STATE VIDEO TAX FAIRNESS ACT OF 2007

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

H.R. 3679

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STATE VIDEO TAX FAIRNESS ACT OF 2007

THURSDAY, FEBRUARY 14, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:15 p.m., in room 2141, Rayburn House Office Building, the Honorable Linda T. Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Sánchez, Conyers, Johnson, Cannon, Keller, and Franks.

Staff Present: Norberto Salinas, Majority Counsel; Adam Russell, Majority Professional Staff Member; and Stewart Jeffries, Minority Counsel.

Ms. SÁNCHEZ. This hearing of the Committee on Judiciary, Subcommittee on Commercial and Administrative Law will now come to order. And I apologize for the late start, but we had votes across the street, and we are expecting more, so we have decided to press on with the hearing and get as much done as we can before the next votes. I would like to recognize myself first for a short statement.

In an era where genre-specific networks rule the airways and the public wants their entertainment on demand, cable and satellite services are more popular than ever. Nearly 100 million U.S. households receive their television programming either from cable or satellite providers. Consumers choose their television service provider based on a variety of factors, including the benefits offered, the availability in the particular location and the cost. No matter which other considerations are important, for most consumers the total cost of a subscription will always be one of the deciding factors. State and local taxes and fees are often overlooked by consumers trying to make smart choices. Because consumers don't know how much those fees might be or how those fees might change if the chosen service provider changes few can make an informed decision between satellite and cable on the basis of price. Many simply are not aware that, depending on the State, a consumer may pay more depending on the chosen television service. Considering the current economic outlook the differences in the taxes could lead some consumers in a particular State to choose one television programming service provider over another to save money. Such decisions taken together could reduce competition for all consumers and therefore lead to higher prices. Today's hearing

will discuss whether there is discriminatory tax treatment by State governments in the video programming services industry. Additionally we will examine what accounts for the differences in tax treatment between the two industries.

Finally, we will examine H.R. 3679, the "State Video Tax Fairness Act of 2007," and whether this approach ensures competition in the industry for the benefit of consumers. Accordingly, I look forward to hearing today's testimony.

[The bill, H.R. 3679, follows:]

I

110TH CONGRESS
1ST SESSION

H. R. 3679

To prohibit discrimination in State taxation of multichannel video programming distribution services.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 27, 2007

Mr. CONYERS (for himself, Mr. CANNON, Mr. BOUCHER, and Mr. FRANKS of Arizona) introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To prohibit discrimination in State taxation of multichannel video programming distribution services.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "State Video Tax Fairness Act of 2007".

SEC. 2. PROHIBITION.

No State shall impose a discriminatory tax on any means of providing multichannel video programming distribution services, including Internet protocol (or any suc-

1 cessor protocol), direct broadcast satellite delivery, and
2 cable television services.

3 **SEC. 3. DEFINITION.**

4 For purposes of this Act, the term ''discriminatory
5 tax'' means any form of direct or indirect tax that results
6 in different net State charges being imposed on substan-
7 tially equivalent multichannel video programming services
8 based on the means by which those services are delivered.

○

Ms. SÁNCHEZ. At this time, I would now like to recognize my colleague, Mr. Cannon, the distinguished Ranking Member of the Subcommittee and co-author of the legislation, for his opening statement.

Mr. CANNON. I thank you, Madam Chair. And I want to thank you for holding the hearing in my—or holding the beginning of the hearing in my absence. And I apologize to our panelists for being late. In light of the shortness of time that we encounter, I would ask unanimous consent to have my statement included in the record.

[The prepared statement of Mr. Cannon follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH, AND RANKING MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

I am pleased that we are holding this hearing after the passage of the Internet Tax Freedom Act Amendments Act of 2007. As the Chairwoman well knows, while I am supporter of this bill, I was also a supporter of the Internet tax moratorium. I am pleased that we are finally having a hearing on this bill, and equally pleased that its consideration did not slow the passage of the Internet tax moratorium extension.

Multichannel video programming distribution services such as cable television and direct broadcast satellite (DBS) providers are the methods by which most Americans receive their television programming. There are currently two DBS providers: DirecTV and EchoStar, which operates the DishNetwork. In addition, a number of the large phone companies, such as Verizon and AT&T, are beginning to roll out new television services over the Internet, which are frequently referred to as IPTV. Each of these platforms for providing television is subject to various state and local taxes.

For example, some states have the same sales tax rate for both DBS and cable providers. Some states have differing rates. Under federal law, DBS providers are exempt from the collection and remittance of local taxes and fees. However, DBS providers must collect and remit sales taxes to the states, which are free to send a portion or all of that money to the localities. By contrast, both cable and phone companies are subject to a multitude of local taxes and fees. It should be noted that in all cases the applicable sales taxes and franchise fees are passed directly onto the consumer.

One of those fees is the franchise fee that cable companies pay localities for the right to do business in that community. In several jurisdictions around the country, including Utah, cable companies have successfully lobbied state legislatures to adopt discounts in the state sales tax for the franchise fees that cable companies pay. These franchise fees are paid by cable companies for the right-of-way that they must use to lay down their infrastructure for delivering cable TV to consumers' homes. But satellite TV does not tear up the streets of a town in order to deliver satellite TV to consumers. Yet satellite consumers still have to pay a higher tax even though their service does not utilize a locality's rights of ways and telephone poles.

In still other jurisdictions, satellite TV subscribers face a higher state sales taxes rate than do cable customers. In Florida, satellite customers pay 13.17% in state sales tax whereas cable customers pay 9.17% in state sales tax—a difference of 4%. In Ohio, only satellite customers pay a 5% state sales tax; cable subscribers pay no sales tax, and this tax was recently struck down as a violation of the Commerce Clause but is under appeal.

The cable companies will argue that they are merely trying to equalize the state and local tax burden that their customers must bear. That, at least, is an argument I can understand. On the other hand, the evidence suggests that at least in some jurisdictions, cable companies are lobbying the state legislatures to raise their competitors' costs. While understandable, that is a bad deal for consumers. In the long run, I would agree most with our witness from the National Taxpayers' Union, who argues that we should be lowering taxes for all customers.

The states will certainly argue that they should be free to tax corporate entities in any way that they see fit. However, state legislatures and Congress should not be picking technological winners and losers. That is for the market to decide. If satellite TV provides better picture and service at a lower price, then consumers will move toward satellite TV. If cable is the better service provider, consumers will flock

to cable. Government should not be advantaging—or disadvantaging—one platform over the other in the form of tax policy.

I think this bill goes a long way to establishing that platform tax neutrality, and I support it.

Madam Chairwoman, I commend you for holding a hearing on this legislation, there are yet other issues affecting interstate commerce that I hope we will consider. To that end, may I suggest that the Subcommittee hold hearings on bills that prevent states from imposing discriminatory taxes on pipelines, rental cars, and cell phones, just to name a few. In the case of wireless industry, I would like to put on the record that discriminatory and regressive taxes imposed on this industry are estimated to be nearly $5 billion a year. An astonishing number and something that warrants study by this Committee.

I thank the Chair for her indulgence and yield back.

Ms. SÁNCHEZ. Without objection, so ordered.

Mr. CANNON. I will yield back.

Ms. SÁNCHEZ. Thank you.

Without objection, the Chair will be authorized to declare a recess of the hearing at any point.

I am now pleased to introduce our witnesses for today's hearing. Our first witness is Mike Palkovic. Did I pronounce that correctly?

Mr. PALKOVIC. You did.

Ms. SÁNCHEZ. Thank you.

Mr. Palkovic is executive vice president of operations for DIRECTV, Inc. In his role, Mr. Palkovic oversees primary contacts with customers from the initial point of sale through the life of the customer's programming service, including customer service, field services and supply chain management. Prior to his current role, Mr. Palkovic was executive vice president and chief financial officer of DIRECTV. He also served as the director of financial planning for DIRECTV. Prior to joining DIRECTV, Mr. Palkovic spent 14 years at Times Mirror Cable Television, where he held a number of positions, including director of business operations; director of contract negotiations and pricing; and director of financial planning and analysis; and corporate accounting manager.

Welcome to our panel today.

Our second witness is Howard Symons. Mr. Symons is a member of Mintz, Levin, Cohen, Ferris, Glovsky and Popeo. Is that correct?

Mr. SYMONS. Yes.

Ms. SÁNCHEZ. Thank you. And practices in the communications section where he represents a wide range of cable, wireless and telecommunication companies and trade associations in regulatory and legislative matters, including implementation of the Telecommunications Act of 1996. Before joining the firm, Mr. Symons served as senior counsel to the Energy and Commerce Subcommittee on Telecommunications in the U.S. House of Representatives. During his 4 years in that capacity he was responsible for the development of legislation on matters ranging from domestic, telephone policy to cable franchising and international communications. He was also responsible for the Subcommittee's oversight of Federal Communications Commission activities in the areas of telephone and cable policy. Welcome to you as well. From 1978 to 1981, Mr. Symons was a staff attorney with Public Citizen's Congress Watch where he was responsible for telecommunications policy issues. And for 10 years, he was an adjunct professor of the National Law Center of George Washington University, teaching a

course in telecommunications law and regulations. That is quite a background.

Our third witness is Kristina Rasmussen. Is that correct?

Ms. RASMUSSEN. Rasmussen.

Ms. SÁNCHEZ. I am sorry, can you repeat that again?

Ms. RASMUSSEN. Rasmussen.

Ms. SÁNCHEZ. Rasmussen. Thank you.

Ms. Rasmussen serves as the National Taxpayers Union's director of government affairs. Her primary duties are lobbying on Federal and State issues; conducting policy research and analysis; assisting in taxpayer education efforts; and formulating reports and opinion editorials. Ms. Rasmussen has been with the National Taxpayers Union since the summer of 2005. Ms. Rasmussen—pardon me, repeat that again.

Ms. RASMUSSEN. Rasmussen.

Ms. SÁNCHEZ. Rasmussen. I will get that correct by the end of the hearing. Ms. Rasmussen previously hailed from the National Federation of Independent Business, where she served as a Federal public policy assistant and intern for former Congresswoman Katherine Harris. In 2003, Ms. Rasmussen traveled to Copenhagen, Denmark, to serve as a research fellow for the Organization for Security and Cooperation in Europe. Ms. Rasmussen's opinion pieces have been featured in the Washington Post, Forbes Magazine, National Review online, Investor's Business Daily, The Hill and the Baltimore Sun, among others. Her television appearances include CNN and C-SPAN, and she has been a guest on numerous radio shows.

Our final witness is David Quam, director of the Office of Federal Relations for the National Governors Association. Mr. Quam manages NGA's legal and advocacy efforts, working closely with Governors, Washington D.C. Representatives and NGA's standing committee to advance the association's legislative priority. Prior to working at NGA, Mr. Quam served as director of International Affairs and general counsel of the International AntiCounterfeiting Coalition, Inc. He was also an associate of the law firm, Powell, Goldstein, Frazer and Murphy, LLP. Additionally, Mr. Quam was counsel on the U.S. Senate Subcommittee on the Constitution, Federalism and Property Rights for the Committee on the Judiciary.

I want to thank you all for your willingness to participate in today's hearing. Without objection, your written statements will be placed into the record. And we are going to ask that you limit your oral remarks to 5 minutes. You will note that we have a lighting system on the table. And it begins with a green light when your testimony time starts. At 4 minutes, you will get a yellow indicator light letting you know you have about a minute to finish your testimony. And then the light will turn red when your time has expired. If the light turns red and you are in mid sentence, we will allow you to complete your final thought before moving on to our next witness. After each witness has had an opportunity to present his or her testimony, Subcommittee Members will be permitted to ask questions subject to the 5-minute limit.

With that, I am going to try to squeeze in Mr. Palkovic's testimony prior to the next series of votes. So would you please begin your testimony.

TESTIMONY OF MIKE PALKOVIC, EXECUTIVE VICE PRESIDENT, OPERATIONS, DIRECTV GROUP, INC.

Mr. PALKOVIC. Thank you. Good afternoon.

Chairwoman Sánchez, thank you for the opportunity to comment today in support of Chairman Conyers and Ranking Member Cannon's proposed State Video Tax Fairness Act, the bill that would benefit all 100 million paid TV subscribers in the United States.

The essence of this fight is a clear matter of consumer welfare; 30 million of your constituents have fled cable largely because satellite companies have offered them more channels, better customer service, better picture quality and typically do it all at a lower price. Now cable is fighting back, but not by competing in the marketplace. Rather cable is persuading State legislatures to raise consumer prices by asking satellite customers to subsidize one of the cable industry's costs of doing business, a franchise fee. It makes no sense, and this Committee and Congress have rejected this premise once before.

H.R. 3679 is a simple amendment to current law that proclaims no discrimination. That is all this bill says. Consumers should be free to choose TV service based on what they care about: price, quality and service. States should not be allowed to punish consumers for their choices by hitting them with higher taxes. Congress has long accepted this nondiscrimination principle clarifying just last fall in a protected IP video from discriminatory State taxes. It should do the same for all competitors in the market. Congress has repeatedly embraced the premise of this bill.

Fair competition benefits everyone. Congress bet on fair competition 16 years agowhen they bet on satellite TV at a time when cable was the only game in town. Competition has kept prices down and improved the quality of service, spurring innovations that consumers now take for granted, like all digital programming, hundreds of Spanish and multicultural channels, DVR technology and a recent explosion in the number of high definition channels. Competition is taking hold, and consumers of video programming are increasingly price-sensitive. Thus, adding 5 percent or more to a satellite subscriber's bill to compensate the cable industry for their franchise fees hurts the competitive balance.

When cable urges you to vote no on H.R. 3679, it is arguing that States should be allowed to discriminate against satellite, literally. Just look at the language of the bill. It is that simple. Cable calls it tax parity. What does tax parity mean to cable? It means that satellite customers should pay higher taxes in order to offset a cost that is unique to cable. The cost comes in the form of local franchise fees. Cable companies voluntarily negotiate these payments with local governments for the privilege of digging up public streets and running cable on public property to subscribers' homes. So franchise fees are not taxes; they are rent.

Don't take my word for it. NGA says it in their written testimony. And cable repeatedly tells its shareholders in their SEC filings, franchise fees are not taxes; they are payments for highly valuable property rights worth billions of dollars. Should satellite TV customers pay franchise fees? Of course not. Their service does not rely on an infrastructure built by digging up public streets or hang-

ing wires on utility poles. This is particularly unfair for those rural customers who do not even have the option of choosing cable.

Congress understood all of this. In the Telecommunications Act of 1996, Congress made it illegal for local governments to impose franchise fees on satellite, even while continuing to allow local governments to collect franchise fees from cable. The House report explained the difference, quote, unlike other video programming distribution systems, satellite-delivered programming services do not require the use of public rights-of-way or physical facilities or services of a community, unquote.

In short, Congress prohibited local governments from charging rent for property rights satellite TV providers don't use and don't need. The latest trend of discriminatory State taxes in six States with more following suit is an end run around congressional intent. The States act as the local government's collection agent, essentially collecting the same franchise fees from satellite that they collect from cable and handing the proceeds right back to their local governments.

In conclusion, we urge you to close this loophole. We are not alone. Groups across the political spectrum support H.R. 3679. You will hear from the National Taxpayers Union momentarily. They are joined by the National Rural Telecommunications Cooperative, Consumers Union, The Media Access Project, Public Knowledge and the Consumer Electronics Association in urging you to adopt this nondiscrimination policy. These diverse consumer groups all understand what is going on here. They know the difference between discrimination and parity. They know the difference between rent and taxes. They know cable once again is angling for an unfair advantage, a way to win in the marketplace without actually competing. Congress has prohibited these ploys before, and it should prohibit them now by passing H.R. 3679.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Palkovic follows:]

PREPARED STATEMENT OF MIKE PALKOVIC

Testimony of

Mike Palkovic

Executive Vice President, Operations

DIRECTV, Inc.

on behalf of DIRECTV, Inc. and DISH Network

before the

House Judiciary Committee

Subcommittee on Commercial and Administrative Law

on

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

February 14, 2008

"No discrimination."

The State Video Tax Fairness Act is as simple as that. HR 3679's one-sentence non-discrimination principle prohibits a state from burdening satellite TV customers with higher taxes than cable customers—or vice versa. Satellite and cable should be allowed to compete on an equal playing field in the arena of television subscriptions, known in the industry as multichannel video program distribution or "MVPD." The 100 million odd subscribers should be free to choose one TV service over the other based on what they care about—price, service, and quality. States should not penalize the 30 million satellite TV customers with additional taxes for choosing the service they believe to be superior. Let the best service win.

Who could be against that? Cable. Why? Because cable has persuaded multiple states to pass taxing schemes that tilt the playing field in its favor. And it is bent on preserving the unfair advantage and proliferating these discriminatory taxing schemes nationwide.

When cable says, "Oppose HR 3679," it is advocating that a state *may* "impose a discriminatory tax on … direct broadcast satellite delivery." Literally. Instead of admitting that, cable, paradoxically, calls for "*overall* tax parity." But on closer inspection, that is a sleight of hand. Cable's definition of "overall" parity does not mean equalizing *taxes*. It means equalizing "taxes, *fees, and other charges*." So, the argument goes, if cable has to pay a fee or a charge, satellite's customers should have to pay it too—in some form or another.

The particular "fees" cable has in mind are franchise fees. Franchise fees are not taxes. They are payments cable companies negotiate to pay local governments in return for the right to dig up streets to lay cables and hang wires from utility poles. Franchise fees are rent for valuable property rights. Satellite does not pay that rent to local governments. Why? Because satellite providers do not need to dig up streets or hang wires on public property to transmit their TV signals to consumers. That is why Congress prohibited local governments from trying to collect franchise fees from satellite providers, even while authorizing local governments to collect franchise fees of up to 5% from cable. Cable's bid for "overall" parity—in taxes *and fees*—is a veiled assault on this principle, which has been critical to Congress's successful effort to promote competition in the industry over the past decade.

Cable's position, then, is stark: Cable has a cost that satellite providers do not. So every state should be allowed to gouge satellite customers with an additional 5% tax. That is not "parity." It is discrimination. It hurts consumers. Congress should prohibit it.

Our testimony begins with a reminder of Congress's stated goals in the MVPD arena. We then turn to Congress's past efforts to level the playing field by prohibiting local governments from charging franchise fees to satellite TV providers. Next, we describe the discriminatory taxes that states are beginning to pass at cable's behest. We then

explain why Congress must act by passing HR 3679. Finally, we rebut cable's various arguments against HR 3679.

I. Congress Has Repeatedly Intervened to Enable Satellite TV to Compete Effectively with Cable

Let us not forget why Congress stepped into the MVPD arena in the first place: For two decades, beginning in the late 1970s, any consumer who wished to subscribe to a broad menu of television programming was stuck with one option—cable. Consumers suffered exactly what one would expect from an entrenched monopoly: stratospheric prices, abysmal service, and little innovation. Congress complained in 1992 that the "average monthly cable rate ha[d] increased almost 3 times as much as the Consumer Price Index." Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, § 2(a)(1), 106 Stat. 1460, 1460 (1992) (codified at 47 U.S.C. § 521 note). Congress intervened because the public was fed up, and outraged voters demanded a solution.

In response to the public outcry, Congress minced no words about the source of the problem: "Without the presence of another multi-channel video programming distributor, a cable system faces no local competition." *Id.* § 2(a)(2). "The result is undue market power for the cable operator as compared to that of consumers and video programmers." *Id.* Accordingly, Congress declared a priority to "increas[e] competition and diversity in the multichannel video programming market." *Id.* § 19, sec. 628(a), 106 Stat. at 1494 (codified at 47 U.S.C. § 548(a)). Congress knew exactly where to look for the solution—satellite TV, also known as direct-broadcast satellite or "DBS." Congress set out to "increase the availability of … satellite broadcast programming." *Id.*

To that end, Congress enacted a series of reforms, beginning with the Cable Television Consumer Protection and Competition Act of 1992, a reform with enough bipartisan support to overcome a presidential veto. Since then, Congress has supplemented the reforms to further stoke competition and raze barriers facing new rivals (especially satellite TV). The reforms have come about every few years: the Satellite Home Viewer Act of 1994, the Telecommunications Act of 1996, the Satellite Home Viewer Improvement Act of 1999, and the Satellite Home Viewer Extension and Reauthorization Act of 2004.

These legislative and regulatory measures have started to yield the desired results. Only in the past few years has satellite TV emerged as a viable rival to cable. Surveying research from "different scholars using different data and different methods … over the course of two decades," commentators have reached a definitive verdict: "The benefits of video competition are conclusive." Jerry Brito & Jerry Ellig, *Video Killed the Franchise Star: The Consumer Cost of Cable Franchising and Proposed Policy Alternatives*, 5 J. Telecomm. & High Tech. L. 199, 212 (2006). The rate of cable price increases has slowed, and the quality of service has improved.

The recent gains, however, are as incomplete as they are fragile. Cable prices still rise above the rate of inflation. The Chairman of the Federal Communications Commission ("FCC") condemned the phenomenon as recently as last month: "The average cost of the … standard cable package[] almost doubled from 1995 to 2005—increasing 93%—while the cost of other communication services didn't just increase less, they *fell*." Remarks of FCC Chairman Kevin Martin, *Rainbow Push Coalition, 11th Annual Wall Street Project Economic Summit* 1-2 (Jan. 9, 2008), *available at* http://www.fcc.gov.

Why? Because, like any entrenched interest with dominant market share, cable has fought mightily to cling to any competitive edge and to erect novel barriers to entry, often in collaboration with state and local governments. The 15-year history of promoting competition in this arena has been a history of constant vigilance by Congress and the FCC to counter these sorts of anticompetitive maneuvers.

II. Congress Prohibited Local Governments from Charging Franchise Fees to Satellite TV

Businesses do not just get to dig up public streets and hang wires from public utility poles for free. Cable companies have to negotiate franchise agreements with local governments to obtain the rights of way necessary to run cables to their subscribers' homes. Local governments have always charged for these valuable property rights. Almost invariably, the franchise fee is a percentage of cable's revenues—a cut of cable's profits. So local governments are, quite literally, partners in the regional businesses. In furtherance of cable's business interests, local governments would often bend to cable's demand to make those rights of way exclusive. And to protect the revenue stream, states and local governments routinely passed regulations to prevent competing technologies from entering the market.

Congress knew all about franchise fees when it embarked on the effort to promote satellite as a competitor to cable. The Telecommunications Act of 1996 explicitly says that satellite TV providers are "exempt from … any tax or fee imposed by any local taxing jurisdiction on direct-to-home service," Pub. L. No. 104-104, § 602(a), 110 Stat. at 144, even while approving of franchise fees imposed on cable up to a 5% cap, *see* 47 U.S.C. § 542(b). Congress took this step because satellite does not need to dig up streets or hang wires on utility poles. As the House Report explained: "Unlike other video programming distribution systems, satellite delivered programming services do not require the use of the public rights-of-way, or physical facilities or services of a community." H.R. Rep. No. 104-204(I), at 124-25 (1995). Rep. Henry Hyde, as Chair of the House Judiciary Committee, expanded on the theme: "Section 602," he said, "reflects a legislative determination that the provision of direct-to-home satellite service is national, not local in nature." 142 Cong. Rec. 2,219 (1996). He continued:

> Unlike cable and telephone companies which utilize public rights-of-way to provide service to their subscribers, providers of direct-to-home services

> utilize satellites to provide programming to their subscribers in every jurisdiction. To permit thousands of local taxing jurisdictions to tax such a national service would create an unnecessary and undue burden on the providers of such services.

Id. In short, as a matter of federal law, local governments may not charge satellite TV providers for rights of way, precisely because satellite providers do not need rights of way when distributing their programming directly to subscribers through the electromagnetic spectrum.

III. Cable Exploits a Loophole in Federal Law to Persuade States to Do Just What Congress Prohibited

Like most any business bent on preserving its dominant market position, cable is nothing if not persistent. Cable almost immediately embarked on a campaign to persuade state legislatures to do what local governments could not. Cable noticed that Congress preserved the power of a *state* to tax satellite TV services, and, if the state wished, to share the proceeds with local governments. *See* Pub. L. No. 104-104, § 602(c), 110 Stat. at 144. Invariably, cable has promoted these laws by applying a pale patina of parity. They have made the very same argument Congress already rejected in 1996: Cable pays franchise fees that, by federal law, cannot be imposed on satellite providers, so it is incumbent on the states to counteract the alleged 5% cost advantage that satellite enjoys. The states that adopt these laws know that they are undermining federal law. Examples of discriminatory state taxes include:

- **Ohio.** This is an example of a blatantly discriminatory tax. Ohio imposes a 5.5% sales tax on DBS, but no equivalent tax on cable or other MVPD competitors. OHIO REV. CODE ANN. §§ 5739.01(B)(3)(p), 5739.01(XX), 5739.02. An Ohio court struck the law as a violation of the Commerce Clause, observing that "[h]aving been prevented by Congress from using its regulatory powers to reduce competition between the two industries, the State of Ohio is trying to accomplish the same thing through its taxing power." *DIRECTV, Inc. v. Wilkins*, No. 03CVH06-7135, slip op. at 121 (Ohio Ct. C.P. Oct. 17, 2007) (unpublished).

- **Tennessee.** Tennessee also transparently discriminates. It imposes a sales tax on cable and satellite of 8.25%, but exempts the first $15.00 of cable television services. TENN. CODE ANN. §§ 67-6-226, -227. This exemption increases the relative state tax burden on DBS by approximately 35%, assuming an average monthly price of $42.76 for expanded basic programming.

- **Florida.** Florida also imposes different sales tax rates on cable (6.8%) and satellite (10.8%). FLA. STAT. § 202.12(1)(a)-(b). The legislature's express purpose was to "restructure[] state and local taxes and fees to account for *the impact of federal legislation* ...." *Id.* § 202.105 (emphasis added). The

discriminatory tax on DBS offsets 62% of the franchise fees that local governments can charge cable.

- **Kentucky.** Kentucky purports to have abolished franchise fees and imposed 5.4% in excise and gross revenue taxes on cable and DBS. KY. REV. STAT. ANN. §§ 136.604, 134.616. However, the same legislation creates a segregated fund for proceeds from the tax and allocates those proceeds to local governments that would otherwise be entitled to the franchise fees—in proportion to the franchise fees they had historically been collecting. *Id.* §§ 136.648(3), 136.650(1)-(2), 136.652(2). In essence, the Commonwealth has therefore stepped in as the collection agent for cable's franchise fee in order to extend the fee to DBS.

- **North Carolina.** In a scheme similar to Kentucky's, North Carolina imposes a 6.75% tax on the gross receipts of both cable and DBS and preempts local franchise fees on cable. N.C. GEN. STAT. § 105-164.4(a)(6). Proceeds from the tax are allocated to local governments in an amount initially based on historical franchise fees and now based on population ratios. *Id.* §§ 105-164.44I(c) 105-164.44I(d).

- **Utah.** Both cable and DBS pay a 6.25% sales tax, but cable receives a 50% credit against the tax for any franchise fees paid. UTAH CODE ANN. §59-26-104.5. The credit lowers the effective rate of tax on cable providers and will save cable approximately $9,536,000 in 2008 and $10,013,000 in 2009. Fiscal Note, Utah State Leg., SB0145 (Jan. 30, 2007).

Cable has recruited sponsors to introduce discriminatory tax bills in Georgia, Iowa, Michigan, and New Jersey, as well. H.B. 979, 149th Gen. Assem., Reg. Sess. (Ga. 2008); S. File 390, 82nd Gen. Assem., Reg. Sess. (Iowa 2007); H.B. 4581, 94th Reg. Sess. (Mich. 2007); Assem. No. 3415, 212th Leg. (N.J. 2006). The details vary but the basic scheme is the same: To saddle satellite TV customers with taxes higher than those paid by cable, giving cable an effective price advantage of 5% or more.

Moreover, some schemes replicate exactly the sort of dizzying patchwork of local regulation from which Congress sought to protect satellite. For instance, in 2005 the Kentucky legislature amended its utility gross receipts license tax, authorizing Kentucky school districts to individually decide whether or not to levy the tax on DBS and, consistent with state guidelines, to set the applicable tax rate. KY. REV. STAT. ANN. §160.614. The burdens associated with such a tax scheme—*i.e.*, matching each address of thousands of DBS subscribers to the appropriate school districts, determining whether each school district had opted to apply the tax, and where it had, calculating the amount of the tax based on each district's rate—are costs that Congress clearly intended to prevent DBS, a uniquely nationwide competitor, from facing.

These laws will sweep the country—unless Congress acts now.

IV. Congress Should Close the Loophole

The sole purpose of HR 3679 is to restore the balance Congress struck in 1996. The bill would preclude states from acting at cable's behest to undermine federal law through the transparent device of restructuring their state and local taxes and fees. Congress should pass HR 3679 because the imperative of protecting satellite TV providers from unjustified fees is every bit as important now as it was a decade ago.

HR 3679 is as simple as it is unobjectionable. Its one sentence says: "No State shall impose a discriminatory tax on any means of providing multichannel video programming distribution services." States may not use their taxing power to favor cable over satellite—or vice versa. This is essentially the same protection Congress already provided for IP video, which is shielded under the Internet Tax Freedom Act's prohibition against discriminatory taxes on electronic commerce. Pub. L. No. 105-277, §1101(a)(2), 112 Stat. 2681 (1998); *as amended* Pub. L. No. 107-75, 115 Stat. 703 (2001); Pub. L. No. 108-435, 118 Stat. 2615 (2004); Pub. L. No. 110-108, 121 Stat. 1024 (2007).

Congress must take this modest step if it wants to have any hope of preserving the extraordinary advances it has made in promoting competition between cable and satellite TV. Consumers should be free to choose between satellite and cable based upon what they care about—price, quality, and service. Satellite TV consistently beats cable on these criteria. States should not be allowed to punish the 30 million American households that subscribe to satellite TV for choosing the product they consider superior.

If Congress does not act now, discriminatory taxes will become the norm. Cable will enjoy an automatic, and artificial, 5% cost advantage over satellite providers nationwide. That will, of course, hurt satellite customers. But it will also hurt cable customers because as long as it can keep satellite prices artificially high, cable can afford to inflate its own prices as well. In the end, competition will diminish, prices will rise, and consumers will suffer.

To be sure, satellite providers can continue to sue to invalidate these discriminatory laws, as they successfully did in Ohio. But in the absence of a clear Congressional command, some courts have been reluctant to invalidate state laws based upon broad constitutional proscriptions. Satellite providers will continue to press ahead in the courts, if need be. But they should not have to spend millions of dollars trying to persuade federal judges to do what Congress clearly has the authority to do and what Congress obviously has intended all along.

V. Cable's Arguments in Support of Discrimination Are Wrong

There is no avoiding this simple truth: In opposing HR 3679, cable is taking the position that a state *should* be allowed to "impose a discriminatory tax on any means of providing multichannel video programming distribution services." Cable cannot bring itself to put it quite that starkly. So it clothes the message in a variety of other arguments. Each of cable's arguments is wrong. Contrary to what cable says:

Discriminatory state laws do NOT promote "tax parity"

Cable begins its attack, inauspiciously, with a paradox that would make even Big Brother blush. It opposes a law prohibiting states from "impos[ing] a discriminatory tax" by asserting that such a law "prohibits states from establishing tax parity."

In truth, cable is not advocating "tax parity." It seeks to equalize "taxes, *fees, and other charges*." Every time cable complains that it "pay[s] more in state and local taxes *and fees* than … satellite … television service," it is referring mainly to *franchise fees*. And every time cable says that states should be allowed to equalize cable's franchise fees with offsetting taxes on satellite, it is contradicting Congress's explicit policy of allowing local governments to impose franchise fees on cable—up to a limit of 5%—but prohibiting them from imposing any franchise fees on satellite.

Franchise fees are NOT taxes, and should not be equalized between businesses that need to acquire valuable property rights and businesses that do not

Congress was correct in 1996, when it concluded that it is appropriate for local governments to charge cable franchise fees, but inappropriate for them to charge franchise fees to satellite TV providers. And it is still correct.

Cable's franchise fees are like rent, a real economic cost that arises from its singular method of distributing video programming. Unlike taxes, which generate revenue for the general operation of government, franchise fees are compensation for costs imposed on, or benefits derived from, local governments—extraordinarily valuable benefits.

Just as satellite TV providers have to pay billions of dollars to buy, launch, and maintain satellites, cable providers have to pay real money to lay cables on public property. Just as satellite providers cannot credibly argue that cable companies should bear a heavier tax to offset the cost of buying satellites, cable cannot get away with arguing that satellite providers should be burdened with a heavier tax to offset cable's costs of doing business.

Don't take our word for it. Let's look at how everyone else—including cable, itself—describes franchise fees:

When convenient, cable admits that franchise fees are costs that pay for valuable rights of way:

- Cable argues that franchise fees are costs when disputing the amount of those liabilities in federal courts, which can enjoin the collection of fees, but not taxes. *E.g.*, *Time Warner Entertainment-Advance/Newhouse Partnership v. City of Lincoln*, 360 F. Supp. 2d 1012 (D. Neb. 2005).

- Cable reports local rights of way as valuable assets—worth billions—when making financial disclosures to shareholders. *See* Time Warner Cable Inc. Quarterly Report (Form 10-Q for Q3 2007) at 27 ($38.1 billion); Charter Communications, Inc., Quarterly Report (Form 10-Q for Q3 2007) at 4, 10 ($9.1 billion); Comcast Corp. Quarterly Report (Form 10-Q for Q3 2007) at 2 ($58 billion); CSC Holdings Inc. Quarterly Report (Form 10-Q for Q3 2007) at 3, 13 ($731.8 million); Mediacom Broadband LLC, Annual Report (Form 10-K for 2006) at 27 ($1.26 billion).

Neutral observers, including Congress, uniformly find that cable's franchise fees are costs of doing business:

- In 1996, Congress described franchise fees not as taxes, but as "fair and reasonable compensation … for use of the public rights-of-way." 47 U.S.C. § 253(a), (c). Two years later, defining the term "tax" in a different law, Congress declared that "such term does not include any franchise fee or similar fee imposed by a State or local franchising authority." Internet Tax Freedom Act of 1998, Pub. L. No. 105-277, § 1105(8), 112 Stat. 2681, 2681-719 (codified as amended at 47 U.S.C. § 151 note).

- When calculating cable's gross revenues, federal courts have held that proceeds collected to pay franchise fees, unlike those collected to pay taxes, cannot be excluded. *City of Dallas v. FCC*, 118 F.3d 393, 397 (5th Cir. 1997) (holding that a franchise fee is "not a tax … but essentially a form of rent").

- Counties and municipalities persuade state courts that franchise fees are costs, not taxes, when defending the imposition of those fees without following procedural requirements for tax increases. *Bruce v. Colorado Springs*, 131 P.3d 1187 (Colo. App. 2005) (a franchise fee is the "cost of doing business"); *Kowalski v. Livonia*, 705 N.W. 2d 161 (Mich. App. 2005) ("[T]he 'franchise fee' is a voluntary payment and consideration in exchange for a commodity.").

- Accountants require cable to treat franchise fees as a cost of doing business similar to salaries, rent, and programming and marketing costs. Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 51*, at 9 (Nov. 1981).

Satellite's exemption from franchise fees is NOT "preferential tax treatment"

For all these reasons, cable is just plain wrong when it asserts that the differential treatment of franchise fees amounts to "preferential tax treatment." The main effect of the preemption provision is to prohibit local governments from fleecing satellite subscribers by exacting franchise fees for rights of way that satellite providers do not use and do not need. Congress essentially said that since satellite providers do not rent public property, local governments cannot charge them rent.

Cable complains that it is subject to other local impositions, such as sales taxes, that satellite does not have to pay. As Congress understood, there are serious policy problems—and, indeed, even constitutional problems—with trying to tax a service with virtually no nexus to a state other than a signal beamed from outer space. Because of cable's significant presence and operations within each local government's jurisdiction, it receives benefits for the local taxes that it pays—benefits that satellite providers would never reap. As such, cable's local tax obligations do not justify abandoning the preemption of local fees and taxes on satellite, or letting states undermine it. That is especially true because, as Congress no doubt understood when enacting the preemption clause, if local governments are given the latitude to do so, many of them will reflexively charge satellite franchise fees but simply label them taxes.

Congressional vigilance is STILL necessary

Contrary to cable's position, Congress cannot afford to turn a blind eye to discriminatory state taxes. The federal policy of protecting satellite TV's capacity to compete with cable is as important as ever.

To be sure, Congress's initiatives to promote satellite TV have borne extraordinary fruit in record time. "Satellite competition has largely replaced price regulation as the constraining force on cable pricing and driving force for innovative services." Gregory S. Crawford, *Cable Regulation in the Satellite Era* 3 (Sept. 5, 2006) (working paper, *available at* http://www.u.arizona.edu/~gsc818/research/papers/cablereg.pdf) (surveying literature). As cable itself admits, "Competition Works. Consumers Win." NAT'L CABLE & TELECOMM. ASS'N, INDUSTRY OVERVIEW (2007), *available at* http://i.ncta.com/ncta_com/PDFs/NCTA_Annual_Report_ 04.24.07.pdf. The record so far speaks for itself:

- ***Competition Results in Lower Prices.*** Economic studies reveal, not surprisingly, that increased competition from satellite and other sources has suppressed cable price rises. In many markets where satellite achieves sufficient penetration, satellite provides the only significant price check on the incumbent cable provider, resulting in a price for cable that is estimated to be 15% lower than it would be without competition. *See* Crawford, *Cable Regulation in the Satellite Era* at 2, 26-27.

- ***Competition Leads to Increased Quality.*** The presence of satellite competition also leads to improved quality of service. *See* U.S. Gov't Accountability Office, *The Effect of Competition from Satellite Providers on Cable Rates* 4 (July 2000). In addition to "expanding channel capacity," cable has responded to satellite competition by "deploying premium tiers, video on-demand, high definition programming, and digital video recorder services." Daniel L. Brenner, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming: Comments of Cable* 10-12 (Nov. 29, 2006), *available at* http://www.ncta.com/PublicationType/Regulatory Filing/3714.aspx.

But this is no time for complacency. Demand for satellite TV appears to be extraordinarily sensitive to price. *See* Austan Goolsbee & Amil Petrin, *The Consumer Gains from Direct Broadcast Satellites and the Competition with Cable Television* 27 (June 2001), *available at* http://www.nber.org/papers/w8317. A discriminatory tax that effectively increases the cost of satellite TV relative to cable by 5% will subvert satellite TV's role as a viable alternative to cable in a particular regional market. And the moment robust competition is undermined, prices will rise—not just for satellite subscribers, but for cable subscribers as well.

The growth of satellite TV providers is no excuse to reverse federal protections

Cable is still the dominant form of distribution around the country—with 70% of all U.S. subscribers. Even satellite's 30% following is misleading, for it represents some markets with deep penetration and others will little penetration—e.g., in urban markets satellite has less than a 13% share of subscribers. U.S. Gov't Accountability Office, *Direct Broadcast Satellite Subscribership Has Grown Rapidly, But Varies Across Different Types of Markets* 7, 14-15 (April 2005). Cable could still reverse the tide of competition by hawking anticompetitive schemes of the sort that it has successfully pressed in multiple states.

Closing the loophole in federal law is NOT a tax hike

Cable argues that HR 3679 "would also likely result in a direct increase in the aggregate taxes on cable customers in states that have enacted" these discriminatory laws. Of course, the only time HR 3679 could impact a state's tax laws is if the state has violated the proscription that "[n]o state shall impose a discriminatory tax on … direct broadcast satellite delivery." So cable's insistence that states will have to change their taxes is a concession that states are currently discriminating.

In any event, cable is wrong. When a state uses its tax laws to discriminate, and that discrimination is illegal, the state must stop discriminating. It could do that in three ways. The most obvious way is to *repeal* the tax that burdens satellite discriminatorily. Another alternative is to *impose* the tax evenhandedly on cable as well. The most likely choice, however, is to spread the tax burden currently imposed on satellite subscribers

across the overall population of subscribers (which is more than three times the size), so the net tax remains the same and the tax on satellite subscribers declines to a third its present size. The choice is the state's to make. Whatever course the state takes, the result will be the same: Consumers will benefit from the robust competition that comes with an even playing field, and the benefit will more than compensate for incremental tax burden that a state might impose to level the playing field.

This is NOT about states' rights

As a last resort, cable portrays this issue as a improper intrusion on "the rights of states" to fashion their own tax schemes. Cable, however, had no trouble urging Congress to override state and local prerogatives when it lobbied for a 5% cap on franchise fees in 1996. And cable did not give a second thought to states' rights when it lobbied just this past summer for a permanent *moratorium* (not simply a principle of non-discrimination) on state taxes on internet access. Cable's pitch was that "[t]he actions of … errant states must be addressed because they … circumvent the will of Congress." *Hearing on the Internet Tax Freedom Act Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 3 (July 26, 2007) (written testimony of Meredith Garwood, Vice President Tax Policy, Time Warner Cable). It went on to assert: "It is hard to imagine that at some point in the future it will make sense to allow access to the Internet to be taxed by thousands of taxing jurisdictions." *Id.* at 2.

The same is true for satellite. The existing preemption statute already addresses the burden of a national service dealing with "thousands of taxing jurisdictions." All HR 3679 would do is deal with the "actions of errant states."

In enacting HR 3679, Congress would be protecting important national interests in an enormous national market, encompassing 100 million American households. Congress has already wisely made the decision not to allow states or local governments to interfere with competition in this national market, particularly when they do so at the behest of the interest with dominant market position. This important goal cannot be defeated by wafting around states' rights and calling it a day.

Congress would advance those national interests while allowing the states to remain free to tax to their hearts' content, so long as they do so without discriminating.

ATTACHMENT

HR 3679 Prohibits Discriminatory Taxation and Levels the Competitive Landscape in the Multichannel Video Industry

The Issue: Discrimination. Satellite TV and cable should compete for subscribers on a level playing field, based on what consumers want—lower prices, higher quality, and better service. Congress has long made it a priority to spur competition in TV service, by promoting satellite and leveling the playing field. But, at cable's behest, states have begun enacting creative tax laws that tilt the playing field in cable's favor by penalizing satellite TV subscribers for their choice with higher taxes. HR 3679 seeks only to right this wrong by announcing a policy that is as simple as it is unobjectionable—*no discrimination*.

The Impact: If enacted, HR 3679 would return the competitive landscape of the multichannel video industry back to what Congress intended it to be—in a word, fair. It would allow market competition to spur innovation and increase the quality and level of service while driving prices down, all to the benefit of the nearly 100 million American households who subscribe to such services. If Congress refuses to act, however, these discriminatory taxes will proliferate, competition will diminish, prices will rise, and consumers will suffer.

Cable says it is for "tax parity," but what it wants is a subsidy:

- Cable is hawking bills in state legislatures that effectively offset cable's franchise fees—a cable-specific cost of doing business—with money from the pockets of satellite consumers.
- These tax bills and laws unjustifiably increase the tax burden on satellite consumers relative to cable.

In 1996, Congress prohibited local governments from charging franchise fees to satellite TV, while upholding franchise fees for cable—and for good reason:

- Franchise fees are NOT taxes; they are rents for valuable rights-of-way: for digging up roads, hanging cables on utility poles, etc.
- Franchise fees are an inherent cost of doing business for cable—NOT for satellite.
- Satellite does not use municipal property for its transmissions; it has its own costs of business—building, launching, and maintaining satellites in outer space.
- Cable customers don't pay for satellites; so satellite customers should not have to pay cable's rent.

In an effort to preserve its dominant market position, cable is exploiting a loophole in federal law to circumvent Congress's prohibition and enact discriminatory state tax laws:

- Florida, Kentucky, North Carolina, Ohio, Tennessee, and Utah have all enacted tax laws that essentially offset cable's costs (franchise fees) with increased taxes on satellite consumers.
- Cable has introduced such bills in several other state legislatures, many of which are pending.

Discriminatory taxes hurt everyone—*except cable*:

- Discriminatory taxes increase satellite's costs—competition suffers.
- Discriminatory taxes decrease state revenue—state budgets suffer.
- Discriminatory taxes stifle competition—consumers suffer.
- Discriminatory taxes subsidize cable's franchise fees and give it an unfair competitive advantage—cable prospers.

There is only one reason why cable opposes HR 3679: because it favors discriminatory taxes on satellite.

Level the playing field. Support Innovation. Support real tax parity.

Ms. SÁNCHEZ. Thank you very much for your testimony. We have been called across the street for votes, so we will stand in recess. We will return immediately following the last vote.

[Recess.]

Ms. SÁNCHEZ. The Subcommittee will come to order. And I believe we left off with Mr. Symons. And I have been advised that I have been mispronouncing your name, and my apologizes.

Mr. SYMONS. That is quite all right, Madam Chairwoman.

Ms. SÁNCHEZ. I would invite you to please give your testimony at this time.

TESTIMONY OF HOWARD J. SYMONS, ESQ., MINTZ, LEVIN, COHN, FERRIS, GLOVSKY AND POPEO PC

Mr. SYMONS. Thank you very much, Madam Chairwoman, and Members of the Subcommittee.

My name is Howard Symons, and I am here today on behalf of the National Cable and Telecommunications Association. Thank you for inviting NCTA to testify today. We strongly oppose H.R. 3679. We believe it represents an unjustified interference into efforts being undertaken by State legislatures to ensure that consumers have a choice of video providers that is neutral as to government-imposed taxes and fees.

The Telecommunications Act of 1996 exempted DBS operators from the administrative burden of collecting and remitting local taxes and fees, but it did not exempt the DBS industry from having to pay taxes that benefit local governments. In practice, however, the law has resulted in a significant disparity between what DBS pays and the taxes and fees imposed on cable operators. In many States, for instance, both DBS and cable operators are subject to State sales taxes, but only cable operators pay additional taxes and fees to localities. In Santa Monica, California, for instance, local taxes and fees add $7.50 to a monthly cable bill of $50.00. Six States have determined that this situation is unfair to cable customers, and they 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 at the local level. The DBS industry unsuccessfully opposed legislation in these six States. And its subsequent court challenges have likewise been unsuccessful save for one local trial court.

Unable to prevail in the 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 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 this issue, it simply prefers not to do so. DBS argues that States should be federally foreclosed from considering local taxes and fees when determining cable's overall tax burden. It claims that local franchise fees are nothing more than payments for local public resources and that allowing an offset to State tax is unfair to DBS operators who do not use these resources. But State governments should be the final arbiters of the tax structure in their own States as long as they exercise that judgment within constitutional bounds, as they have.

And DBS's core assertion that franchise fees represent no more than a payment for rights-of-way is incorrect. As the Fourth Circuit noted in rejecting this claim, franchise fees are spread among a wide proportion of the population because they are passed through to all cable subscribers. And the proceeds go to general operating funds of localities, not for rights-of-way maintenance. In fact, cable operators generally pay separately for any repairs to the rights-of-way related to the installation and upgrade of their networks. DBS also argues that franchise fees must be rent for rights-of-way because businesses don't get rights-of-way for free, but that is simply not true. Telephone companies, for instance, generally do not pay for public rights-of-way. And as a Sixth Circuit explained, State and local governments are under no mandate to charge for rights-of-way. This is readily apparent from the fact that not every road is a toll road. And there are other taxes imposed on cable operators at the local level that are separate and apart from franchise fees that have no link whatsoever to the use of rights-of-way. There is certainly no rationale for excluding such fees from a comparison of cable and DBS's tax burdens.

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 annual revenue. They certainly don't need an unfair tax advantage over cable, phone and wireless competitors. It is wholly appropriate for State legislatures to let the marketplace rather than artificial distinctions in taxes and fees drive consumer choice from among multichannel video alternatives. The Federal Courts, having found that the States are acting appropriately, there is simply no problem that requires congressional intervention. Thank you very much, and I would be happy to answer any questions.

[The prepared statement of Mr. Symons follows:]

PREPARED STATEMENT OF HOWARD J. SYMONS

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
February 14, 2008

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

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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.

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[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.

Ms. SÁNCHEZ. Thank you very much for your testimony.

Ms. Rasmussen, I would invite you to give your testimony at this time.

TESTIMONY OF KRISTINA RASMUSSEN, DIRECTOR OF GOVERNMENT AFFAIRS, NATIONAL TAXPAYERS UNION

Ms. RASMUSSEN. Thank you. Once again, my name is Kristina Rasmussen. I am director of government affairs for the National Taxpayers Union. We are a grassroots organization of taxpayers with 362,000 members nationwide.

NTU believes that H.R. 3679, the "State Video Tax Fairness Act of 2007," would help ensure that consumers, not State governments, pick marketplace winners and losers. Americans really expect nondiscriminatory tax treatment; yet six States, that of Ohio, Florida, Kentucky, North Carolina, Tennessee and Utah, levy discriminatory taxes on satellite TV. In the case of Ohio, lawmakers approved a special tax on satellite TV viewers but completely exempted cable users. As a result, satellite consumers paid over $26 million in extra taxes in 2005. In Tennessee, the first $15 of monthly cable service charges is exempted from a tax paid by both cable and satellite. For price-sensitive consumers, these differences can determine which service they ultimately purchase. At the end of the day, consumers shouldn't have to pay higher taxes just because they use satellite instead of cable or vice versa.

Now the need for this bill rests largely on how we measure and compare the various government-imposed burdens on the video services industry. Defining a franchise fee as a cost of doing business as opposed to an outright tax has much to do with reconciling the situation at hand. Yes, a franchise fee remains a mandatory burden that customers, employees and shareholders ultimately bear. However, NTU believes that the recovery of an actual and legitimate expense of a given government service, especially those for which an entity voluntarily avails itself, can meet the definition of a user cost rather than a tax. We have a long record of opposing unreasonable fees, especially when they have no connection to the resulting services. However, there are distinct benefits received in exchange for cable franchise fees, such as rights-of-way for laying cable and, historically, exclusive rights to provide service within a given jurisdiction.

If cable companies believe they are being overcharged by localities, they should negotiate to reduce their fees. If franchise fees are used solely as revenue spigots for local governments, we support efforts to change existing law to remedy that. Until then, NTU believes that H.R. 3679 provides a logical starting place, the State level, for reconciling some of these tax burdens to ensure that no one is put at a competitive disadvantage. From NTU's viewpoint, our laws should reflect low taxes and free markets. We are not ignorant of the federalism concerns involved with this issue. However, we need to recognize the urgency of protecting residents of all 50 States from predatory taxes at the non-Federal level. As a practical matter, States and localities can sometimes be oblivious to the blight of consumers and businesses facing unfair taxation. Until citizen activists can establish comprehensive tax limitation and reduction measures in their communities, we believe it is perfectly

reasonable for Congress to set some sensible boundaries through Federal law and the Constitution's commerce clause. We have seen this occur with great success with the Internet Tax Freedom Act, and similar nondiscrimination protection for wireless service is being pursued in this Congress. Consumers of video services should not be forgotten.

Now, much of this debate over tax discrimination has focused on a form of fairness that only fills government coffers further. That is making sure providers of similar services suffer the misery of equally harsh taxes. While we recognize that some States could abuse H.R. 3679 and raise taxes on cable instead of lowering them on satellite systems, we understand the bill's intent as one that would keep any additional taxes on television service at bay when we would welcome language clarifying this point. But at the very least, State governments should not discriminate among products or services by disadvantaging one with heavier taxes.

Thank you for allowing me to submit this testimony. While we see merits on both sides of the discussion, we ultimately feel that satellite consumers should not be forced to pay additional taxes to reach or surpass parity with franchise fees. At this time, we would classify a vote in favor of H.R. 3679 as the pro-taxpayer position in our annual rating of Congress.

Thank you very much.

[The prepared statement of Ms. Rasmussen follows:]

PREPARED STATEMENT OF KRISTINA RASMUSSEN

I. INTRODUCTION

Chairwoman Sánchez and Members of the Committee, my name is Kristina Rasmussen. I am Director of Government Affairs for the National Taxpayers Union (NTU), a grassroots organization of taxpayers with 362,000 members nationwide. I encourage you to find out more about NTU on our website: www.ntu.org.

I offer this testimony in support of H.R. 3679, the State Video Tax Fairness Act. This bill would address the issue of discriminatory video services tax policy by prohibiting inequitable state taxes that are dependent on the mode of programming delivery.

NTU approaches this bill not from the corporate or government perspective, but that of the taxpayer and the consumer. We look for indications of neutrality, simplicity, and transparency when we review proposals to change tax policy, and we believe all three goals are furthered by this bill. In deciding to support H.R. 3679, we were particularly mindful of tax/fee distinctions and issues of federalism, as evidenced by the following testimony. NTU believes that passage of H.R. 3679 would help ensure that consumers—not the states—pick marketplace winners and losers.

II. TELECOM TAXATION VERSUS OTHER PRODUCTS AND SERVICES

Telecommunication services of all varieties have been targets for disproportionate and punitive taxes since the Spanish-American War. These taxes have slowed much of the progress and productivity that could have emerged to enrich our society sooner.

Indeed, a recent survey completed by researchers at the Heartland Institute found that taxes and fees on telecommunication services (e.g., TV and telephone) were typically more than twice as high as those on other retail goods. The average difference was a rate of 13.4 percent for telecommunication, versus 6.61 percent for other products. The same study noted that taxes and fees on communication services directly cost taxpayers more than $37 billion annually, not to mention the yearly "deadweight loss" to the economy of more than $11 billion.

There is a clear need to reduce overall telecommunication tax burdens, promote consumer choice, and provide a neutral playing field among similar products. As such, NTU regularly supports efforts to cut or eliminate telecommunication taxes and fees. We have also advocated in favor of statewide franchising reforms that allow the entry of new competitors into the video, voice, and data delivery markets.

At the federal level, we have endorsed efforts to prevent discriminatory taxation of Internet and wireless services (specifically, the Permanent Internet Tax Freedom Act of 2007 and the Cell Phone Tax Moratorium Act), and we support the application of this principle to video services.

III. STATE TAXATION AMONG VIDEO SERVICES

"Playing favorites" is an accusation often leveled at authority figures like bosses and teachers, but TV fans never expected discriminatory treatment to come from a state's Tax Code. Currently, six states (Ohio, Florida, Kentucky, North Carolina, Tennessee, and Utah) levy state video service taxes on satellite TV that are higher than those levied on cable TV or other similar consumer products.

In the case of Ohio, lawmakers approved a special 5.5 percent tax on TV viewers getting their signal from a satellite service. Cable users, on the other hand, are completely exempt from the tax. So a viewer and his neighbor could be enjoying the same TV program, but one would be paying more in taxes if he uses a satellite dish while the other viewer uses cable. And the resulting bill isn't insignificant—satellite consumers in Ohio paid $26.2 million in extra taxes in 2005. In Florida, satellite TV is taxed by the state at a higher rate than cable (13.17 percent versus 9.17 percent).

In the state of Kentucky, recent statewide reforms levied a combined 5.4 percent tax on both satellite and cable, and then sent revenues back to localities proportionate to the franchise fees they had been receiving from cable prior to the reform. North Carolina employs a similar set-up. We are concerned that satellite consumers are now being squeezed by new taxes to pay funds toward fee totals they would never have had to pay. We believe this system violates Congress's intent in the Telecommunications Act of 1996 to keep local franchise fees off satellite service.

In Utah, both cable and satellite pay a 6.25 percent tax, but cable can apply half of any franchise fees paid toward this burden, thereby lowering the operative tax rate. In Tennessee, both cable and satellite consumers pay a sales tax of 8.25 percent, but the first $15 of monthly cable service charges are exempted from this tax (charges above $27.50 are taxed at a 7 percent state rate). For price-sensitive taxpayers, these differences can determine which service they ultimately purchase.

Imagine paying a higher tax rate if you received your salary via direct deposit instead of a check. Or paying taxes on chocolate ice cream but not vanilla. The same thing goes with TV service: Consumers shouldn't have to pay higher taxes just because they use satellite instead of cable, or vice versa.

IV. TAX PARITY AND FRANCHISE FEES: A DIFFICULT RECONCILIATION

The need for H.R. 3679 rests largely on how the various government-imposed burdens of the video services industry are measured—which, in turn, could help determine what types of taxes are discriminatory in nature. The answer is, admittedly, not a simple one. Yet, this very question is reason to embrace rather than shun enactment of H.R. 3679.

Opponents of the legislation contend that the "franchise fees" local governments often extract from cable companies are not sufficiently accounted for when comparing state-level tax policies toward cable and satellite television products. Defining a franchise fee as a "cost of doing business" as opposed to an outright tax has much to do with reconciling differences at the state level. While this fee remains a mandatory burden that customers, employees, and shareholders ultimately bear, NTU believes that the recovery of an actual and legitimate expense of a given government service, especially those for which an entity voluntarily avails itself, can meet the definition of a user cost rather than a tax.

We recognize that a franchise fee is a form of extraction by the government, and we have supported and will continue to support efforts to reduce this cost. NTU has a long record of opposing fees and efforts to increase them, especially when they bear little relation or have no connection to the services they are supposed to support. For example, NTU recently opposed attempts to prolong the existence of a special Virginia vehicle registration fee that had been created to fund the now-concluded Jamestown 2007 celebration. The extension of this fee beyond the life of the event it was created to fund would be a clear example of a fee bearing no relation to the promised service.

However, there are distinct benefits received in exchange for cable franchise fees, such as "rights of way" for laying cable necessary for delivering a product. As an aside, we note the strange logic between tying a company's right-of-way cost to an unrelated measurement such as gross revenues. Presumably the cost of "renting" space to run cable is fixed to local property values, so why should the cost be a set portion of their earnings? Regardless, if cable companies believe they are being over-

charged by localities for this benefit, we strongly believe they should be working to convince state and local governments to reduce their fees.

There is, however, another important consideration in the debate over H.R. 3679. Unlike many user charges, which entities simply figure as a baseline necessity in order to do business, franchise fees actually deliver a reverse benefit to the payer: historically, in the case of cable TV, the exclusive right to provide service within a given jurisdiction. Surely the value of these franchises is considerable to their holders. Despite various government pricing and service-provision regulations, a franchise fee confers protection from competitors using the same mode of transmission and, in the case of competition from other modes of transmission, serves as a way to muddy the fiscal waters and argue for higher taxation.

In truth, comparing the tax burdens of video providers depends upon many variables. Cable companies contend that the franchise fees they pay constitute a dollar-for-dollar tax burden that their competitors don't face, but the situation is not cut and dry. Some states provide a credit for franchise fees paid in order to offset other taxes. Meanwhile, for many years, satellite providers have had to competitively bid for the use of federally owned spectrum over which they can transmit their signals. One could argue that this "right of way" through space is somewhat analogous to the terrestrial rights of way cable companies are paying for under franchise agreements. For their part, however, satellite providers do not seem to be operating under the premise that cable companies should pay an equivalent of spectrum auction costs in order to "level the playing field."

Certainly, satellite companies also pay a "cost of business" in preparing, launching, and maintaining their satellites as a precondition of getting their products into homes and businesses. This cost is reflected in the price of their product as opposed to a separate line-item charge on a cable bill. We don't begrudge the right of cable companies to pass along their business costs to consumers. NTU recognizes that visibility and transparency of government costs are good things for the consumer and the tax reform movement as a whole. However, satellite consumers shouldn't be forced to pay an additional tax for the appearance of parity, especially when satellite's delivery costs are already accounted for in its price.

Insomuch as franchise fees are used solely as revenue spigots for local governments instead of a payment rendered in exchange for certain tangible benefits, we support efforts by the cable industry to change existing law to reflect this actuality.

Until then, NTU must work toward parity for taxpayers among truly comparable costs. NTU believes that H.R. 3679 provides a logical starting place—the state level—for reconciling some of these tax burdens to ensure that no one is put at a competitive disadvantage.

V. FEDERALISM AND COMPETITION ISSUES

From NTU's viewpoint, the color of law should always take on a hue that reflects low taxes and free markets, which is a major reason why we support H.R. 3679. However, we are not unmindful of federalism considerations surrounding this measure. During NTU's nearly 40-year history, we have often observed the benefits of tax competition in America's vibrant "laboratory of the states." This phenomenon has, among other things, kept taxpayers in nine states free from a homegrown income tax, and, in five states, unburdened by a general sales tax.

Some elected officials have raised an objection to H.R. 3679 on the grounds that the legislation would further curtail the ability of states and localities to craft tax policy that can be tailored to the specific conditions and outcomes they seek. This concern is not completely devoid of merit, but it does not approach the urgency of protecting residents of all 50 states from predatory taxes at the non-federal level.

Surely, state and local officials would concede that their current taxation powers are far from unlimited, and are often proscribed by other levels of government. California, Oregon, and Washington, for example, limit the rate of tax and/or the annual growth of assessments allowable under city and county property tax systems. Other states, such as Colorado, Michigan, Missouri (and again, California), specifically compel localities to seek the approval of voters prior to levying some or all types of new taxes. Further limitations are established through regulatory decisions, one of the more notable being the California Franchise Board's ruling earlier in this decade that the Los Angeles County Assessor could not claim situs for property tax purposes on satellites in permanent earth orbit simply because they were once manufactured in the County.

There are more direct analogies to the legislation before us today. For all of its regulatory drawbacks and lack of clarity in some areas, the federal Cable Communications Act has for nearly 25 years capped the level of franchise fees that local governments can charge at 5 percent. This provision, incidentally, had strong sup-

port from the cable industry, which at the time made many of the same arguments on behalf of a federal limit that we are making today.

Established law has long recognized—sometimes to the detriment but mostly for the good of taxpayers—that telecommunications services can often defy state boundaries as well as the jurisdiction of taxing authorities. Subsequent FCC rulings and legislative acts in the 1970s and 1980s lifted the restrictions on cable operators that traditional broadcasters sought to impose so as to avoid competition.

The federal Internet Tax Freedom Act, which became law in 1998 and has been renewed under various names since, has shielded online consumers from discriminatory tax burdens on Internet access. Current legislation in Congress, H.R. 436, would provide for a three-year moratorium on new mobile telephone service taxes whose rates exceed those on comparable non-mobile products. Both approaches have strong support from NTU.

But why should federal intervention be the solution to taxpayer protection issues such as these? Don't citizens have other options, including the electoral process, to effect change? In several senses they do. In addition to participating in elections, citizens can—in some states—initiate binding statewide legislation through the petition process.

As a practical matter, however, states and localities can sometimes be oblivious, and often contemptuous, toward the plight of consumers and businesses facing unfair taxation. The City of Corvallis, Oregon provides but one example of where elected leaders resorted to a noxious tax scheme to make wireless phone services far less affordable. Voters demolished this proposal when it was referred to them in 2006, but this laudable outcome entailed extraordinary efforts on the part of local residents (including our own members) to beat back the tax hike. Until citizen activists can establish comprehensive tax limitation and reduction measures in their communities, it is perfectly reasonable for Congress to set some sensible boundaries under federal law and the Constitution's Commerce Clause.

What about cases in which tax collusion, dressed up as tax competition, poses a direct threat to the well-being of taxpayers and consumers across the nation? For example, many officials are seeking Congress's blessing for a "Streamlined Sales and Use Tax Agreement" (SSUTA) that would establish a common regime for the application of sales taxes across state borders.

Yet, the SSUTA battle is not being fought over the small share of retail sales that are not subject to direct purchase taxes; the ultimate objective is to dramatically increase sales tax rates and their reach through interstate collusion, and put a padlock on the "laboratory of the states." Such an action may not be on the immediate horizon for taxes on cable and satellite television service, but legislation that would increase discrimination between these modes of video is being introduced throughout the nation. Moreover, federal jurisprudence in this area is not as well established as it has been on the question of state taxation of remote sales. These factors argue in favor of an "insurance policy," in the form of H.R. 3679, to prevent harm to taxpayers in the future.

VI. FAIRNESS, COMPLEXITY, AND TRANSPARENCY

The fight over what does and does not constitute a tax, an offset, and so forth, reflects the complexity found in our tax laws. Many of the taxpayers who make up our membership believe that the entire Tax Code is desperately in need of an overhaul that promotes simplicity and transparency. Although H.R. 3679 is aimed at one narrow area of our tax laws, NTU supports it because it provides for a crisp prohibition against discrimination and sets up strong "base rules" for future reform efforts.

Much of the debate over tax discrimination in the video services community has improperly focused on a form of "fairness" that only fills government's coffers further—that is, making sure providers of similar services suffer the misery of equally harsh taxes. Policymakers would do well to remember that the "fairest" fee or tax rate—for providers and taxpayers alike—is zero.

Failing the most far-sighted tax policy of a zero rate (which happens to be simple and transparent), at the very least, state and local governments should not discriminate among products or services by disadvantaging one with heavier taxes. Yet, as I just mentioned, inflicting the same measure of pain on all entities is no solution to the question of "fairness." Rather, taxes should be eased across the board. This is why NTU has championed reforms that would lower the tax burdens on all participants in the video services market.

While we recognize that states could abuse H.R. 3679 and raise taxes on cable instead of lowering them on satellite systems, we understand the bill's intent as one that would keep any additional taxes on television service at bay.

VII. CONCLUSION

Thank you, Chairwoman Sánchez, for allowing me to submit this testimony. Many issues of interest to taxpayers are found within the debate over state tax treatment of video services. While we see merit on both sides of the discussion, we ultimately feel that satellite consumers should not be forced to pay additional taxes that demand "parity"—or more—with fees imposed for unrelated benefits.

If the House and Senate were to consider the State Video Tax Fairness Act today, we would classify a vote in favor of H.R. 3679's original language as the "pro-taxpayer" position in our annual Rating of Congress.

And again, on behalf of our 362,000 members, NTU is pleased to offer our thoughts to the Subcommittee as you move forward with this important measure.

Ms. SÁNCHEZ. Thank you Ms. Rasmussen, is that correct? By the end of this hearing I promise you I will have that down.

Mr. Quam.

TESTIMONY OF DAVID C. QUAM, DIRECTOR OF FEDERAL RELATIONS, NATIONAL GOVERNORS ASSOCIATION

Mr. QUAM. Chairwoman Sánchez, Representative Cannon, and Members of the Subcommittee. Thank you for inviting NGA, National Governors Association, to testify here again. It seems like I was here just a few months ago. Since I think we all have maybe Valentines reservations we have to get to, I will be brief.

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. It is a common refrain I have had before this Committee on several issues. Today I am also joined in opposition to this particular bill by the National Association of Counties, the U.S. Conference of Mayors and the National League of Cities. I should note that I believe it was 2 years ago I was before this Committee, and we were having a general discussion on communications taxes and what needed to be done to reform them. There was a lot of recognition that the silos that we currently have with regard to communications, and I would say video services as well, do not necessarily serve us in the current climate that we face, both from a competitive standpoint, a regulatory standpoint and a tax standpoint. We discussed the need for possibly technology neutrality, competitive neutrality and also finding solutions that are revenue neutral for State and local government. From those basic principles, the NGA had hosted several industry meetings trying find some solutions that could work at the State and local level to address those concerns.

One thing that became very clear, and it is one thing that I think we face with this particular bill, is that, from an industry standpoint, industry stakeholders either want to preserve any advantage they currently have or disadvantage their competitor if they can. The bill today, unfortunately, I think mirrors more of those concerns rather than finding technology neutrality, competitive neutrality and revenue neutrality for States.

What I would argue is that several States have actually taken the steps since that hearing to try to find a more competitive framework, to try to bring the taxation or the treatment of two different types of video services into a single solution at the State level that works for both State and local government. This bill unfortunately would undo some of those solutions. Because we have a system whereby cable traditionally has been subject to franchise

fees and satellite services have not—as a matter of fact, it is the Federal Government who said local governments cannot tax DBS service—we have a natural unbalance that was caused really under Federal law. When you have apples and oranges, it becomes very difficult to reconcile those in some single one-size-fits-all. Leaving the solutions to State and local government and allowing State and local government to create parity is the solution to moving this forward and to finding a way to either get out from under a traditional silo approach or to move forward with something that is more streamline and ultimately can encompass all communications technologies, both on the video side and ultimately communications. Because I think that is where States and localities will have to go, I believe that is where they have started to go.

Unfortunately, the bill before us, because it is unclear, because some of its definitions are not well-founded, ultimately what it would do is increase litigation; it would actually discourage State efforts to create tax parity; and together with existing Federal prohibitions, it would further entrenchestablished disparities between multichannel video providers. At the end of the day, Governors and State legislators, when you are talking about State taxes, need to make the decisions and find the solutions. You don't need another Federal restriction that would actually hamper those efforts at the State level. I think that is what this bill does, and that is why you see opposition from NGA and several of the local and national groups. Thank you.

[The prepared statement of Mr. Quam follows:]

PREPARED STATEMENT OF DAVID C. QUAM

Chairwoman Sánchez, 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.

Ms. SÁNCHEZ. I want to thank the panel for their testimony and for their patience with respect to our voting schedule. We will now begin our round of questioning. And I will begin by recognizing myself first for 5 minutes.

Mr. Palkovic, how do you respond to Mr. Quam's assertions that H.R. 3679 would remove the authority of States to modernize existing State and local tax systems?

Mr. PALKOVIC. It is our view that that is not the case. It is not what we are asking them to do. What we are asking them to do, whether it is modernizing the tax system or whether it is entertaining any tax of any kind, to simply not discriminate against satellite. This is simply a bill that we support because it eliminates their right to take into their own hands and apply their judgment on interpreting what Congress intended to do. So if they do it in a fair basis and a nondiscriminatory basis, we have got no argument with them.

Ms. SÁNCHEZ. Okay.

Mr. Symons, a Fifth Circuit decision in 1977 held that a franchise fee is not a tax but in fact a form of rent. Other courts and even Congress have agreed, if that is true, then franchise fees should be considered simply a cost of conducting business and therefore not related to tax. Why should we or States consider taxes and fees when determining parity in the tax treatment of video programming providers?

Mr. SYMONS. Well, Madam Chairwoman, in fact, franchise fees really are much more closely akin to a tax than to a fee for a particular benefit. They go into general revenues, and cities use them for whatever they want to use them for. They are called franchise fees. That is what the Cable Act calls them, but in fact, they bear no relationship to the cost of rights-of-way or rent. They are simply a fee for doing business, which really amounts to the same thing as a tax. And we think that it is completely fair and in fact just for the States to take those into account in determining the total taxes and fees that cable operators have to pay. In fact, they are wholly unrelated to being a regulated cable operator. If you are a deregulated cable operator, you still pay a franchise fee. There is simply another way for a city to collect money from an entity doing business in a town, and we believe that for these purposes are appropriately treated as a tax. And this is an issue that was presented to the courts in this particular context, putting aside the Fifth Circuit case. And in each case, five, four or five Federal Courts disagreed with the DBS industry's characterization of these as fees that shouldn't be counted and found that they should be counted as taxes as part of the overall burden that cable operators pay within a State.

Ms. SÁNCHEZ. Thank you.

Ms. Rasmussen, am I getting there, am I getting close?

Ms. RASMUSSEN. Rasmussen.

Ms. SÁNCHEZ. Can I just call you Ms. R?

Ms. RASMUSSEN. That would be fine.

Ms. SÁNCHEZ. I think that would eliminate a lot of trouble on my part.

You represent a grassroots organization of taxpayers and therefore have the interest of consumers in mind. And you indicated in your written testimony that H.R. 3679 provides a logical starting place for reconciling some of the tax burdens placed on taxpayers. How would you improve this legislation to minimize or at least equalize the burden on all cable and satellite providers?

Ms. RASMUSSEN. Well, as I indicated in my oral remarks, I definitely think it could benefit from the conclusion that this is not meant to equalize upwards. We don't want taxpayers to have to suffer the misery of equally harsh taxes. We are trying to keep their burdens as low as possible.

Ms. SÁNCHEZ. Okay. Thank you.

And Mr. Quam, welcome back to our humble little Subcommittee. Do you think that franchise fees should be considered a form of tax instead of a license to conduct business or rents for right-of-ways.

Mr. QUAM. Franchise fees, really, I think the discussion before sort of points out, they are somewhat of a hybrid really. You have got the courts saying that they should be treated more like a tax and actually look like a tax in the way they are collected; they are based on gross revenues, or gross receipts, and go into general funds, especially of local governments, much more akin to a tax. At the same time, there is a strong argument to say that this is for rent, rent of the use of the public right-of-way. And so I don't think really you can characterize them as one or another.

However, one thing is true, and that is, ultimately the decision as to how franchise fees, franchises in particular, are handled, really again it has to be done—it has been done at the local level because it was with regard to local rights-of-way. Right now you are seeing many more States take up the mantle and do it on a statewide basis. I think it is critical that in this time of transition, both on a technology standpoint and a competitive standpoint, that decision has got to remain with the State and local government.

Ms. SÁNCHEZ. Even when adding taxes and fees in some States, such as Ohio, still imposes a higher burden on satellite providers. Can you explain the rationale for that disparity?

Mr. QUAM. I think you would have to ask the Ohio State legislature for where they came up. But ultimately the decision rests with the elected officials. And much as the debate we had before, if they make the wrong decision, that is what votes and elections are for. But ultimately those decisions on taxation and tax systems at the State level need to be made with the State.

Ms. SÁNCHEZ. Thank you. And I thank you all.

At this time, I would recognize the distinguished Ranking Member, Mr. Cannon, for questions.

Mr. CANNON. Madam Chair, I would just as soon pass and come back and do my questions last if that is okay with you. But I thought I would make a comment first. I think I am the first Cannon in my family that married a Dane, and so the name Rasmussen comes easily to me. I am happy to help you out with that. She is in fact a Rasmussen a generation or two back. Thank you.

Ms. SÁNCHEZ. I think that is the only name in the history of this Subcommittee which has truly stumped me. I usually get it by the end of the——

Mr. CANNON. It is a culture that ought to be separated from the rest of us, except through their Viking ships that invaded my——

Ms. RASMUSSEN. I will be sure to tell my Danish husband all of this tonight.

Ms. SÁNCHEZ. Okay, so Mr. Cannon will pass until later. I would invite the Chairman of the full Committee and distinguished Member of the Subcommittee, Mr. Conyers, for 5 minutes.

Mr. CONYERS. Well, I was here to celebrate the Ranking Member and I being back on the same track, and now he's backing out on me.

Mr. CANNON. I was just going to make sure that everything works out fine. In fact, if you are going to take the last question, I will go now and you can wrap up.

Mr. CONYERS. Well, actually, there is another Subcommittee. And since you and I are all on board, and we even have Trent Franks, I am feeling pretty good about this.

The one we don't know about is the Chairperson herself. I mean, she's been holding her cards pretty close here.

Ms. SÁNCHEZ. I am waiting for a full and fair hearing on the matter before I determine which position to take.

Mr. CONYERS. Oh, gosh. This is wonderful. But I will put my statement in the record.

Ms. SÁNCHEZ. Without objection.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Some economists suggest that our Nation may be on the verge of a recession in light of tightening credit in the financial marketplace, the growing mortgage foreclosure crisis, and the uncertain employment sector, among other concerns.

In this climate of economic insecurity, American families are increasingly forced to pay even more attention to how they spend their money. Sadly, these decisions sometimes must be made based on the difference of only a few cents or dollars.

For example, many households that pay for television programming service can choose to receive very similar services from cable or satellite providers. In certain states, however, consumers who receive television programming from satellite providers pay more in taxes than subscribers of cable television.

Discriminatory taxes imposed on one type of service provider not only increases the cost to the consumer, but undermines the benefits of competition. Less competition usually means higher prices for all consumers.

To address this imbalance with respect to the imposition of these taxes, I introduced—along with my colleagues from Utah (Representative Chris Cannon) and Arizona (Trent Franks)—H.R. 3679, the "State Video Tax Fairness Act of 2007."

This bipartisan legislation accomplishes three critical goals. First, it will allow consumers to benefit from the lower prices that will result when a state imposes a fair and nondiscriminatory tax on all providers.

Second, it will reinvigorate competition in the paid television programming industry by ensuring a level playing field for all providers.

Third, it will preserve a state's ability to raise revenue. Although taxes constitute a significant state and local revenue source, they should be imposed evenly within an industry.

This legislation is supported by various consumer rights groups, including the Consumers Union and the Media Access Project as well as the National Taxpayers Union, which is represented at our hearing today.

Discriminatory taxation among similarly situated providers in an industry creates an economically unbalanced marketplace of winners and losers that is based on who receives the most favorable tax treatment, rather than who provides the best value to consumers.

H.R. 3679 addresses this imbalance in imposed state taxes so that consumers will be the winners.

Accordingly, I look very much look forward to hearing from the witnesses today.

Mr. CONYERS. And I am going to ask for a debriefing from the rest of our staff when I get back.

But I am happy about the fact that we're keeping our word. We said when we'd introduce the legislation we would hold a hearing. And this looks like a very representative group of witnesses you've brought forward, Madam Chair. Thank you very much.

Ms. SÁNCHEZ. Thank you, Mr. Chairman. We strive to be fair on this Committee.

My distinguished colleague from Florida—the State eluded me for a moment—Mr. Keller, you are recognized for 5 minutes of questions.

Mr. KELLER. Thank you, Madam Chairwoman.

Mr. Quam, you said that you'd be brief because of your Valentine's Day reservations. That really hurt my feelings. The fact that you would rather be at a romantic dinner with your wife instead of discussing comparative tax policy with a bunch of middle-aged politicians is just shocking.

Ms. SÁNCHEZ. Hey, hey, hey, middle-aged, that's quite a stretch.

Mr. KELLER. All right.

Mr. CANNON. Madam Chair, he has averaged the two of us.

Mr. KELLER. Mr. Palkovic, let me start with you, tell you what my concerns are. Just to simplify the issue a bit, you look at Florida. The cable TV service is taxed at 6.8 percent, and satellite is at 10.8 percent. And it's your position, essentially, that that is an unfair discriminatory tax, because they pay substantially more, correct?

Mr. PALKOVIC. That's correct.

Mr. KELLER. Mr. Symons, your view is that it's really not fair because the cable companies, unlike the satellite companies, also have to bear the burden of paying the local franchise fee, is that correct?

Mr. SYMONS. That's correct.

Mr. KELLER. And Mr. Palkovic says, yeah, but that's for right of way and other issues that you guys don't have to buy, whereas you guys have to go through the big expense of purchasing and maintaining satellites, correct?

Mr. PALKOVIC. That's correct.

Mr. KELLER. All right. Now, with that as background, my concern, Mr. Palkovic, if we pass this legislation—and it sounds good on the face—is that instead of cable paying 6.8 and satellite paying 10.8 in my State, I would be worried about the State legislature saying, "Okay, you want it fair? Then we will then turn around and increase the cable service tax rate up to 10.8 as well." And that would cause me grief, because I don't want taxes to go up on anyone.

How would you alleviate that concern?

Mr. PALKOVIC. Well, we don't want that either. We're not here saying that we're in favor of higher taxes for consumers. There are other ways that you could resolve the issue in Florida. You could average the tax. You could lower the 10.8 to 6.8. You know, you could do a number of things that would not affect the consumer. And if it is a revenue issue for the State, you could align them both at 8.8 percent. And we would live with whatever it is, as long as it's fair.

Mr. KELLER. So if we amended this language to essentially make sure that type of scenario didn't happen, that there was equalization but not through mandatory tax increases, is that something you could live with?

Mr. PALKOVIC. Yes, we would live with that. We just want it to be fair.

Mr. KELLER. Mr. Symons, same question. Would you be concerned, if we passed this legislation, that instead of in Florida paying cable 6.8 and satellite 10.8, the response from the legislature was just an increase to make you guys now pay 10.8 on top of the local fees?

Mr. SYMONS. Well, we would certainly object to that. The——

Mr. KELLER. I mean, I know you'd object to that, but is that one of your concerns?

Mr. SYMONS. Sure, if this bill passed, it would require—or, it would require all equalization to be equalization up.

Mr. KELLER. Okay.

Mr. SYMONS. And if you would indulge me for a second. In Florida, in fact there are two taxes imposed on cable, and the taxes are in fact equal. There is a pending challenge right now in the Florida courts to the tax scheme that the Attorney General down there, a former Member of this Committee, is defending against these very kinds of claims, I think very compellingly, I might add.

Mr. KELLER. Well, the 10.8 stat that I'm giving you versus 6.8, that's Congressional Research Service, so I'm just going to use that for now for the sake of argument.

Let me ask you a question, though, since I have you here. One the major points in your testimony is that Congress shouldn't interfere with the State's power to tax here. But isn't it true, in the interest of straight talk, that cable companies have supported legislation before this Committee that prevent States from enacting discriminatory taxes, such as the Internet Tax Freedom Act?

Mr. SYMONS. Absolutely, Mr. Keller. We strongly supported the Internet Tax Freedom Act. And we believe that, when you are talking about the Internet and maintaining the competitiveness of that very important medium, the action of this Committee and Congress is very appropriate. By contrast, passing a tax break for the DBS industry doesn't rise to the level of justifying preemption.

Mr. KELLER. Okay.

Ms. Rasmussen, I saw that you spent some time working for a Florida congresswoman there. You, as someone who is known to be a champion of taxpayers, your organization, I know you want low taxes for everybody. Are you concerned at all that in a State like Florida that the response of the legislature may be just to increase taxes on the cable companies versus lowering the satellite taxes? And if so, what are your thoughts about how we deal with that?

Mr. RASMUSSEN. That's absolutely a concern of ours. And you can be guaranteed that, were that situation were to be suggested, we would be on the ground with our many, many thousands of Florida members, fighting such an increase. But as it stands right now, the status quo isn't acceptable to taxpayers either.

Ms. SÁNCHEZ. The time of the gentlemanhas expired.

Mr. KELLER. Thank you. I yield back.

Ms. SÁNCHEZ. Thank you.

I would now like to recognize Mr. Johnson for 5 minutes of questions.

Mr. JOHNSON. Thank you, Madam Chair.

The satellite TV industry feels that it is being discriminated against by States that would tax satellite service as those States

tax cable TV service, either through franchise fees or through other fees or taxes, whatever you would call them.

What I want to ask is, does the satellite TV industry consider franchise fees to be in the nature of taxes? Of course it's been described as a hybrid, but isn't it a fee that's in the nature of a tax?

Mr. PALKOVIC. No, we do not agree with that. We think it's fundamentally an operating cost that is required to negotiate a franchise agreement to get the right to provide service. There's a number of things in any of the franchise agreements that the cable operators signed. They have a number of obligations that they step up to in order to get the right to be the—if not the legal exclusive provider, the de facto exclusive provider of cable in these communities. And that's a cost they have been paying for decades. Literally decades they've been paying franchise fees and agreeing to that every time they renew these agreements.

Mr. JOHNSON. And the States and localities to which they pay those franchise fees, the money goes into the general fund or for some other public purpose; is that correct?

Mr. PALKOVIC. I believe that statement is correct. Our view is——

Mr. JOHNSON. And so those services for the people are paid for through taxes, fees, whatever you call them, but it is a stream of income to the State and/or local governments?

Mr. PALKOVIC. Typically it is the local.

Mr. JOHNSON. And there are some States that, I suppose, States and localities, that do not levy a tax in addition to the franchise fee.Would that be accurate?

Mr. PALKOVIC. That's correct.

Mr. JOHNSON. And in those cases, would it not be fair to conclude that satellite TV would have a competitive pricing advantage over cable TV providers, because they don't have to pay any fees to the State for a public purpose?

Mr. PALKOVIC. Well, we have our own set of operating costs that are different in terms of the way we deliver the signal. The cable industry doesn't have to put billions of dollars of satellites up and pay fees to the FCC to secure satellite spectrum to operate those satellites.

Mr. JOHNSON. And, of course, there is no benefit to the State and local governments from the standpoint of fees or taxes that would be levied on the satellite TV provider if there is not the same fees being levied or the same tax being levied on the cable providers.

Mr. PALKOVIC. Well, our issue today that we're talking about is not about various taxes that are applied at the local level. We're talking about——

Mr. JOHNSON. Well, I know, but I'm just trying to get to the—I guess what I'll say is this. States and local governments benefit from the cable TV fees, franchise fees that are paid. And some States and localities also benefit from taxes that are paid. But when you have a situation where cable TV franchise fees are being paid, no taxes are being paid by the cable TV providers, it puts the satellite industry in a superior competitive position, but it leaves the taxpayers without the benefit of the services that they would get from the fees generated by the provider.

Mr. PALKOVIC. Yes, that's correct. I think that's what Congress intended when they wrote the law the way they did.

Mr. JOHNSON. And so now we're faced with a situation where the satellite industry is asking Congress to prevent States from imposing discriminatory taxes, or, in other words, taxing the satellite TV but not taxing cable TV to the same extent, with no offset for franchise fees.

Mr. PALKOVIC. That's correct. We believe that's unfair.

Mr. JOHNSON. And isn't it unfair to the taxpayer that—isn't it unfair to the taxpayer that the cable franchise fees would subsidize the general fund in such a way that the satellite TV does not?

Mr. PALKOVIC. Well, you're describing what the local communities decide to do with the money that they charge. Our view is that——

Mr. JOHNSON. Well, they would actually have no money to decide how to allocate if——

Mr. PALKOVIC. They negotiated a fee in exchange for allowing a cable operator the rights to provide cable service to that community. It was a negotiated agreement between the cable operator and the local community.

Ms. SÁNCHEZ. The time of the gentleman has expired.

I would now like to recognize Mr. Cannon, batting clean-up for the Subcommittee in the area of questioning. You're recognized for 5 minutes.

Mr. CANNON. You know, one of the really nice things about many of the hearings we had this year, including this one, is that we've had great witnesses that have different viewpoints and have expressed them all pretty well.

Is there any point that any of you feel like you need to make still? Because I think it has been a pretty darn good hearing and a very clarifying hearing.

I am not seeing any looks or hands on the table, so I would yield back my time, Madam Chair.

Ms. SÁNCHEZ. That's a first.

Mr. CANNON. Actually, in defense, it's not a first. But this is a great panel.

Ms. SÁNCHEZ. It feels like a first.

I think we have had tremendous testimony from the witnesses. And, again, I want to thank you all for your patience, in particular with the delays, given the votes that we had across the street.

Without objection, Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer as promptly as you can, so they, too, can be made a part of the record.

And, without objection, the record will remain open for 5 legislative days for the submission of any other additional materials.

Again, I thank everybody for their time and their participation. And this hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 4:45 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

LETTER FROM GARY SHAPIRO, PRESIDENT AND CEO,
THE CONSUMER ELECTRONICS ASSOCIATION (CEA)

Consumer Electronics Association
1919 South Eads Street
Arlington, VA
22202 USA
(866) 858-1555 toll free
(703) 907-7600 main
(703) 907-7601 fax
www.CE.org

October 26, 2007

Dear Representative:

On behalf of the Consumer Electronics Association, I urge you to support H.R. 3679, the State Video Tax Fairness Act, as introduced with bipartisan support from Representatives John Conyers (D-MI), Chris Cannon (R-UT), Rick Boucher (D-VA), and Trent Franks (R-AZ).

CEA represents more than 2,200 consumer electronics companies, which include direct broadcast satellite (DBS) and fiber makers and sellers.

Recently, several states have imposed discriminatory sales taxes on DBS providers. H.R. 3679 would ensure that no state may impose a discriminatory sales tax on any distributor of multichannel video programming, including DBS, fiber-based providers like Verizon FiOS TV, and IP-based AT&T U-verse TV.

After years of cable dominance, consumers increasingly have a choice of broadband and entertainment providers. H.R. 3679 would ensure continued growth, consumer choice and a level playing field for these providers.

I urge you to join your colleagues in supporting the State Video Tax Fairness Act.

Sincerely,

Gary Shapiro
President and CEO

LETTER FROM ANDREW JAY SCHWARTZMAN, PRESIDENT AND CEO, MEDIA ACCESS PROJECT

August 2, 2007

The Honorable John Conyers
Chairman
Committee on the Judiciary
United States House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

I am writing in support of the enactment of a pay-TV non-discrimination principle as part of any legislation which would renew the Internet tax moratorium.

As you know, Consumers Union has endorsed such legislation, and I wish to associate my organization with the views expressed in Consumers Union's July 30, 2007 letter to you. In particular, I share Consumers Union's well-expressed concern that incumbent cable TV operators have been able to exercise market power to raise rates far in excess of inflation, and that discriminatory state sales taxes against satellite subscribers will only exacerbate these anti-competitive conditions.

Whatever platform they choose for video, consumers should pay based on competitive conditions, not discriminatory tax policies.

Sincerely,

Andrew Jay Schwartzman
President and CEO

1625 K STREET, NW - SUITE 1000 WASHINGTON, DC 20006 PHONE: (202) 232-4300 FACSIMILE: (202) 466-7656
HTTP://WWW.MEDIAACCESS.ORG

LETTER FROM PETE SEPP, VICE PRESIDENT FOR COMMUNICATIONS, THE NATIONAL TAXPAYERS UNION (NTU)

October 9, 2007

Protect Taxpayers by Passing the State Video Tax Fairness Act!

Dear Member of Congress:

On behalf of the 362,000 members of the National Taxpayers Union (NTU), I write to strongly endorse the State Video Tax Fairness Act (H.R. 3679) sponsored by Congressmen Conyers, Cannon, Boucher, and Franks. This bill would address the growing issue of discriminatory state video services tax policy by prohibiting inequitable net taxes that are dependent on the mode of programming delivery. For example, six states (Florida, Kentucky, North Carolina, Ohio, Tennessee, and Utah) levy video service taxes on satellite television that are significantly higher than those levied on cable television. Passage of H.R. 3679 would help ensure that consumers – not the states – pick marketplace winners and losers.

Much of the debate over tax discrimination in the video services community has improperly focused on a form of "fairness" that only fills government's coffers further – that is, making sure providers of similar services suffer the misery of equally harsh taxes. Policymakers would do well to remember that the "fairest" fee or tax rate – for providers and taxpayers alike – is zero. Telecommunications of all varieties have been targets for disproportionate and punitive taxes since the Spanish-American War, slowing much of the progress and productivity that could have emerged to enrich our society sooner.

Failing the most far-sighted tax policy of a zero rate, at the very least state and local governments should not discriminate among products or services by disadvantaging one with heavier taxes. Yet, as I mentioned earlier, inflicting the same measure of pain on all entities is no solution to the question of "fairness." Rather, taxes should be eased across the board. That is why NTU has championed reforms that would lower the tax burdens on *all* participants in the video services market.

If the House and Senate consider the State Video Tax Fairness Act, we would classify a vote in favor of H.R. 3679's original language as the "pro-taxpayer" position in our annual Rating of Congress. We urge your co-sponsorship of this important bill.

Sincerely,

Pete Sepp
Vice President for Communications

108 North Alfred Street ✶ Alexandria, Virginia 22314 ✶ Telephone 703-683-5700 ✶ Fax 703-683-5722 ✶ www.ntu.org ✶ ntu@ntu.org

LETTER FROM GIGI B. SOHN, PRESIDENT, PUBLIC KNOWLEDGE

Public Knowledge

January 31, 2008

The Honorable John Conyers
2426 Rayburn House Office Building
Washington, DC 20515-2214
Sent via fax to: 202-225-0072

Re: *Support H.R. 3679, The State Video Tax Fairness Act*

Dear Representative Conyers,

I am writing to express Public Knowledge's support for H.R. 3679, *The State Video Tax Fairness Act*, sponsored by Representatives Conyers, Cannon, Boucher and Franks. H.R. 3679 prevents states from imposing discriminatory taxes on pay television services. This act would directly benefit consumers by encouraging fair competition between different types of pay television providers.

Cable television operators are charged a franchise fee to compensate local governments for damages related to the installation of cable's physical infrastructure, as well as for the rights-of-way required by the cable network. Recently, state governments have begun implementing an additional tax on all pay television providers. In practice these taxes single out non-cable pay television providers for discriminatory taxation. The cable television industry justifies these new taxes on the grounds that they level the playing field between cable television and competing pay television services, such as direct broadcast satellite television. In fact these taxes tilt the playing field back in cable's favor. In the case of cable, these costs reflect payment for services that are actually used. When applied to non-cable pay television providers, they merely represent an attempt to impose an undue burden on cable's competitors.

Taxes or fees that single out a specific type of provider for discriminatory treatment hurts consumers. This type of tax imposes costs on providers where none exist, therefore interfering with the competitive marketplace. Without competition in the marketplace, prices for consumers will rise and innovation will be stifled. Public Knowledge believes that all technologies should be allowed to compete on their merits. This competition will create the maximum possible benefit for consumers, and will spur innovation in the future.

I urge you to support H.R. 3679 to assure that *all* pay television delivery technologies will be allowed to compete fairly in the marketplace. This will ensure that consumers get the greatest possible choice at the lowest possible cost.

Sincerely,

Gigi B. Sohn
President

The Public's Voice in the Digital Age

1875 Connecticut Ave, NW
Suite 650
Washington, DC 20009

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publicknowledge.org

PREPARED STATEMENT OF THE FEDERATION OF TAX ADMINISTRATORS (FTA)

The Federation of Tax Administrators (FTA) is an association of the tax administration agencies in each of the 50 states, the District of Columbia, Puerto Rico, and New York City. We are pleased to have the opportunity to present our views on legislation that would authorize states to require certain remote sellers to collect state and local sales taxes on goods and services sold into a state.

FTA opposes The State Video Tax Fairness Act of 2007 (H.R. 3679) as an unwarranted intrusion into state sovereignty. The bill would:

- Result in significant litigation,
- Reverse state action upheld by state and Federal appellate courts to reach parity in the tax treatment of cable and video service providers,
- Freeze into place and exacerbate the preferential tax treatment that satellite video service providers currently have over cable video service providers.

BACKGROUND.

Cable Video Service Taxes. Twenty-four states impose a sales tax on video services provided by cable companies. Local governments in 18 states impose sales taxes on cable video services. In addition, 47 states authorize local governments to impose a franchise fees on cable services. Such fees are capped at 5 percent of gross revenues by federal law. Franchise fees are intended, in part, to capture the costs of using the public rights of way by the cable companies and to provide compensation for the franchise granted to the cable company.[1] From an economic standpoint, franchise fees operate like a tax in that they are based (in most cases) on gross receipts from sales of cable services and are assumed to be shifted forward to the consumer.

Satellite Video Service Taxes. Federal law (P.L. 104–104, Title VI, § 602, Feb. 8, 1996) prohibits the imposition of local taxes and fees (i.e., sales taxes and franchise fees) on direct broadcast satellite services, but it preserves the ability of states to tax such services and distribute a portion of the proceeds of the taxes to local governments. Twenty-seven states impose a sales tax on satellite video service providers. Some states rebate a portion of the state sales tax to local governments. One state, Ohio places a sales tax on satellite companies that is higher than the regular state sales tax and pays over the extra amount to local governments.

Legislative Analysis. The State Video Tax Fairness Act of 2007 (H.R. 3679) prohibits a "discriminatory tax," which is defined as any direct or indirect tax that "results in different net State charges" on substantially equivalent video services based on the means by which those services are delivered. The term "net State charges" has no meaning in state tax law, which will undoubtedly lead to litigation.

H.R 3679 seeks to prohibit the two different approaches that several states have used to provide parity of tax treatment between cable and satellite service providers. The prohibition of these approaches would eliminate the steps taken to provide parity and freeze into place the preferential tax treatment of satellite service providers. The two approaches addressed in the legislation are:

(1) Some states have used the authority granted in ¶602 to levy a state sales or excise tax on satellite services that is roughly equivalent to the combined state and local sales or excise tax on cable television services and have redistributed a portion of the state tax back to localities.

(2) Some states have considered a portion of the franchise fee levied against cable service providers to be a tax and allowed a portion of the franchise tax to be taken as a credit against the state sales tax in an effort to bring the rate of combined taxes and franchise fees on cable services into closer alignment with the tax on satellite services.

Judicial History. There have been several state and Federal judicial decisions that have ruled the various aspects of laws regulating the taxation of cable and satellite video service providers. All Federal and state appellate decisions have upheld the approaches taken by the states to the taxation of cable and satellite video service providers. H.R. 3679 would reverse the appellate decisions. The following is a summary of the various judicial decisions[F1].

[1] The "fee" rationale is weakened as states and localities allow other video service providers (e.g., telecommunications companies) to provide video services via fiber optic cable they have in place, making the franchise fee even more like a tax.

FEDERAL APPELLATE DECISIONS

In *DirecTV Inc. and Echostar Satellite, L.L.C. v. State of North Carolina*, 632 S.E.2d 543 (N.C. Ct. App., 8/1/06) two satellite companies contended that North Carolina's sales tax on satellite providers discriminated against interstate commerce in violation of the Commerce Clause, by favoring the cable companies against which they compete. The sales tax was not applicable to cable service, although cable companies had to pay a local franchise tax that did not apply to satellite companies. The satellite companies contended that they use satellites, which they characterized as "out-of-state facilities," to deliver their programming, while cable companies use "in-state facilities," their transmission facilities and cable infrastructure, to deliver their programming. The appellate court ruled that the tax did not discriminate against satellite providers. The court determined that whether a company is subject to the tax "depends only upon how companies deliver television programming services to its subscribers, and not whether delivery of the programming services occurs inside or outside the state of North Carolina.[2]

In *DirecTV, Inc. and Echostar Satellite, L.L.C. v. Tolson*, No. 07–1250 (4th Cir., 1/10/08) the Fourth Circuit Court of Appeals has upheld the dismissal of a case that rejected claims by satellite companies that the elimination of a franchise fee by the State of North Carolina violated the Commerce and Supremacy Clauses of the U.S. Constitution. Previously the Court of Appeals of North Carolina rejected claims that a five-percent state sales tax on satellite subscriber service violated the federal and state constitutions. Two satellite companies had claimed that North Carolina's sales tax on satellite providers discriminated against interstate commerce in violation of the Commerce Clause, by favoring the cable companies against which they compete. The tax was not applicable to cable service, although cable companies had to pay a five-percent local franchise fee that did not apply to satellite companies.

STATE APPELLATE DECISION

In *Treesh v. DirecTV, Inc.n et al., No. 2006-CA-001983-MR (Ky. Ct. App., 9/7/07)* the Kentucky Court of Appeals ruled the Federal Communications Act does not prevent the imposition of a school district utilities gross receipts license tax can be imposed on a satellite company. The Court determined that the Act contemplated the Kentucky tax structure. The Act exempts satellite video services from local taxes but does not prevent a state from taxing such services. The Act allows local governments to receive revenues from the state tax. The state required school districts to impose the tax unless the district opted out. The tax was paid to the state and the state distributed the revenues.[3]

STATE TRIAL COURT DECISION

In Ohio Judge Daniel Hogan of the Franklin County Court of Common Pleas in Columbus ruled Nov. 7 that the state's four-year-old 5% sales tax on satellite television is unconstitutional for it does not apply to cable. The ruling was not unexpected; in October 2005 the judge issued a summary judgment on some of the issues in the case, finding before trial that there were enough facts to invalidate the tax. Ohio's Department of Taxation has indicated it will appeal the judge's decision, and ask the court to allow the tax to be collected as the appeal is pending.

Conclusion. To a considerable degree, the state efforts at which H.R. 3679 addresses were intended to promote a greater degree of parity between the total taxation (including franchise fees) of cable services vs. satellite video service providers. FTA believes such decisions should be within the authority of states and localities as long as constitutional standards of non-discrimination are not violated. By dealing only with state level taxation, H.R. 3679 could prohibit the methods of achieving parity between state and local taxes on satellite and cable video service providers and lead to a higher local and state tax burden on cable companies than satellite companies.

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[2] North Carolina has since revised its tax laws to prohibit local taxation of both cable and satellite TV and substituted a state level sales tax in its place.

[3] State law in Kentucky has been amended to subject both satellite and cable services to the same system of state taxation.

LETTER FROM CHRIS MURRAY, SENIOR COUNSEL, CONSUMERS UNION

The Honorable John Conyers, Chairman
Judiciary Commitee
United States House of Representatives
Washington, DC 20515

July 30, 2007

Dear Chairman Conyers:

As the House Judiciary Committee considers renewal of the Internet tax moratorium, Consumers Union asks that you use this opportunity to protect consumers from discriminatory cost increases imposed on satellite-TV and other video subscribers.

Strong interest groups with no interest in promoting price competition to cable TV monopolies have advocated higher State sales taxes for satellite subscribers than for cable subscribers, with the effect of raising the price of satellite TV in relation to cable. While Consumers Union in no way opposes the raising of revenue by State governments to pay for the vital services provided at the State level, we are concerned that discriminatory video taxes undermine the price competition offered by satellite TV.

Consumers benefit from competition in the pay-TV market, with lower prices, better programming, and better service. Lower-cost alternatives give lower-income individuals more affordable pay-TV, thereby broadening the television town square in our democracy. They also discipline incumbent cable TV operators—who have raised their rates nearly three times faster than inflation for years—against further steep rate hikes. If the effect of discriminatory State sales taxes against satellite subscribers is to raise the price of satellite TV, then consumers generally suffer.

As you consider legislation regarding the Internet tax moratorium, which already includes a non-discrimination provision addressing online and off-line commerce, Consumers Union supports the enactment of a pay-TV non-discrimination principle that allows States to raise revenue as they see fit, but in an equitable manner between all pay-TV providers. Whether consumers choose to watch video via cable, satellite, the Internet, or any other platform, they should pay a rate that reflects true competition, not artificial inflation based on discriminatory public policy.

Sincerely,

Chris Murray, Senior Counsel
Consumers Union

LETTER FROM NIEL RITCHIE, EXECUTIVE DIRECTOR, LEAGUE OF RURAL VOTERS

February 7, 2008

The Honorable Linda T. Sanchez, Chairwoman
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Madam Chairwoman:

I am writing on behalf of the League of Rural Voters to oppose passage of H.R. 3679, the so-called "State Video Tax Fairness Act of 2007." I understand that your subcommittee will hold a hearing on this bill February 14 and I ask that this letter be made part of the hearing record.

The League of Rural Voters comprises rural consumers across the nation who have an interest in supporting the efforts by various states to level the playing field between the cable and DBS industries. Specifically, a number of states including Florida, Kentucky, North Carolina, Utah, and Virginia have passed legislation that would ensure that consumers have a tax-neutral choice when it comes to selecting a video service provider.

It should not be the business of the federal government to interfere in efforts by states to equalize the tax burden borne by customers of different video services. If anything, the federal government should support efforts by states to equalize the tax burdens placed on rural consumers. Federal courts have ruled repeatedly that the states' efforts do not constitute discrimination against DBS, and there is no good policy reason for the Federal government to do what DBS operators have failed to convince the state legislators or the Federal courts to do. Please uphold the ability of state governments to level the tax burden for video customers and oppose H.R. 3679.

Thank you for your time and consideration. Please do not hesitate to contact me if the League of Rural Voters or I may be of further assistance in this matter.

Sincerely yours,

Niel Ritchie
Executive Director

cc:file

P.O. Box 80259 Minneapolis, MN 55404
612.879.7578 phone 612.879.7567 fax
www.leagueofruralvoters.org

LETTER FROM MARK C. ELLISON, SENIOR VICE PRESIDENT, BUSINESS AFFAIRS & GENERAL COUNSEL, THE NATIONAL RURAL TELECOMMUNICATIONS COOPERATIVE (NRTC)

NATIONAL RURAL TELECOMMUNICATIONS COOPERATIVE
2121 COOPERATIVE WAY
HERNDON, VIRGINIA
20171-4542
VOICE 703 787 0874
FAX 703 464 5300
WEB WWW.NRTC.COOP

October 15, 2007

Dear House Judiciary Committee Member:

The National Rural Telecommunications Cooperative (NRTC) represents over 1400 rural utilities throughout the United States. On their behalf, I am writing to express our strong support for H.R. 3679, The State Video Tax Fairness Act, sponsored by Reps. Conyers, Cannon, Boucher and Franks.

H.R. 3679 seeks to end the practice of states imposing discriminatory taxes on different providers of multi-channel television services. This legislation is necessary because, to date, six states have imposed taxes that specifically target subscribers of Direct Broadcast Satellite (DBS) television services, resulting in higher costs for DBS subscribers and competitive disadvantage for DBS companies.

As you know, NRTC's primary mission is to bring telecommunications solutions to rural America. Our first enterprise was the launch of C-band satellite television in 1987 and then, in the early 1990's, NRTC entered into an agreement with DIRECTV that allowed our members to promote and distribute that service in their rural markets. Ultimately, NRTC reached nearly 2 million homes in rural areas bringing far greater choice than had been available through off-air or cable service. Even today, DBS subscribership is heavily deployed in rural areas. Accordingly, the burden of state taxes which discriminate against DBS customers fall disproportionately on rural consumers.

We are aware of the specious argument put forward by cable interests that state DBS taxes are merely an effort to offset the competitive effects of the franchise fees that cable television companies pay. Franchise fees are not state taxes; they are payments to local governments to compensate those governments for the cable provider's use of public rights-of-way, damage to streets, etc. Those costs are inherent to cable television's technology, just as the costs of spectrum, orbital slots, satellites, and customer premise equipment are inherent to DBS technology. It is anti-competitive for states to tax DBS subscribers in order to impose on DBS a cost which is inherent to cable technology.

I am therefore writing to urge you to cosponsor H.R. 3679 to preserve tax fairness, promote video competition, and promote quality of life for rural television consumers.

Thank you for your consideration.

Sincerely,

/s/

Mark C. Ellison
Senior Vice President, Business Affairs &
General Counsel

RESPONSE TO POST-HEARING QUESTIONS SUBMITTED TO MIKE PALKOVIC BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Record Question for Mike Palkovic from Linda Sanchez, Chair

1. **H.R. 3679 addresses sales tax fairness, but not the overall tax burden issue, as Ms. Rasmussen mentions in her written statement. Would DirecTV support legislation addressing the overall tax burden for the benefit of all consumers? The overall tax burden of course would include taxes and any fees that could not be argued are for "rights-of-way."**

   NTU testified, "...satellite consumers shouldn't be forced to pay an additional tax for the appearance of parity, especially when satellites delivery costs are already accounted for in its price." NTU has said, and the satellite industry has stated repeatedly, that the cable industry can seek to lower their franchise fees if they think those fees are too high. Cable companies voluntarily undertake to pay these fees as part of a negotiated contract. Cable companies pay these franchise fees in return for a direct benefit—a property right—that the cable companies, alone, enjoy. Not just anyone can dig up a public street or hang wires from a public utility pole. Local governments own that property, and they charge rent for it.

   H.R. 3679 is designed to address a specific problem – the abuse by states of a loophole in Congress's preemption of local taxes and fees on satellite.

   It does not need to go further. There is no evidence that local governments are abusing their power to tax cable. Many local governments do not impose sales taxes on cable, those that do generally impose a small tax. In exchange, cable, with its significant physical presence, benefits from the resulting local services. Absent abuse, there is no need to interfere with local government's relationship with cable.

2. **Should states consider all taxes and fees imposed on providers and subscribers to determine the tax rates on all subscribers? Please explain your response?**

   States should not pick winners and losers with their sales tax policy. 22 states have chosen to apply an equal sales tax for all providers of video services and the satellite industry accepts that.

   H.R. 3679 simply states: "No State shall impose a discriminatory tax on any means of providing multichannel video programming distribution services." It demands tax parity. Cable opposes the bill, protesting that it, too, is for "tax parity." The only way cable can support that claim, though, is by insisting that franchise fees *are* taxes.

So, cable argues, if cable pays a franchise fee, it is only fair that satellite customers should pay an offsetting amount in taxes.

So which is it—a fee or a tax? Several authorities on the subject had this to say:

"Franchise fees . . . are commonly understood to be consideration for the contractual award of a government benefit."

"[F]ranchise fees [are] a form of 'rent.'"

Cable's "largest asset[s]" are "cable franchise rights" purchased with franchise fees.

In contrast, "[t]axes simply have no contractual element; they are a demand of sovereignty."

These are not the assertions of satellite TV partisans but rather the words of *cable companies*. In supplemental written testimony recently submitted to the subcommittee for the record and again attached below, we demonstrate: (I) that franchise fees are not taxes; (II) that cable consistently and emphatically tells everyone else that franchise fees are not taxes; and (III) that Congress and the courts consistently agree that franchise fees are not taxes. Accordingly, it is patently unfair for states to use franchise fees to justify higher consumer taxes on satellite subscribers.

3. It seems that this legislation addresses your concerns in just a handful of states. How many people would passage of H.R. 3679 affect immediately? Are we here simply to consider the taxes on subscribers in only a few states?

At a minimum this bill ensures that the 30 million households who have chosen satellite television over their cable TV provider will not face discriminatory state taxes advocated by the cable industry. Furthermore, all 105 million pay TV homes are hurt when a state uses sales taxes to pick winners and losers among competing video products.

To date, six states have charged satellite subscribers higher rates to subsidize the cable industries' franchise fees, dozens more states have considered, or are evaluating, similar discriminatory regimes. This discrimination forces your constituents who sought an alternative to the incumbent cable provider to continue to pay that industries' cost, franchise fees.

States have typically been very clear on this point. The State of North Carolina General Assembly's bill summary plainly asserts: "Replaces local revenues from franchise fees with a new distribution of shared sales tax collections from telecommunications, cable and satellite television service;" North Carolina abolished local franchise fees and replaced them with a state consumer sales tax that is higher for satellite subscribers than it is for cable subscribers even though satellite subscribers gain absolutely no benefit from the local cable industries' franchise. Thus, in North Carolina and beyond, satellite subscribers subsidize the cost of a service they have chosen **not** to use.

The ramifications of state laws that favor one technology over another go well beyond the 105 million pay TV homes.

SUPPLEMENTAL SUBMISSION

ON BEHALF OF DIRECTV & ECHOSTAR

BEFORE THE HOUSE JUDICIARY COMMITTEE, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

HEARING ON H.R. 3679, THE "STATE VIDEO TAX FAIRNESS ACT OF 2007"

SUBMITTED FEBRUARY 26, 2008

One question dominated the Subcommittee's hearing on H.R. 3679 last week:

Is a franchise fee a tax?

The battle lines were sharply drawn. Satellite TV providers and their supporters testified that franchise fees are rents for valuable rights of way, and nothing like a tax. Cable testified that "all franchise fees . . . levied on cable operators must be viewed as taxes." Testimony of Howard J. Symons at 6 (internal citations omitted). At every turn, cable's testimony referred to "taxes and fees" in the same breath as if they were equivalent. *See, e.g., id.* at 1, 2, 3, 8, 9, 10. And then, in its tally of the state and local taxes that cable pays, cable included franchise fees on almost every line. *See id.* at 3.

The dispute goes to the heart of H.R. 3679. The bill simply says: "No State shall impose a discriminatory tax on any means of providing multichannel video programming distribution services." It demands tax parity. Cable opposes the bill, protesting that it, too, is for "tax parity." The only way cable can support that claim, though, is by insisting that franchise fees *are* taxes. So, cable argues, if cable pays a franchise fee, it is only fair that satellite customers should pay an offsetting amount in taxes.

So which is it—a fee or a tax? Several authorities on the subject had this to say:

- "Franchise fees . . . are commonly understood to be consideration for the contractual award of a government benefit."
- "[F]ranchise fees [are] a form of 'rent.'"
- Cable's "largest asset[s]" are "cable franchise rights" purchased with franchise fees.
- In contrast, "[t]axes simply have no contractual element; they are a demand of sovereignty."

Are these the words of satellite TV partisans? No. These are the words of *cable companies*. In this supplemental submission we demonstrate: (I) that franchise fees are not taxes; (II) that cable consistently and emphatically tells everyone else that franchise fees are not taxes; and (III) that Congress and the courts consistently agree that franchise fees are not taxes.

I. Franchise Fees Are Not Taxes

Franchise fees do not look anything like taxes. Consider the facts:

1. Local governments do not impose franchise fees the way they impose taxes. Cable companies voluntarily undertake to pay these fees as part of a negotiated contract.

2. Cable companies pay these franchise fees in return for a direct benefit—a property right—that the cable companies, alone, enjoy. Not just anyone can dig up a public street or hang wires from a public utility pole. Local governments own that property, and they charge rent for it.

3. The property rights that cable companies buy with franchise fees are highly valuable. Cable companies treat them as prized assets.

4. The franchise agreements that are negotiated at arms-length between cable and local governments look nothing like tax codes. They are intricate contracts that include all sorts of terms that one would never find in a tax code.

You don't call it a "tax" when a merchant pays rent for the right to set up a bodega on public property or a hot dog franchise at a public stadium. You don't call it a "tax" when an advertiser pays to post an ad on the side of a bus or on the Metro. And it is not a tax when cable negotiates an arms-length contract to purchase prized property rights necessary to sell its service.

II. The Two Faces of Cable

The simple truth is that cable doesn't call it a "tax" anywhere outside the confines of this debate over tax parity. Cable's current definition of a franchise fee is a transparent ploy to defeat a bill designed to level yet another unfair advantage that cable has managed to garner. We know this because in every other forum, to every other audience, cable tells a different story—from court filings to SEC filings to local government negotiations.

Cable tells courts: Franchise fees are NOT taxes

Cable routinely tells courts that franchise fees are *not* taxes. The question has been relevant, for example, in cases where cable has litigated over how much it will have to pay.[1] As one cable company successfully explained to a federal court:

> Municipal franchises have long been understood to be contracts. Franchise fees, in turn, are commonly understood to be consideration for

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[1] *See, e.g.*, Opp. Br. to Def's Mot. for Summary Judgment at 14 in *Time Warner Ent't Advance Newhouse P'ship v. City of Lincoln*, Case No. 8:04- CV-2049 (D. Neb. 2004) (attached at Exhibit A); *Texas & Kansas City Cable Partners, L.P v. City of West University Place*, Civ. Action No. 7-05-4177 (S.D. Tex. April 14, 2006), *available at* 2006 WL 1437647.

> the contractual award of a government benefit. Many cases have treated franchise fees as a form of "rent." Cable franchises are enforceable as contracts, even though they are traditionally awarded by ordinance. . .. The contractual nature of cable franchise fees removed them far from "taxes." Taxes simply have no contractual element; they are a demand of sovereignty. The consent of the taxpayer is not necessary to their enforcement.

Exhibit A at 15 (internal quotations and citations omitted). We could not say it any better ourselves.

Cable tells shareholders and the SEC: Franchise fees are payments for valuable property rights

Cable tells the same story to its shareholders and to the SEC. It admits that the rights it obtains from local governments in exchange for "franchise fees" are valuable assets. According to cable companies, franchise fees buy local rights of way worth *billions of dollars*—assets that are *more valuable than all their other assets combined.* Here's what cable executives say:

- "*Our largest asset, our cable franchise rights*, results from agreements we have with state and local governments that allow us to construct and operate a cable business within a specified geographic area."[2]

- "As of December 31, 2006, [Time Warner Cable] had approximately $41.0 billion of unamortized intangible assets, including . . . franchises of $38.1 billion on its balance sheet. At December 31, 2006, *these intangible assets represented approximately 74% of TWC's total assets*."[3]

- "Cox believes that the franchises, although contractually non-exclusive, *provide economic exclusivity* for broadband video services to an incumbent cable operator." In other words, Cox tells its investors and the SEC that it is using franchise fees to buy itself a monopoly.[4]

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[2] Comcast Corp. Annual Report (Form 10-K for 2007) at 32 (Feb. 20, 2008) ("Comcast 2007 Annual Report") (emphasis added).

[3] Time Warner Cable, Inc. Annual Report (Form 10-K for 2006) ("TWC 2006 Annual Report") at 38 (Feb. 23, 2007) (emphasis added).

[4] Cox Communications, Inc. Annual Report (Form 10-K for 2005) at 71 (Mar. 29, 2006).

Scan the SEC filings of any cable company for any year, and you will see similar statements.[5] When you pay money to governmental entities as a quid pro quo for property that represents three-quarters of your company's total value, it is ludicrous to characterize the money you pay as a tax.

In those same SEC filings, cable companies also depict franchise fees as a cost of doing business—not as a tax. Cable treats franchise fees the way they treat any other business expense, such as payments to purchase TV programs and salaries they negotiate with employees. Once again, here are cable's own words from a representative SEC filing:

- "Costs of revenue include: video programming costs . . . high speed data connectivity costs; Digital Phone network costs[;] maintenance of the Company's delivery systems; *franchise fees*, and other related expenses." TWC 2006 Annual Report at 66-67 (emphasis added).

The franchise agreements speak for themselves

Perhaps the best evidence of what cable thinks franchise fees are—and what they pay for—can be drawn from the franchise agreements themselves. Teams of cable lawyers pore over these documents. Cable companies own every word that appears in these documents.

The first characteristic that is evident from scanning any one of these franchise agreements is that they are, well, agreements. They waddle, smell, and quack like contracts. They do not look anything like tax ordinances. For example, Monterey, California's franchise agreement with Cablevision is 51 pages. It is rife with terms that you would never find in any tax code, provisions about: acceptance; the rights reserved by the city; waivers; construction standards; the method and timing of fee payments; termination, revocation and forfeiture; liquidated damages and other remedies; maintenance and inspection of books and records; time of the essence; and force majeure. *See* http://www.monterey.org/cable/final.pdf.

As important as the contractual nature of these agreements is how they describe the deal. Invariably, they describe these deals as payments for valuable rights of way, not as taxes for the general public welfare. They almost always have clauses that read something like this one (drawn from Comcast's 151-page contract with Fairfax, Virginia):

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[5] *See, e.g.,* Time Warner Cable Inc. Quarterly Report (Form 10-Q for Q3 2007) at 27 (Nov. 7, 2007) (franchise rights valued at $38.1 billion); Charter Communications Holdings, LLC, Quarterly Report (Form 10-Q for Q3 2007) at 4, 10 (Nov. 13, 2007) (franchise rights valued at $9.1 billion); Comcast Corp. Quarterly Report (Form 10-Q for Q3 2007) at 2 (Oct. 26, 2007) (franchise rights valued at $58 billion); CSC Holdings Inc. Quarterly Report (Form 10-Q for Q3 2007) at 3, 13 (Nov. 8, 2007) (franchise rights valued at $731.8 million); Mediacom Broadband LLC, Annual Report (Form 10-K for 2006) at 27 (Mar. 27, 2007) (franchise rights valued at $1.26 billion).

> *Grant of Authority*. . . . [T]he County hereby grants the Grantee *the right to own, install,* [and] . . . operate, a Cable System *along* . . . *the Public Rights-of-Way or public land* within the Franchise Area.

http://www.fairfaxcounty.gov/cable/regulation/franchise/comcast/comcast_franchise_2005.pdf (emphasis in original). Translation: Cable is paying money to rent public land.

The same features appear in most any franchise agreement one might randomly choose.

* * *

In short, cable has two stories about franchise fees. One story is what cable is telling this Subcommittee. The other story is what cable tells everyone else: courts, its owners and investors, the SEC, and its contracting partners. The two stories are irreconcilable—but the truth is clear: Franchise fees are simply not taxes.

III. Congress, the Courts, and the FCC Agree that Franchise Fees are Not Taxes

Congress, the courts, and the FCC consistently agree that cable's franchise fees are not taxes, but are a cost of cable's business. And they often do so at *cable's* prodding. Here are some examples:

- Congress defined the term "tax" in the Internet Tax Freedom Act of 1998—a bill cable vocally supported. In the definition, Congress declared that "such term does not include any franchise fee or similar fee imposed by a State or local franchising authority." Pub. L. No. 105-277, § 1105(8), 112 Stat. 2681-719 (codified as amended at 47 U.S.C. § 151 note).

- Just last year, the FCC confirmed that "[o]ne of the primary justifications for cable franchising is the [local government's] need to regulate and receive compensation for the use of public rights-of-way."[6]

- Federal courts have distinguished between proceeds collected to pay franchise fees and those collected to pay taxes, invoking the same reasoning that cable itself propounds in its filings: "*Franchise fees are* not a tax . . . but essentially a form of rent [i.e.,] *the price paid to rent use of public right-of-ways.*" *City of Dallas v. FCC*, 118 F.3d 393, 397-98 (5th Cir. 1997) (citations omitted; emphasis added).[7]

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[6] *In re 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*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd. 5101, ¶ 23 (Mar. 5, 2007).

[7] *See, e.g., Time Warner Ent't Advance/Newhouse Partnership v. City of Lincoln*, 360 F. Supp. 2d 1012, 1017 (D. Neb. 2004); *cf. Qwest Comm. Corp. v. City of*

- Counties and municipalities agree. They frequently try to persuade state courts that franchise fees are costs, not taxes, when defending the imposition of those fees without following procedural requirements for tax increases. *See Bruce v. Colorado Springs*, 131 P.3d 1187 (Colo. App. 2005); *Kowalski v. Livonia*, 705 N.W. 2d 161, 162 (Mich. App. 2005).

- The courts routinely side with these authorities. As a Michigan appellate court recently held: "Plaintiffs [i.e., cable subscribers] accurately and unreservedly admit that the cable 'franchise fees' are voluntary. This is true whether viewed from the perspective of the subscriber or the supplier, because each pays the charge in exchange for a service: the provider pays the city for its valuable franchise and the subscriber, in turn, pays the supplier for the privilege of receiving cable programming. Therefore, the 'franchise fee' is a voluntary payment and consideration in exchange for a commodity." *Kowalski*, 705 N.W. 2d at 162.

Conclusion

A vote for H.R. 3679 is a vote for "tax parity." Cable is just plain wrong when it asserts that it is protecting "tax parity" by advocating against the bill. Its position is based on the assumption that franchise fees are taxes, and that they, too, must be equalized. Cable is wrong. Franchise fees are not taxes. Congress has said it. Courts, the FCC, and local governments say it. Cable says it, too—but only when it serves its purposes. Congress should not be fooled by cable's contrary position here.

Berkeley, 146 F. Supp. 2d 1081, 1092 (N.D. Cal. 2001) (franchise fee described as "annual rent compensation").

RESPONSE TO POST-HEARING QUESTIONS SUBMITTED TO HOWARD SYMONS, ESQ., BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

RESPONSE OF HOWARD J. SYMONS
on behalf of the
National Cable & Telecommunications Association

TO QUESTIONS FROM CHAIR LINDA SÁNCHEZ

April 11, 2008

Question 1: **As Mr. Quam indicated in his written testimony, several states have recently worked to modernize their tax systems to create parity within the tax treatment of video programming providers. Mr. Palcovic would assert that the restructuring of the tax systems in North Carolina and Kentucky intentionally favors cable. Please respond.**

Response 1: The tax systems established in North Carolina and Kentucky do not favor cable, but rather ensure equal treatment of cable and direct broadcast satellite (DBS) operators by equalizing the tax burdens imposed on cable and DBS operators. North Carolina established tax parity by eliminating local franchise fees paid by cable operators and imposing the same 6.75% state tax uniformly on both cable and DBS operators. Kentucky took a different approach, retaining its state tax of 5.4% on cable and DBS operators; cable operators receive a credit for any franchise fees they pay to local communities, but such franchise fees have largely been eliminated. In both cases, the states determined that the interests of fairness and promoting competition were best served by taking into account all taxes and fees that both providers pay at the state as well as the local level, so that consumers may have a tax-neutral choice of video providers.

Question 2: **Satellite providers have argued before several courts about this same issue: that some states are imposing higher tax rates on their services when compared to cable services. They won recently in Ohio. How do you explain away a court holding that the 5.5% tax imposed on satellite providers but not on cable providers is unfair?**

Response 2: The only court to rule on the Ohio tax was the local trial court in Franklin County, Ohio. That court did not find that the tax was "unfair," but rather held that the Ohio legislature's tax effort interfered with the interstate commerce clause because it "discriminates against interstate commerce in practical effect."[1/] This ruling is contrary to the holdings of all the Federal courts that have examined the issue, and we are confident that it will be overturned.

In reality, the difference in tax burden between what cable and satellite providers would pay under the Ohio tax scheme would be minute. Noting that satellite providers were paying no taxes or fees, the Ohio legislature attempted to establish tax parity between cable and DBS operators by imposing the state sales tax of 5.5% on DBS operators. Taking into account all state and local taxes and fees, cable operators pay a 5.26% tax plus other charges imposed by local governments that result in roughly equivalent burdens. Thus, cable and DBS operators pay nearly the identical amount of taxes in aggregate to state and local governments.

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

Question 3: **Ms. Rasmussen and Mr. Palcovic argue that H.R. 3679 is pro-consumer because it would increase competition and lower costs to consumers. However, the cable industry opposed the legislation. Please respond to the argument by Ms. Rasmussen and Mr. Palcovic that H.R. 3679 is pro-consumer.**

Response 3: The cable industry does not believe that H.R. 3679 is pro-consumer because, contrary to the arguments raised by Ms. Rasmussen and Mr. Palcovic, its passage would deny subscribers a tax neutral choice and likely result in higher taxes and fees for cable subscribers.

H.R. 3679 attempts to outlaw state tax equalization statutes by foreclosing states from considering the taxes and fees that cable operators pay to localities when determining the overall tax burden of a cable operator. A likely result is that cable operators will continue to be, as they are in 44 states today, subject to a higher tax burden than satellite operators. These costs, in turn, are passed on to cable subscribers and raise the overall price of the service. Because satellite operators will have an unfair cost advantage over cable operators, subscribers will not have a true free choice of video provider. Competition and consumers are best served by ensuring 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.

Question 4: **In your written testimony, you indicate that the definition of "discriminatory" is problematic. Please discuss how you would improve this definition to prevent future litigation over which taxes and fees to include when assessing the discriminatory impact of a "net state charge."**

Response 4: The word "discriminatory" is inherently open-ended and subject to varying interpretations. Under this standard as defined by the bill ("any form of direct or indirect tax that results in different net State charges"), almost every tax would be subject to investigation and review to determine whether it is permissible. It would be fairer if the term "discriminatory tax" were defined to mean "any form of direct or indirect tax that results in different aggregate State and local charges (including all taxes and fees of any kind) being imposed on multichannel video programming services or providers of such services."

RESPONSE TO POST-HEARING QUESTIONS SUBMITTED TO KRISTINA RASMUSSEN BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

April 10, 2008

Dear Representative Sanchez:

Here are my responses to your follow-up questions regarding H.R. 3679, the State Video Tax Fairness Act of 2007.

1. *Should states consider taxes and fees when determining the total burden on consumers?*

While taxes and fees are all mandatory payment extractions from the perspective of the taxpayer, NTU believes there are instances where taxes and fees are not directly comparable with each other. If fees are a payment rendered in exchange for certain tangible benefits and have a connection to the services they go to support, we would recommend using caution when comparing them to general taxes. On the other hand, if fees are used solely as revenue spigots for local and state governments with no attendant benefits and services, they would be more readily compared to a tax.

An open budget discussion involving elected officials, administrative staff, service providers, and customers may be necessary to determine which of the above scenarios apply to any given state or locality. NTU believes such conversations are an indicator of a healthy, involved, and fiscally responsible democracy.

2. *Several states have different approaches to imposing taxes and levying fees on video programming providers. Which method is the most fair for consumers price-wise and which will increase competition?*

NTU believes the "fairest" tax rate – for providers and taxpayers alike – is zero. In this ideal situation, prices are not artificially increased by government, and providers compete with each other for customers based on product cost and merit.

That being said, NTU does recognize the value of promoting a "laboratory of the states" where tax competition among jurisdictions ultimately benefits taxpayers. We do not view H.R. 3679 as a charge to impose one method of video programming taxation on all states; rather, we see H.R. 3679 as a way to protect residents of all 50 states from arbitrary, in-state tax policies. We leave it up to state and local governments to decide upon the best method of taxation for their confines, provided they don't use their laws to internally discriminate against similar product/service offerings.

Sincerely,

Kristina Rasmussen

Kristina Rasmussen
Director of Government Affairs

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RESPONSE TO POST-HEARING QUESTIONS SUBMITTED TO DAVID QUAM BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Questions for the Record for David Quam
From Linda T. Sánchez, Chair

1. **What affect would passage of this legislation have on state and local revenues? Please be specific if at all possible.**

No specifics revenue projections are available to answer this question. I acknowledge that by requiring tax parity between video service providers, the legislation could, for those states that do not tax satellite services now, increase revenues for states as they are forced to create a new tax to reach parity. Such action, however, would come with a political price.

States may also lose revenues if they decide to lower taxes on cable providers to that of satellite services, which in some states is zero.

A more likely scenario is that a state would strive to restructure state and local taxes and franchise fees in a manner that is revenue neutral to the state while still supporting local governments.

2. **You indicated in your written statement that several states have restructured their tax systems to create parity, especially in the video programming industry. Mr. Palkovic suggests that North Carolina's and Kentucky's tax systems intentionally favor cable. Please respond.**

From the standpoint of the National Governors Association, the proposed legislation is not about cable vs. satellite, but the authority of a state to develop and manage its own revenue systems. That authority is one of the core elements of state sovereignty and the U.S. federal system.

Both North Carolina and Kentucky crafted video service tax systems that ensure consumer choice is not influenced by the amount of government taxes and fees on the bill. Both systems have withstood challenge in court. In matters concerning state taxation, Congress should defer to states and rely on the Constitution and the courts to protect taxpayers.

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