Communications Taxes: State Trends and Policy Implications

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NCSL Task Force on State and Local Taxation
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Overview

• Industry trends
  • Wireless
  • Wireline
  • Multi-channel video
  • Streaming video
  • Other digital services

• Implications for state & local revenues
  • Trends & revenue impacts
  • What should policymakers do?

• Concluding thoughts
Industry Trends – Wireless

- Emergence in late-1990s
- Rapid growth 2000-2010
- Maturity / slower growth 2011 to present
Wireless Trends continued

- Consumer demand shifting from voice to data/Internet access
- Wireless carriers shifting away from subsidizing handsets
- Prepaid wireless market share growth has stalled at about 20% after rapid growth
- Carriers are looking for revenue growth from non-telecom services
Industry Trends -- Wireline

• Cord cutting

• Cable VOIP competition against incumbent local exchange companies – bundled packages

• Over-the-top VOIP

• Software defined networks with scalability and flexibility for business customers
Industry Trends -- Wireline

- Intensive capital investment requirements
- Demographic trends impacting usage
- Challenging regulatory environment
Industry Trends – Multichannel Video

- Telecom Reform Act of 1996 created more competition and provided fledging satellite TV with an exemption from the imposition or collection of any local taxes

- First round of significant multichannel video competition against cable operators came from satellite TV in mid-90’s

- Next round of video competition against cable operators came from telecom companies in the mid-2000’s

- Competition increased with bundling of video, Internet and voice communications in “triple play” during 2000’s
Industry Trends – Streaming Video

- Most recent round of video competition – 2012 to present – from non-network companies

- Over-the-top video (OTT) available directly from companies over broadband connections

- New providers include technology companies (Amazon, Netflix, etc.), content companies (Sony, Time Warner, HBO, etc.) and social media companies (YouTube, Facebook, etc.)

- “Skinny bundles” now offered by some video programming distributors
US Telephone Subscribers
2001 - 2014

Prepaid
Contract Wireless
US VOIP
US Switched Wireline
Pay TV Video Competition
1995-2015
### Top 10 Video Subscription Services

<table>
<thead>
<tr>
<th>SERVICE</th>
<th>SUBSCRIBERS</th>
<th>SERVICE</th>
<th>SUBSCRIBERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Netflix</td>
<td>47.0 MILLION</td>
<td>6. Hulu</td>
<td>12.0 MILLION</td>
</tr>
<tr>
<td>2. DIRECTV</td>
<td>25.3 MILLION</td>
<td>7. VerizonFiOS</td>
<td>4.7 MILLION</td>
</tr>
<tr>
<td>3. Comcast</td>
<td>22.4 MILLION</td>
<td>8. Altice</td>
<td>4.6 MILLION</td>
</tr>
<tr>
<td>4. Charter</td>
<td>17.5 MILLION</td>
<td>9. Cox</td>
<td>4.0 MILLION</td>
</tr>
<tr>
<td>5. Dish</td>
<td>13.9 MILLION</td>
<td>10. Frontier Communications</td>
<td>1.7 MILLION</td>
</tr>
</tbody>
</table>
Choosing Netflix

A poll of Americans age 13 to 54 who have watched some streaming programming found that Netflix was their most frequent choice when they want to watch a TV show. That was also true for all age groups surveyed except baby boomers.

Where do you go most frequently when you want to watch a TV show?

<table>
<thead>
<tr>
<th>Method</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netflix streaming subscription</td>
<td>37%</td>
</tr>
<tr>
<td>DVR or TiVo service</td>
<td>14%</td>
</tr>
<tr>
<td>A TV channel during its original air time</td>
<td>12%</td>
</tr>
<tr>
<td>Hulu (paid) subscription</td>
<td>7%</td>
</tr>
<tr>
<td>YouTube</td>
<td>7%</td>
</tr>
<tr>
<td>Amazon Prime subscription</td>
<td>3%</td>
</tr>
<tr>
<td>Online, on a free site</td>
<td>2%</td>
</tr>
<tr>
<td>Video on demand</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>16%</td>
</tr>
</tbody>
</table>

Percentage who chose Netflix, by age group

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Young millennials (13-24)</td>
<td>50%</td>
</tr>
<tr>
<td>Older millennials (25-34)</td>
<td>40%</td>
</tr>
<tr>
<td>Generation X (35-49)</td>
<td>28%</td>
</tr>
<tr>
<td>Baby boomers (50-54)</td>
<td>22%</td>
</tr>
</tbody>
</table>

Source: E-Poll Market Research survey of 1,328 people in the U.S., ages 13 to 54, conducted online in July 2016. All respondents had viewed a full-length streamed program within the previous six months.
Implications for State / Local Revenues

- **Trend**
  - Total telephone subscriber numbers are flat and may decline

- **Impact**
  - Per line fees (911, etc.) no longer growing, may decline
  - Raising taxes will continue to push consumers toward untaxed or lower tax alternatives for communication services
Trends and Revenue Implications

• Trend
  • Wireless revenues per subscriber falling

• Impact
  • Less revenue from percentage-based consumption taxes
  • To the extent that consumers are spending money on other goods or services, impact may depend on the breadth of the states sales tax base
Trends and Revenue Implications

- **Trend**
  - Wireless business model shifting away from subsidizing handsets

- **Impact**
  - Subsidy was built into cost of telecom service, which in many states is taxed at rates above sales tax
  - Reduced telecom tax revenues
  - Revenue from handset sales shows up in general sales tax collections, not telecom tax collections
Trends and Revenue Implications

• Trend
  • Consumer demand shifting from voice to data / Internet Access and other consumer media services

• Impact
  • Less state and local revenue from traditional communication services as demand shifts from services taxed at rates above the sales tax to services taxed at general sales tax rates or not taxed at all
  • High telecom tax rates will exacerbate consumer shifts to new technologies that may not be taxable
Trends and Revenue Implications

- **Trend**
  - Substantial number of consumers subscribe to satellite TV multichannel video

- **Impact**
  - No local revenue from Satellite TV customers – satellite TV not required to collect local taxes and fees from customers
  - High tax rates will exacerbate consumer shifts to new technologies with lower tax burden
Trends and Revenue Impacts

**Trend**
- “Over the Top” (OTT) competing in the video marketplace

**Impact**
- Reduced local franchise fee revenues
- Providers of OTT may not be required to collect tax (no nexus)
- Tax policies that treat video companies unfavorably compared to OTT providers may give consumers additional incentives to seek untaxed or lower taxed alternatives
What Should Policymakers Do?

- State and local tax policies should not be picking winners and losers – states need to modernize their statutes to reflect the current marketplace.

- Modernize taxation of video services to ensure taxes will not vary depending on who provides the service and whether they own network facilities.
What Should Policymakers Do?

- Need to end discriminatory taxation of video services to level the playing field
  - Without legislative action, continued administrative efforts to expand existing industry taxes to new providers of streaming video are likely (e.g., CA Utility User Tax, Chicago amusement tax)
  - Potential for continued disputes and litigation
  - OTT providers are technology and content businesses
What Should Policymakers Do?

- States and Congress working together need a modern framework for sourcing digital goods and services, similar to what was implemented for wireless service in 2001.

- States and Congress working together need to address nexus over remote sellers, including remote sellers of digital products and services.
What Should Policymakers Do?

• End discriminatory taxation of communications services to level the playing field

• End specific taxes imposed on a per line/device for communication technologies

• Shift funding for 911 programs – starting with NG911 – from end-user communication specific fees to general fund revenue sources
What Should Policymakers Do?

- Florida CST Task Force (2012)
  - Local government & industry representatives
  - Studied trends in Florida CST and made recommendations to the legislature

- Recommendations
  - Repeal the communications services tax
  - Raise the sales tax by 0.3%
  - Revenue neutral
  - Would shifts portion of tax burden from FL residents and businesses to out-of-state visitors
Concluding Thoughts

• This presentation focused on end user taxes on communications & video services

• Taxation of communications infrastructure investment also needs to be modernized – this Task Force has addressed that issue with policy statements

• The current tax structure punishes companies that invest in infrastructure and rewards companies that use this infrastructure to sell digital and other intangible products and services

• State economic growth and prosperity will increasingly depend on communications infrastructure investment
Concluding Thoughts

• Industry trends will make it difficult or impossible for states and localities to rely on communications providers and their customers for disproportionately high revenues.

• The failure to modernize tax policy will only accelerate industry trends that will lead to a decline in communications tax revenues.

• The failure to modernize communications tax policy could have a detrimental impact on communications companies that are expanding and modernizing networks upon which state economies will depend for economic growth.
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