrary, section 602(c) of the Act specifically provides that states may impose taxes on DBS operators and remit the revenues from those taxes to local governments.[3/] Thus, while Congress wanted to provide some administrative convenience for DBS operators, it fully intended for them to pay taxes to the state and that the state would remit such monies as it deemed appropriate to the localities.

In practice, however, limiting taxes on DBS operators to those imposed at the state level has created a significant disparity between what they pay and the taxes and fees imposed on cable operators. In many states, both DBS and cable operators are subject to state sales taxes, but only cable operators pay additional fees and taxes to localities. In Iowa, for instance, DBS and cable operators are both subject to a 5% state sales tax, but cable operators are also subject to a local sales tax of up to 2% as well as a franchise fee of up to 5%. Cable providers in Iowa therefore pay up to 12% in taxes and fees compared to the 5% paid by DBS providers. In Minnesota, DBS and cable operators pay a 6.5% state sales tax, but cable providers also pay a local sales tax of up to 1%, plus a local franchise fee of up to 5%, plus a 2.77% (average) PEG fee for a total of 15.27%, compared to 6.5% for DBS.

These tax disparities directly affect cable customers. For example, in San Antonio Texas, a cable customer pays $6.55 in taxes and fees on a $49.95 bill, which consists of a 5% franchise fee, 6.35% state sales tax, 1.125% city sales tax and a 0.75% local district sales tax. A satellite

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2/ *Id.*, § 602(b)(5).

3/ *Id.*, § 602(c).

customer in the same community pays only the state tax -- or $3.12 for the same bill.[4/] In Santa Monica, California, cable customers pay a 5% franchise fee and a 10% city utility users tax. Satellite customers pay neither of these. On a $49.95 monthly bill, that means cable customers in Santa Monica pay $7.50 more than satellite customers.

States Have Recently Adopted Legislation To Equalize Tax Obligations, And These Efforts Have Been Upheld By The 4th And 6th Circuit Courts Of Appeal

In recent years, state legislatures have begun to recognize the tax disparity that has grown since 1996. Six states -- Florida, Kentucky, North Carolina, Ohio, Tennessee, and Utah -- have enacted legislation to equalize the aggregate tax burden on cable and DBS operators. These six states recognized the competitive inequity and unfairness to consumers that disparate taxation of DBS and cable had produced, and enacted statutes that appropriately take into account all the taxes and fees that cable pays, at the local as well as at the state level. While section 602 prohibits direct local imposition of taxes and fees on DBS operators, it does not preclude states from establishing tax parity between cable and DBS operators that takes account of the local taxes and fees that cable operators pay.

The tax parity legislation in these six states took several forms. In North Carolina, the state eliminated local franchise fees and imposed a 6.75% sales tax on both cable and DBS. In Kentucky, the state imposed a state tax of 5.4 % on cable and DBS operators, but gave cable operators a credit for franchise fees they actually pay to localities. Under the Utah legislation, cable operators receive a partial credit toward the 6.25% state sales tax obligation. Cable operators are eligible for a credit of half of their paid franchise fees, or up to 2.5% off of the state sales tax obligation.

[4/] Mark Schichtel and Tom Donnelly, *TV Taxes: Setting the Record Straight*, 2008 STATE TAX TODAY, 19-8 (Jan. 29, 2008).

The attempts to equalize the tax obligations of cable and DBS operators have been challenged by the DBS industry in several states. For example, in North Carolina and Kentucky, DBS brought suit claiming that the tax structure was discriminatory because it treated what it called "in-state" cable operators more favorably than "out-of-state" DBS operators by taking cable's municipal tax and fee payments into account in determining the amount of state sales tax cable pays.[5/] The Federal district courts, and ultimately the 4th and 6th Courts of Appeal, rejected DBS's challenges and upheld the statutes. The 6th Circuit observed that Kentucky's statute simply "substituted a uniform state taxation scheme" and had not otherwise "altered any competitive balance among in and out-of-state competitors."[6/] The Federal District Court in North Carolina agreed.[7/] On appeal, the 4th Circuit found that under principles of comity, which require Federal courts to have "scrupulous regard for the rightful independence of state

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5/ Characterizing cable as an "in state" service is contrary to the longstanding determination that cable service is an *interstate* service because a cable system delivers video programming to its subscribers from all over the country. *See United States v. Southwestern Cable Co.*, 392 U.S. 157, 164, 178 (1968) (finding that CATV systems "are engaged in interstate communication" and holding that "the Commission's authority over 'all interstate . . . communication by wire or radio' permits the regulation of CATV systems."); *accord Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 699-700 (1984) ("the Court [in Southwestern Cable] found that the Commission had been given 'broad responsibilities' to regulate all aspects of interstate communication by wire or radio by virtue of § 2(a) of the Communications Act of 1934, 47 U.S.C. § 152(a), and that this comprehensive authority included power to regulate cable communications systems"). The FCC itself has cited *Crisp* for the point that cable is an interstate service. *Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992*, 22 FCC Rcd 5101, ¶ 136 n.464 (2007). By the same token, DBS's assertion that they have little in-state presence stretches the imagination. DBS providers maintain local receiving equipment and lease capacity on local fiber lines in each state, enabling them to retransmit broadcasts of local affiliate stations. Like many cable operators, DBS providers have legions of independent contractors and branded trucks that use local streets servicing customers. They also utilize the in-state services of retailers to facilitate the sale of their products and services.

6/ *DIRECTV, Inc. and Echostar Satellite, LLC v. Mark Treesh, Commissioner for the Dept. of Revenue for the State of Kentucky*, 487 F.3d 471, 480 (6th Cir. 2007).

7/ *DIRECTV, Inc. and Echostar Satellite, LLC v. E. Norris Tolson, Secretary of Revenue,* 498 F.Supp.2d 784, 801-02 (E.D.N.C. 2007).

governments,"[8/] all franchise fees and charges levied on cable operators must be viewed as taxes and that Federal courts cannot order "North Carolina to restore tax authority to its political subdivisions that it has seen fit to revoke."[9/] A summary of these cases is attached to my testimony.

There has only been one case in which a state's effort to equalize taxation across all levels of state government has been struck down, and that was by a local trial court in Ohio. The Ohio law at issue assessed a 5.5% state sales tax on DBS providers but not on cable providers, which are subject to local franchise fees of up to 5%. The court of common pleas in Franklin County held the law unconstitutionally discriminatory, finding that the differential tax treatment benefited in-state economic interests and burdened out-of-state economic interests.[10/] The trial court's decision is being appealed by the State Attorney General, and we are confident that it will be overturned, consistent with the logic and reasoning of the Federal courts that have examined this issue.

Having largely been defeated in state legislatures and courts, the DBS industry now seeks Federal intervention concerning how the states should structure their tax laws. The DBS providers focus on franchise fees -- to the exclusion of other local taxes imposed on cable operators -- and argue that states should be Federally foreclosed from considering the taxes and fees that cable operators pay to localities when determining the overall tax burden of a cable operator. They claim that local franchise fees are nothing more than payments for use of local

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8/ *DIRECTV, Inc. and Echostar Satellite, LLC v. E. Norris Tolson*, Secretary of Revenue for North Carolina, Case No. 07-1250, 2008 WL 95768, at 4, quoting *Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, 454 U.S. 100, 108 (1981).

9/ *Tolson*, 2008 WL 95768, at 14.

10/ *DIRECTV, Inc., et al. v. William W. Wilkins, Tax Commissioner of Ohio*, Case No. 03CVH06-7135, at 118, 124 (Ohio Com. Pl. 2007).

public resources, and that allowing an offset to state taxes is unfair to DBS operators who do not use those resources.

These are precisely the same arguments that the DBS industry unsuccessfully made to the Courts of Appeals. In response, the 6th Circuit explained, "States and local government are under no mandate to charge for the use of local rights-of-way; this is readily apparent from the fact that not every road is a toll road."[11/] Indeed, telecommunications companies generally do not pay for use of the public rights-of-way. The 4th Circuit also rejected the DBS argument, finding that North Carolina's treatment of franchise fees was entitled to comity. As the court noted, franchise fees are "spread among a wide proportion of the population" because cable providers may pass those charges onto customers, and the proceeds go towards general operating funds, not funds for rights-of-way maintenance.[12/] In fact, cable operators generally pay separately for any repairs to the rights-of-way related to the installation and upgrade of their networks. That cable providers receive something in exchange for the payment of franchise fees -- the right to use public rights-of-way -- is not determinative, the court found, because "[t]axpayers . . . often receive something of value in exchange for their taxes."[13/]

H.R. 3679 Is A Needless Intrusion On States' Efforts To Structure Their Tax Systems

H.R. 3679 attempts to outlaw tax equalization statutes, such as the ones passed by the six states, by limiting tax parity to "net State charges," *i.e.*, taxes imposed and collected at the state level. The intent behind the proposed bill is to prohibit the aggregation of state taxes, local taxes and fee burdens that certain states have done in order to establish tax parity. H.R. 3679 may even bar an approach like North Carolina's because some of the sales tax revenues collected are

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11/ *Treesh*, 487 F.3d at 479.

12/ *Tolson*, 2008 WL 95768, at 11.

13/ *Id.* at 8, n.3.

remitted to localities as specifically permitted under current law. For the following reasons, we believe that H.R. 3679 is an unwarranted intrusion in the state efforts to structure their tax systems, and would simply perpetuate the competitive inequality that DBS currently enjoys by virtue of section 602.

First, it is for the states to decide how to balance the taxes and fees imposed on cable operators, DBS operators, or other taxpayers in their states, and to determine whether it is appropriate to equalize taxing burdens by adjusting state taxes to account for local taxes and fees that are not equally borne by competitors. It is wholly unsurprising that DBS operators, Federally exempted from the collection or remittance of taxes or fees imposed and administered by local governments, would oppose counting the local taxes and fees paid by cable operators in cable's overall state tax burden. Yet the six states that have passed statutes have decided to take franchise fees and local taxes into account in determining the aggregate state tax burden imposed on cable operators. As long as the state tax measure is within constitutional limits -- as the Federal courts thus far have found that these types of measures are -- there is no problem that requires Congressional intervention.

Second, it is wholly appropriate for state legislatures to decide that cable operators should enjoy the same administrative relief in the collection and remittance of local taxes that DBS has enjoyed for over a decade. Today, DIRECTV and EchoStar are the second and third largest video distributors in the United States with more than 30 million subscribers and $25 billion in combined annual revenue. They are Fortune 500 companies that do not need any further tax advantages over their cable, phone, and wireless competitors. State legislatures should be applauded, rather than condemned, for seeking to ensure tax neutral video competition rather

than continuing to allow the state tax codes to determine winners and losers in the video and communications service marketplace.

Third, DBS's assertion that local franchise fees represent no more than payment for use of the rights-of-way by cable operators is incorrect. In fact, as the Courts noted above found, franchise fees are simply a required payment for the privilege of providing cable service.[14/] The Cable Act specifically does not define a franchise fee as a fee assessed for rights-of-way use; rather, section 622 of the Cable Act defines franchise fee, in relevant part, as "a tax, fee, or assessment of any kind imposed by a franchising authority . . . on a cable operator . . . solely because of their status as such."[15/] While some franchising authorities use franchise fee revenues to help defray the costs of managing their public rights-of-way, they are not required to do so, or to use the franchise fees they receive for any other specific purpose. Further, the amount of the franchise fee is not based on the costs incurred by the franchising authority for management and upkeep of the rights-of-way. Indeed, a franchising authority may collect franchise fees even when the cable operator has been deregulated by the FCC and so the franchising authority is not incurring any costs in regulating the provider, and many state laws permit municipalities to collect franchise fees even if municipalities do not serve as the franchising authorities in the state.

Moreover, there are many fees and taxes imposed on cable operators and other communications service providers at the local level separate and apart from franchise fees that have no link whatsoever to use of the rights-of-way. Local sales taxes, utility user taxes, "amusement" taxes, and other locally imposed taxes and fees are imposed on cable operators in

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14/ *See, e.g.*, *Tolson,* at 8, n.3.

15/ 47 U.S.C. § 542(g)(1).

addition to the franchise fees they pay. There is no rationale for excluding such fees from a comparison of cable and DBS's relative tax burdens.

Finally, the bill's open-ended definition of "discriminatory" will introduce substantial uncertainty into states' attempts to manage their fiscal matters. H.R. 3679 defines "discriminatory" as "any form of direct or indirect tax that results in different net State charges" on "substantially equivalent" providers of multichannel video. The manifold ambiguities in this language will inevitably lead to litigation over which taxes and fees to include when assessing the discriminatory impact of a "net State charge."

For these reasons, we respectfully urge the Subcommittee not to approve this bill, but rather to allow each state to choose the means of establishing tax equality for the benefit of consumers, and to ensure a tax neutral competitive video marketplace. The interests of fair competition and tax parity demand no less.

Thank you very much and I would be happy to answer any questions.

SUMMARY OF SATELLITE LITIGATION

Kentucky

- *DirecTV, Inc., et al. v. Treesh*, No. 3:05-CV-00024 (2007). The United States Court of Appeals for the 6th Circuit upheld the District Court's decision dismissing DirecTV's and EchoStar's claims that Kentucky's provision of tax credits to offset franchise fees discriminates against interstate commerce.

- *DirecTV, Inc., et al. v. Treesh*, No. 05-CI-01623 (2007). The Kentucky Court of Appeals, overruling the state trial court, held that Kentucky's local school taxes are levied by the State and therefore are not preempted by section 602 of the Telecommunications Act of 1996.

North Carolina

- *DirecTV, Inc. v. Tolson*, No. 07-1250 (4th Cir., Jan. 10, 2008). The U.S. Court of Appeals for the 4th Circuit affirmed the Federal District Court's dismissal of DirecTV and Echostar's ("DBS") appeal of a lawsuit challenging North Carolina's system for taxing satellite and cable under the Commerce Clause of the U.S. Constitution. The 4th Circuit held that principles of comity prevent federal courts from interfering with North Carolina's tax system. The District Court had also rejected DBS's argument that the system discriminated against interstate commerce. DBS challenged revisions to North Carolina tax laws enacted in 2005 and 2006. The 2005 revision increased the state sales tax rate from 5% to 7%, extended the tax to cable service providers, and allowed cable companies a credit against the new sales tax for local franchise taxes paid. In 2006, North Carolina repealed the authority of localities to impose franchise fees on cable operators and instead required a portion of the state sales tax be distributed to local governments. The 4th Circuit held that "the principle of comity reflects the recognition that states should be free from federal interference in the administration of their taxes" and the requested relief by DBS "would be heavy handed indeed, and would be a particularly inappropriate intrusion by the federal courts into North Carolina's tax laws."

- *DirecTV, Inc. v. State of North Carolina, et al*, 632 SE2d 543 (N.C.App. 2006). The North Carolina Court of Appeals upheld a 2001 State law imposing a 5% sales tax on DBS, but not cable service; localities were authorized to impose a 5% franchise fee on cable services providers based on gross receipts. DBS had challenged this arrangement on Commerce Clause grounds.

Tennessee

- *DirecTV, Inc., et al. v Chumley*, No. 03-2408 (Tenn. Chancery Ct. filed Aug. 19, 2003). Discovery in this case is ongoing.

Florida

- *DirecTV, Inc., et al. v. State Department of Florida, et al.*, No. 05-CA-1037 (Fla. Cir. Ct. filed May 4, 2005). DirectTV and Echostar have filed suit alleging that the Florida Communications Services Tax discriminates against interstate commerce in violation of the Dormant Commerce Clause of the United States Constitution. The State's motion to dismiss is pending.

- *Ogborn v. Zingale*, Case No.: 1D07-1831 (Fla. Dist. Ct. App., 1st Dist.). A group of satellite service customers filed suit against the State of Florida alleging that the Florida Communications Services Tax discriminates against interstate commerce in violation of the Dormant Commerce Clause of the United States Constitution. The trial court dismissed the suit and the case is currently pending before the 1st District Court of Appeals.

Ohio

- *DirecTV, Inc., et al. v. Wilkins*, No. 03CVH06-7135. On October 17, 2007, the Franklin County Court of Common Pleas ruled that Ohio's tax on satellite providers discriminates against interstate commerce. The parties have filed cross-motions regarding the appropriate remedy and entry of a final Order is pending. The state has indicated that it intends to appeal this ruling.