Is cable TV getting a better break than satellite?

Tax Match: The States vs. the Services

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State and local governments are scrambling to maintain revenues they feel are being threatened by new technologies. The explosive growth in e-commerce, for example, is threatening sales tax revenues, because an e-commerce vendor without a physical presence in a state is not obliged to collect sales tax.

The potential loss of tax revenue from VoIP service also terrorizes tax collectors. Likewise, state and local governments feel the popularity of satellite TV and radio service could result in decreased tax revenues and are fighting back by imposing tax structures on satellite TV that do not apply to cable.

State and local governments are concerned about losing revenue from income taxes, property taxes and franchise fees.

Property Taxes

A cable television company has substantial amounts of property (i.e., buildings and equipment) on the ground in the local jurisdictions they service. Ad valorem taxes on these assets provide significant revenue to local governments.

A satellite service provider, on the other hand, has limited taxable assets on the ground, except for uplink facilities; transponders are far beyond the taxing jurisdiction of local governments.

This did not stop the City of Virginia Beach, however, from attempting to tax transponders owned by International Family Entertainment that were in geosynchronous orbit 22,000 miles above the earth. It took a 2002 decision by the Virginia Supreme Court to prevent the city from taxing the transponder.

Franchise Fees

Cable TV companies pay substantial franchise fees to local governments for using public rights-of-way to run their cables. Since satellite providers only use signals beamed through the atmosphere, they do not need to make franchise payments (at least until local governments figure out a way to tax the signals through the airwaves).

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Income Tax

Most states have a corporate income tax structure that takes into account the sales, payroll and assets a company has in their states. The company's total income is multiplied by an apportionment formula that imposes income tax based on the proportion of sales, assets and payroll in the state.

The fewer employees and assets in a state in proportion to overall employees and assets, the less taxable income apportioned to the state.

Since a cable TV company typically has significantly more employees and assets in a state then do satellite companies, most states derive higher income tax revenue from cable companies.

This is not to say that satellite providers are getting a free ride on state income tax. Since their assets and payroll are concentrated where their headquarters and uplink facilities are located, they pay a higher proportion of their taxes to those states.

Government Strikes Back

Faced with the fact that the technological innovation of home satellite service is resulting in reduced state and local tax revenue, governments are fighting back the only way they can: by imposing tax on the service itself — but, in some cases, not on cable service.

North Carolina adopted a 5 percent tax on satellite TV service. DirecTV and Echo Star paid this tax then filed a lawsuit for a refund. The legal basis for the lawsuit was that the tax on satellite service — but not on cable TV service — discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution.

DirecTV and Echo Star lost the first round of the controversy last June when the trial court judge ruled against their refund claim. The decision is being appealed.

Because the basis of the refund claim revolves around the Commerce Clause, the case might ultimately be decided by a United States court (where DirecTV and Echo Star would likely find a friendlier forum).

Satellite providers have filed litigation in a Florida court to challenge Florida's tax structure. Although Florida's tax is imposed on both cable and satellite services, the rate varies from county to coun-

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ty, so that some counties charge a higher rate for satellite service. It will likely be some time before the outcome of this case becomes final.

In 2003, the Ohio legislature adopted a tax on satellite service, but not on cable TV. As yet there have not been reports of litigation by satellite providers on the same basis that DirecTV and Echo Star challenged the North Carolina tax.

Recently the Virginia tax commissioner ruled that a sales tax exemption for the purchase of cable TV equipment does not apply to the purchase of satellite equipment, based on a highly technical reading of the exemption statute.

There is clearly a developing trend to tax satellite operations to increase state and local revenues.

Leveling the Field

Tax disparities between satellite and cable can be addressed in three venues: Congress, state legislatures and the courts.

Under its power to regulate interstate commerce, Congress has the power to preempt state and local taxation of satellite service. In 2002, a bill was introduced by Rep Tom Davis of Virginia to prohibit imposition of state and local taxes on satellite radio service under the rationale that the infant technology needed to be protected from taxation so it could develop. The bill did not advance.

The Internet Tax Freedom Act was passed in 1998 to install a moratorium on state and local governments imposing taxes on Internet access and from imposing multiple, discriminatory taxes on e-commerce.

The original tax moratorium expired in 2001, amid bickering over whether Congress would allow state and local governments to require e-commerce vendors to collect sales taxes, which was not a component of the original act.

A two-year extension through 2003 expired amid more bickering and was recently extended again. One of the critical issues concerned Internet access: equalizing tax treatment between providers of DSL and cable TV. DSL providers of broadband service were subject to telecom taxes, while cable providers were not.

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The moratorium was finally reinstated last April with the DSL provision a part of it.

To add to the turmoil, state and local governments were holding out for congressional action to require sales tax collection on Internet sales. They were pressuring their congressional representatives to not give in on the unrelated issue of Internet access tax preemption until there was agreement on the sales tax collection issue.

Unable to come to a consensus, Congress merely extended the moratorium until November 2007, while adding the DSL language. This battle demonstrates the difficulties in getting legislation to create a level playing field in the telecom tax arena.

It also shows that for state and local governments to give up one source of revenue (i.e., telecom tax on DSL service), they will expect something in return: the as-of-yet-undelivered legislation to require e-commerce merchants to collect sales taxes on Internet sales.

Satellite providers cannot realistically expect federal legislation on state and local taxation of satellite TV and radio service unless the state and local governments can get something in return.

State Legislatures

Since the problem started with state legislatures that adopted statutes allowing unequal treatment, the industry could take the initiative and go back to change tax rules. As demonstrated by the DSL/cable Internet access battle in Congress, state and local governments will demand something in return.

One solution would be to have the state income tax apportionment formula modified to be weighted more heavily toward sales rather than assets and employees (of which satellite companies have few). If the state income tax is apportioned solely based on sales, income to the state will increase.

Many states have already adopted or are considering "single sales factors" for all businesses, so the industry might not be giving up much by agreeing to a single sales factor in exchange for a tax break on satellite service.

The revenue-loss problem facing local governments from property and franchise taxes could be alleviated in part by a revenue-sharing agreement with state governments that would earn more income tax revenue if a single sales factor deal was reached with the satellite industry.

The Courts

The satellite industry is currently fighting in the courts, where it does not have to compromise as it likely will need to do in Congress or in state legislatures. Unfortunately, court battles take years, and the result is uncertain. And even if the industry is successful on the Commerce Clause argument, Congress could step in and allow states to tax satellite service through federal legislation.

The disparities of tax treatment between cable and satellite TV services will not be resolved overnight. In the meantime, it would be unwise for cable TV companies to start publicizing to their customers the tax advantages their service has over satellite service in some states.

Although the disparity is not of the cable industry's making, perception by the public that it is behind the unequal treatment could lead to loss of political support in the legislature battles to come.

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