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MEMORANDUM

November 7, 2002

TO:

FROM: Gardner F. Gillespie

RE: DBS Tax Issues

The purpose of this memorandum is to discuss two issues raised by the representatives of Echostar and Direct TV at the hearing before the Governor's Task Force on Tax Policy in Nevada on November 6, 2002. The DBS witnesses suggested that a DBS tax would be unconstitutional and that local government franchise fees should be considered as "rent" for use of public rights-of-way and merely a "cost of doing business" for cable operators.

I. A Five-Percent State Tax on DBS Gross Receipts Would Be Constitutional.

Although the DBS industry representatives were not specific in their contentions that a five-percent tax on DBS revenues would be unconstitutional, we can conceive of only three bases for such an argument. We considered each of these arguments before proposing the tax, and we firmly believe the arguments are entirely without merit.

A. Commerce Clause

Nevada allows for taxation to the full extent permitted under federal constitutional principles. *See, e.g., Certain-Teed Products Corp. v. Second Judicial Circuit,* 87 Nev. 18, 479 P.2d 781 (1971). State taxes will survive a claim under the Commerce Clause of the United States Constitution if (1) the activity taxed has sufficient nexus with the state; (2) the tax does not discriminate against interstate commerce; (3) the tax is fairly apportioned among the states, and (4) the tax is related to services provided by the state. *See Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 277-78 (1997). The DBS tax proposed here meets these criteria, in the same way that a similar tax imposed on long distance telephone service by Illinois was held by the Supreme Court to meet the criteria in *Goldberg v. Sweet,* 488 U.S. 252 (1989).

(1) Nevada has "a substantial nexus with the interstate communications reached by the tax." *Id.* at 260. The DBS providers' signals are beamed to their customers in Nevada, who obtain authorization from the DBS

companies to descramble the signals. The DBS providers have a sufficient physical presence in Nevada both by their provisioning service to hundreds of thousands of Nevada residents on a daily basis pursuant to contracts, as well as their use of agents resident in Nevada to sell DBS services. *See Scripto, Inc. v. Carson,* 362 U.S. 207 (1960).

(2) The tax will not discriminate against interstate commerce because "the economic burden of the [Nevada DBS tax] falls on the [Nevada DBS] consumer." *Goldberg.* 488 U.S. at 266. Furthermore, the tax imposes the "rough equivalent of an identifiable and 'substantially similar' tax on interstate commerce" – the municipal fees imposed on cable operators under NRS 711.200. *Oregon Waste Systems, Inc. v. Department of Environmental Quality,* 511 U.S. 93, 102-03 (1994).

(3) The tax will be fairly apportioned because there is no risk that the DBS company will be subject to taxation in more than one state for the service provided to Nevada customers. *Goldberg,* 488 U.S. at 266.

(4) The tax will be fairly related to services provided by the state to the Nevada consumers who will bear the burden of the tax and enjoy the benefit of state services. *Id.* at 266-67.

B. First Amendment

The Supreme Court has held that imposing a sales tax on cable operators while exempting satellite subscription service providers and print media from the tax does not violate the First Amendment. *See Leathers v. Medlock,* 499 U.S. 439 (1991). The same rationale would apply to a tax that does the reverse -- impose a tax obligation on satellite providers while exempting cable operators, who are already subject to similar tax obligations.

C. Equal Protection

So long as differential tax treatment is reasonable and is not arbitrary, it will survive an equal protection challenge. *See, e.g., Medlock v. Leathers,* 842 S.W.2d 428, 431 (Ark. 1992). Here the tax is based on the different treatment by the state's municipalities and is intended to equalize the overall state and local burdens imposed on these competitive industries. *See Oregon Waste Systems, Inc. v. Department of Environmental Quality,* 511 U.S. 93 (1994); *Communications & Cable of Chicago, Inc. v. City of Chicago,* 668 N.E.2d 13 (Ill. App. 1988).

Based on these precedents upholding similar taxes, we believe that the proposed DBS tax would clearly be constitutional.

As noted earlier to the Task Force, the States of Florida and North Carolina have imposed similar state taxes intended to equalize the burdens imposed by

the states and their political subdivisions on cable operators and DBS providers. Florida enacted legislation in 2001 to impose a tax on DBS providers that is 4.5 percent higher than the tax on cable operators. See Fla. Stat. Ann. § 202.11(3) & (6). North Carolina enacted a tax entitled "Equalize Taxations Between Satellite TV and Cable TV" in 2001, imposing a five-percent tax on DBS gross receipts. 2001 N.C. Sess. Laws 2001-424 (SBA 1005, HB 231). To the best of our knowledge, neither of these laws has been challenged by the DBS industry.

II. The "Fees" Paid by Cable Operators in Nevada Do Not Represent "Rent" for the Use of the Rights-of-Way, and Governmentally Imposed "Costs of Doing Business" Should be Equivalent.

At the hearing before the Task Force on November 6, 2002, the DBS representatives argued that the franchise fees that cable operators pay to local governments are "rent" for use of the public rights-of-way and should be viewed simply as a "cost of doing business," different from other governmentally imposed fees and taxes.

Cable operators in Nevada pay an annual "fee" of five-percent of their gross revenues to local governments. 1/ This "fee" is defined under NRS 354.598814 as "a charge imposed by a city or public utility [defined to include cable operators under NRS 354.598817(2)] for a business license, franchise or right of way over streets or other public areas." The fee is collected by municipalities and placed with other tax revenues in the municipal general funds.

Franchise fees imposed by local governments under NRS 354.598814 *et seq.* are not "rent" for use of the rights-of-way and are no more a "cost of doing business" than are any other kind of government-imposed fees or taxes.

It has been settled common law throughout the United States for more than a century that municipal streets are held in "trust for the public" and are not subject to being rented to private parties. I have written a law review article on this very subject, to be published by the Dickinson Law Review this month. *Gardner F. Gillespie, Rights-Of-Way Redux: Municipal Fees on Telecommunications Companies and Cable Operators, 107 Dick. L. Rev. ___ (forthcoming 2002).* A copy of the page proofs of the article is attached to this memorandum. As noted at page 114, courts in at least eight states have explicitly held that municipalities are not entitled to charge rent to utilities for use of the public rights-of-way. Although no Nevada court has addressed the issue, there is no reason to believe that Nevada would depart from this widely held understanding.

1/ "Gross revenues" are defined under NRS 711.200 in the same way that "gross revenues" are defined in the proposed gross receipts tax on DBS.

It is true, as noted by the DBS representatives who testified before the Task Force, that the Fifth Circuit loosely characterized franchise fees as "essentially a form of rent" in one case. *City of Dallas v. FCC,* 118 F.3d 393, 397 (5th Cir. 1997). But the issue before the court was whether the franchise fee collected by cable operators should itself be considered to be part of the cable operator's "gross revenue" under federal law, not whether any municipality has the authority to charge "rent" for use of the right-of-way. Nor was the court addressing whether it would be somehow discriminatory for a state to equalize the burdens imposed by state and local governments on cable operators and satellite providers by imposing a state tax on the latter mirroring the amounts imposed by the state's political subdivisions on the former.

The DBS representatives also argued to the Task Force that franchise fees should be viewed as a "cost of doing business." But the fact that such fees are a "cost of doing business" does not suggest that a similar tax on DBS providers would not be a fair and comparable "cost of doing business." In fact, the court in the *City of Dallas* case noted that any tax or fee imposed on a company (and not directly on the company's customer) is a "normal expense of doing business." *Id.* The point here is not whether franchise fees are a "cost of doing business," but whether it is unfair for the state to permit its political subdivisions to impose a "cost of doing business" of five percent of gross revenues on one provider of multi-channel video services in a market while no state governmental entity imposes a similar "cost of doing business" on a direct competitor.

III. Conclusion

Cox Communications of Las Vegas respectfully submits that the DBS industry's effort to avoid contributing its fair share to meet the revenue needs of Nevada and its political subdivision should not be accepted. Just as other states have recently imposed taxes on DBS to obtain a revenue contribution from these huge national corporations equal to that provided by cable operators to their municipalities, Nevada should enact a similar tax. Certainly, in light of the State's need for additional revenue, the increasingly powerful and successful DBS industry should not have a free ride.

Attachment

ccs: Steve Schorr
Misty Grimmer