



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Amended:	<b>05/17/11</b>	Bill No:	<b><a href="#">Senate Bill 530</a></b>
Tax Program:	<b>Satellite TV</b>	Author:	<b>Wright</b>
Sponsor:	<b>Author</b>	Code Sections:	<b>Part 14.5 (commencing with Section 33001) of RTC</b>
Related Bills:		Effective Date:	<b>Upon enactment, but operative 1st calendar quarter 90 days after enactment</b>

**BILL SUMMARY**

This bill imposes a 6% tax on direct broadcast satellite television service providers on their gross revenues, as defined.

**Summary of Amendments**

Among other things, the amendments to this bill since the previous analysis add a repeal date of January 1, 2020, and require the Legislative Analyst's Office (LAO), in collaboration with the Board of Equalization (BOE), to assess and evaluate the impact of the proposed tax, as specified.

**ANALYSIS**

**CURRENT LAW**

Under existing law, there is no state-imposed tax or fee on the satellite service subscriptions or the monthly charges billed in connection with the provision of direct broadcast satellite television service to subscribers or customers.

In general, direct broadcast satellite television service providers (DBS service providers) either pay a sales tax or collect the use tax associated with the monthly rental or lease of the satellite receiver by the subscriber for use in the subscriber's home or business location.

The Sales and Use Tax Law (Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code (RTC)) imposes a sales or use tax on the gross receipts from the sale of, and on the sale price of, tangible personal property, unless specifically exempted or excluded by statute. Sections 6011 and 6012 of the Sales and Use Tax Law define "sales price" and "gross receipts" as the total amount of the sale, lease, or rental price, without any deduction on account of the cost of materials used, labor or service costs, interest charged, losses, or any other expenses related to the sale of the property. However, the law expressly excludes from the definition of "gross receipts" and "sales price" the amount of any tax (except manufacturers' or importers' excise tax) imposed by the United States upon or with respect to retail sales and not including the amount of any tax imposed by the state upon diesel fuel, or the amount of any transactions or sales tax or use tax imposed by any city, county or city and county, or special taxing district within this state. "Gross receipts" and "sales price" also do not include the following: amounts charged for the value of intangible personal property in certain technology transfer agreements; certain charges for transporting landfill; and

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amounts equal to the sales or use tax on the federal manufacturers' or importers' excise tax imposed on specified fuel purchases under certain conditions.

Under existing law, cable service in California is subject to direct local taxation based on the rationale that they use public rights-of-way and are granted a local monopoly. Cable service is regulated by the federal government and the State of California and is subject to a regulatory fee levied by the FCC. In California, two principal fees and charges are levied on cable television connections.

- Franchise fees are paid to local governments by privately-owned cable companies for the privilege of using local government property and rights-of-way. Federal law prohibits franchise fees from exceeding 5 percent of gross revenues, while state law also limits franchise fees to a percentage of gross revenues. State and federal laws also prevent companies from providing cable services without acquiring a franchise. California has delegated to cities and counties the franchising authority over cable companies, whose fee payments represent a general fund revenue source.
- Utility-user taxes (UUTs) are gross proceeds taxes levied by some local governments on cable television services and other utilities, such as telephone, gas, and electric services. UUT rates generally range from 5 percent to 7 percent and represent a general fund revenue source for local governments.

The franchise fee paid by cable companies in California is specified in the Public Utilities Code, Sections 5800 to 5970, also referred to as the Digital Infrastructure and Video Competition Act of 2006. The fee amount is based on a percentage of the franchise holder's gross revenues. With respect to that franchise fee, subdivision (g) of Section 5860 defines "gross revenues" to include "all revenue actually received by the holder of a state franchise, as determined in accordance with generally accepted accounting principles, that is derived from the operation of the holder's network to provide cable or video service within the jurisdiction of the local entity." Gross revenues also includes the following: (1) all charges billed to subscribers, including revenue related to programming, equipment rentals, late fees, and insufficient fund fees; (2) franchise fees passed through to, and paid by, the subscribers; (3) commissions that are paid as compensation for promotion or exhibition of any products or services, such as "home shopping" or similar channels; and (4) a pro-rata portion of all revenues pursuant to compensation arrangements for advertising. However, certain revenues that are not included in the definition of "gross revenues" are: (1) amounts not actually received, including, but not limited to bad debt, refunds, rebates, and discounts; (2) revenues received by an affiliate, unless it has the effect of evading the franchise fees, or if the revenue is not otherwise subject to such fees; (3) revenues from services considered to be noncable or non-video services under federal law, including, but not limited to, telecommunications services and information services; (4) revenues paid by subscribers to "home shopping" or similar networks directly from the sale of merchandise; (5) revenues from the sale of video service for resale in which the reseller collects a subscriber fee similar to the franchise fee; (6) amounts billed to and collected from subscribers to recover any governmental tax or fee, including, but not limited to, sales and use taxes, gross receipts taxes, excise taxes, utility users taxes, public services taxes, and communication taxes; (7) revenue from the sale of capital assets not used by the purchaser to receive cable services; (8) revenue from directory or Internet advertising; (9) revenue received as reimbursement for specific marketing costs.

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**PROPOSED LAW**

This bill would add Part 14.5 (commencing with Section 33001) to Division 2 of the RTC to impose an excise tax on direct broadcast satellite television service providers in an amount equal to 6 percent of their gross revenues. The revenues from the proposed tax would be deposited in the General Fund and transferred to the Local Safety and Protection Account established in the Transportation Tax Fund by Section 10752.2 of the Vehicle License Fee Law (Part 5 (commencing with Section 10701) of Division 2 of the RTC).

The bill would provide the following definitions:

- "Direct broadcast satellite television service" and "DBS service" would mean any television programming transmitted or broadcasted by satellite directly to the subscriber's premises.
- "DBS service provider" or "DBS provider" would mean any person that sells DBS service.
- "Subscriber" would mean any person, firm, partnership, corporation, limited liability company, or other entity paying to receive video service in this state.

In addition, the bill defines "gross revenues" to mean all revenue of the DBS service provider, as determined in accordance with generally accepted accounting principles, that is derived from the sale of DBS service in this state. The DBS service provider must also use the same method of determining revenue under generally accepted accounting principles as that which the DBS service provider uses in determining revenues for the purpose of reporting to national and state regulatory agencies. The bill goes on to further specify what types of revenue are included and not included in the definition of "gross revenues."

**Revenues included**

- All charges billed to subscribers in this state for any and all DBS service, including all revenue related to programming provided to the subscriber, equipment rentals, late fees, and insufficient fund fees.
- Compensation received by the DBS service provider that is derived from the DBS service provider's operation with respect to commissions that are paid to the DBS service provider as compensation for promotion or exhibition of any products or services on the provider's network, such as a "home shopping" or similar channel.
- A pro rata portion of all revenue realized by the DBS service provider or its affiliates pursuant to compensation arrangements for advertising derived from DBS service in this state. The allocation shall be based on the number of subscribers in this state divided by the total number of subscribers in relation to the relevant regional or national compensation arrangement.

**Revenues not included**

- Amounts not actually received, by the DBS service provider, even if billed, such as bad debt; refunds, rebates, or discounts to subscribers or other third parties; or revenue imputed from the provision of DBS services for free or at reduced rates to any person as required or allowed by law, including, but not limited to, the provision of these services to public institutions, public schools, governmental agencies, or

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employees, except that foregone revenue chosen not to be received in exchange for trades, barter, services, or other items of value shall be included in gross revenue.

- Revenues received by any affiliate or any other person in exchange for supplying goods or services used by DBS service provider to provide DBS services. However, revenue received by an affiliate of the DBS service provider from the affiliate's provision of DBS service shall be included in gross revenue as follows:
  - To the extent that treating the revenue as revenue of the affiliate, instead of revenue of the DBS service provider, would have the effect of evading the payment of taxes that would otherwise be paid to the state under this part.
  - The revenue is not otherwise subject to the tax to be paid to the state under this part.
- Revenue derived from services other than DBS service, including, but not limited to, revenue derived from Internet access service, telecommunications services, and information services.
- Revenues paid by subscribers to "home shopping" or similar networks directly from the sale of merchandise through any home shopping channel offered as part of the DBS services.
- Revenues from the sale of DBS services for resale in which the seller is required to collect the tax under this part from the reseller's subscribers.
- Amounts billed to, and collected from, subscribers to recover any tax, fee, or surcharge imposed by any governmental entity on the DBS service provider, including, but not limited to, sales and use taxes, gross receipts taxes, excise taxes, utility users taxes, public service taxes, communication taxes, and any other fee not imposed by this section.
- Revenue from the sale of capital assets or surplus equipment not used by the purchaser to receive DBS services from the seller of those assets or surplus equipment.
- Revenue from directory or Internet advertising revenue, including, but not limited to, yellow pages, white pages, banner advertisement, and electronic publishing.
- Revenue received as reimbursement by programmers of specific, identifiable marketing costs incurred by the DBS service provider for the introduction of new programming.
- Security deposits received from subscribers of a DBS service provider, excluding security deposits applied to the outstanding balance of a subscriber's account and thereby taken into revenue.

**Bundled services.** In the case where the DBS service is bundled with other products or services, so that a subscriber pays a single fee for more than one service or receives a discount on DBS services, gross revenues will be determined based on an equal allocation of the package discount, that is, the total price of the individual service at advertised rates compared to the package price, among all services comprising the bundle. If the DBS service provider does not offer any component of the bundled package separately, the DBS service provider will declare a stated retail value for each

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component based on reasonable comparable prices for the service for the purpose of determining the tax based on the package discount.

**Local Public Safety and Protection Account.** The Account is reestablished in the Transportation Tax Fund on July 1, 2011. The funds in the Account are continuously appropriated to the Controller for allocation pursuant to Government Code Sections 29553, 30061, and 30070, Penal Code Section 13821, and Welfare and Institutions Code Sections 18220 and 18220.1. The Director of the Department of Finance (DOF Director) shall annually, as specified, make a written determination of whether any of the moneys derived from the DBS service provider tax are being allocated by the state for any other purpose besides those referenced sections. The DOF Director must submit the written determination to the BOE and specified Legislative Committees.

If the DOF Director determines that any moneys derived from the DBS service provider tax are being used for any unauthorized purpose, the BOE shall immediately cease collection of the taxes and shall resume collection of the tax only upon the receipt of a written determination from the DOF Director that the funds from the DBS service provider tax are being allocated only for the authorized purposes.

**Report.** The LAO, in collaboration with the BOE, shall conduct a study, on or before December 31, 2018, to assess and evaluate the impact of the DBS service provider tax. Any costs related to the study shall be allocated to the LAO and BOE from the DBS service provider tax.

**Miscellaneous.** The bill specifies that the tax would be collected and administered by the BOE in accordance with the Fee Collections Procedure Law.

The act is an urgency statute but would not become operative until the first day of the first calendar quarter commencing more than 90 days after the effective date of the act.

The tax is repealed January 1, 2020.

#### BACKGROUND

Three bills over the last several years have been introduced that were also related to direct broadcast satellite television service.

- SB 1849 (Comm. on Budget & Fiscal Review, 2002) would have imposed a tax on each subscriber of DBS service in this state at a rate of 5% of the total gross charges incurred by the subscriber. This budget trailer bill died on the Senate unfinished business file.
- AB 1016 (Ridley-Thomas, 2005) was legislative intent language to impose a tax on DBS service providers in an amount equal to 8% of the amount the provider charges its customers for monthly service. This bill died at the Assembly desk.
- SB 354 (Wright, 2009) would have required the BOE to study the impact of new video and voice alternatives, including DBS services, on local tax and fee revenues and report its findings to the Legislature. This bill was not heard in a policy or fiscal committee.

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**COMMENTS**

1. **Sponsor and Purpose.** This bill is sponsored by the author and is intended to provide a funding source that would preserve the tax base for local public safety programs.
2. **The May 17, 2011 amendments** (1) add a repeal date of January 1, 2020, (2) provide several provisions related to the Local Public Safety and Protection Account, and (3) requires the LAO, in collaboration with the BOE, to assess and evaluate the impact of the proposed tax, as specified.
3. **Is the definition of "gross revenues" appropriate for the DBS service providers?** As mentioned previously in the analysis, the cable providers in California are required to pay a franchise fee to local governments. The fee amount is based on a percentage of the franchise holder's gross revenues, with "gross revenues" defined in terms almost identical to those used in this bill. The inclusion and exclusion of certain revenues in order to define "gross revenues" for the purposes of the franchise fee was arrived at with the participation of the cable industry. It would seem that this bill would use the same model for the DBS service providers – the author's office should be engaging the affected industry and arriving at definitions appropriate for that industry.

Since the BOE is not familiar with the business model of the DBS service provider industry, we are concerned that the bill may not be capturing the revenue specific to these providers, that may be different from the revenue received by the cable industry. For example, gross revenues is defined to include equipment rentals, late fees, and insufficient fund fees. But what if the DBS service provider industry has more revenue attributable to other types of fees or charges, i.e. "cancellation charges," "upgrade fees," or something similar? What about the compensation from commissions that are paid to the DBS service provider for promotion or exhibition from "home shopping" channels? What if the providers also get their revenues from some other source, such as royalties? While there may be compensation arrangements for advertising, what if the DBS service providers don't have it structured the same way as the cable industry (i.e., pro rata portion and regional compensation arrangements)? Moreover, the cable industry apparently has "affiliates" which must also pay a franchise fee. Does the DBS service provider industry have a similar type of affiliate arrangement, or do they have other types of business partners? Given the attempt to tax the "gross revenue" of the DBS service providers, it would seem prudent to involve the industry that may be subject to the tax so as to be able to better understand how the BOE will administer the tax functions (registration, returns, auditing, collection, appeals, etc.) and allow the BOE to better estimate the cost and revenue impacts, as well as to avoid any unintended consequences.

4. **Bundled services.** In general, DBS service providers team up with Internet and phone service providers to offer their satellite television service along with Internet and phone service in their customers' plans. Customers may choose a bundled service plan for several reasons, but generally these include the convenience of a single bill or the lower costs associated with bundling the services. In order to determine the tax on gross revenues from the package discount offered for bundled services, the DBS service provider has one of two options: (1) in those cases where

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the DBS service provider offers the components of a bundled package separately, the gross revenues will be determined based on an equal allocation of the package discount (comparing the total cost of the services at advertised rates to the package price for those same services); or, (2) where the DBS service provider does not offer any component of the bundled package separately (e.g. Internet or phone service), then the DBS service provider would declare a retail value for each component based on reasonable comparable prices for that other product or service.

The BOE would be responsible for various administrative tax functions, including the auditing of the returns filed to determine if the correct amount of tax was remitted. BOE staff is not familiar with the current process by which the cable industry pays the franchise fee to local governments, including the provisions related to the bundling of services. The BOE would be concerned with the process by which the DBS service provider self-declares a retail value for each component of a bundled package based on the "reasonable comparable prices." The BOE would like to work with the DBS service providers to determine if there might be an alternative process or if additional or alternative sources of information are available to the DBS service providers.

**5. Other technical concerns.** As the BOE is not familiar with the cable or DBS service provider industry, the BOE would need additional clarification regarding certain revenues included or excluded from "gross revenues." These include, but are not limited to, the following:

- Revenues included as compensation received by the DBS service provider that is derived from the DBS service provider's operation with respect to commissions that are paid to the DBS service provider as compensation for promotion or exhibition of any products or services on the provider's network, such as a "home shopping" or similar channel. The BOE would ask, how is this revenue distinguishable from revenues received as reimbursement by programmers of specific, identifiable marketing costs incurred by the DBS service provider for the introduction of new programming?
- Can the DBS service provider industry provide "identifiable marketing costs?" What are these costs? This seems to be a vague term that would require additional explanation or refinement.
- Revenues would also include a pro rata portion of all revenue realized by the DBS service provider or its affiliates pursuant to compensation arrangements for advertising derived from DBS service in this state. BOE is unsure how this revenue is distinguishable from revenue derived from directory or Internet advertising revenue, including, but not limited to, yellow pages, white pages, banner advertisement, and electronic publishing.
- With respect to the pro rata portion of advertising revenue, the allocation is based on the number of subscribers in this state divided by the total number of subscribers in relation to the relevant regional or national compensation arrangement. It would seem necessary to use some sort of prior time period as a basis for future reporting; otherwise the allocation could change on a daily basis, which would make it more difficult for the BOE when auditing tax returns.
- Section 33003 (c)(3) states that, for the purposes of determining gross revenue, the DBS service provider shall use the same method of determining revenue

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under generally accepted accounting principles as the method that the DBS service provider uses in determining revenues for the purpose of reporting to national and state regulatory agencies. The BOE would be concerned that the determination of gross revenues may depend upon which state the DBS service provider is headquartered, which could cause more uncertainty and administrative difficulty for the BOE audit staff.

- 6. Funding necessary for administrative start-up costs.** The provisions of this bill would be effective immediately but would be operative on the first day of the first calendar quarter commencing more than 90 days after the effective date. If passed, it is possible that the bill would be operative by January 1, 2012, in the middle of the 2011-12 fiscal year. The BOE would incur administrative start-up costs related to identifying and registering taxpayers, developing computer programs, and developing forms, publications, and returns, training staff, and creating regulations related to the proposed tax. Since these costs would not be identified in the BOE's 2011-12 budget, the BOE would need an adequate direct appropriation to cover these costs.

With respect to the latest amendments to the Local Safety and Protection Account, which provide that the Controller allocate the proceeds from the DBS service provider tax pursuant to Government Code Sections 29553, 30061, and 30070, Penal Code Section 13821, and Welfare and Institutions Code Sections 18220 and 18220.1, the BOE's costs to administer the duties imposed on it by this bill should either be included as an authorized allocation or language should be added to specify that the Legislature will appropriate funds from the General Fund, or some other appropriate language to address the BOE's costs.

Staff is available to work with the author's office to address this issue.

- 7. Bill should have a longer delayed operative date.** The bill provides for a delayed operative date to the first day of the first calendar quarter commencing more than 90 days after the effective date. However, given the issues identified in the analysis, the BOE would need at least a six-month lead time from the effective date of the bill before the bill becomes operative to allow the BOE time to interact with the DBS service provider industry, assess the need for regulatory actions, and, if necessary, adopt regulations to implement the proposed tax. Within that time the BOE would also perform the administrative start-up tasks. The language should specify that the tax would go into effect on the first day of the first calendar quarter commencing at least six months following the bill's effective date.
- 8. The bill should provide additional detail regarding the immediate cessation, and subsequent resumption, of collection of the taxes.** As amended, the bill now has trigger language that would require the BOE to "immediately cease collection of the taxes" upon receipt of a written determination from the DOF Director that funds derived from the DBS service provider tax are being used for an unauthorized purpose. The BOE is concerned that the language is ambiguous and could be interpreted to mean collection of all DBS service provider taxes, including past due amounts or amounts already accrued. In this scenario the BOE would have additional costs related to, among other things, refunds, additional compliance efforts to cease collections, issues regarding the processing of tax returns and accompanying payments, special notices to taxpayers, training of staff, and related programming issues. If the author only intended for collection to cease for taxes

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accrued on or after the receipt of the written determination from the DOF Director, then that should be clarified. In that case, the BOE would have additional costs related to processing of tax returns and payments, special notices to taxpayers, training of staff, and related programming issues.

In the event the BOE ceases collection of the taxes, the BOE would resume collection of the tax only upon receipt of a written determination from the DOF Director that the DBS service provider tax proceeds are only being allocated for specified purposes. If that were to occur, does the author intend that the period of time from which the BOE was notified to cease collection to the period of time that the BOE resumes collection is excluded or exempt from the DBS service provider tax? Would the BOE just suspend collection of the tax, but the tax obligation continue to accrue? In other words, would the DBS service providers still need to pay the tax, just not have to report or pay within the period that BOE is required to cease collection?

The immediate cessation and subsequent resumption of the tax could also place a costly burden on the DBS service providers, especially if the industry reimburses themselves from their subscribers. Without a workable timeframe for cessation and resumption of the taxes, the costs to administer this provision could weigh heavily on both the State and the industry.

## **COST ESTIMATE**

The BOE would incur non-absorbable costs to adequately develop a new tax program. These costs would include identifying and registering taxpayers, developing computer programs, and designing forms, publications, and returns, training staff, and creating regulations related to the proposed tax. As detailed in comment 8, the BOE would incur varied costs dependent on the author's intent regarding the immediate cessation, and subsequent resumption, of collection of the taxes. BOE would have additional costs related to the agency's collaboration with LAO to conduct a study of the impact of the DBS service provider tax. While a detailed estimate of these costs is pending, the costs to administer a new program would be substantial, in the millions of dollars.

## **REVENUE ESTIMATE**

### **BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

Currently, there is no existing law to impose a tax or fee on satellite subscriptions or monthly charges in connection with the provision of direct broadcast satellite television service to customers or subscribers. DBS service providers pay either sales tax or collect the use tax associated with the monthly rental or lease of the satellite receiver in the subscriber's home or business location. This is in contrast to cable service providers, who are subject to direct local taxation based on the rationale that they use of public rights-of-way and are granted a local monopoly. The cable industry is regulated by the federal government and the State of California and is subject to a regulatory fee levied by the FCC. California has two principal fees, which are a franchise fee not to exceed five percent of gross revenues and a utility user tax not to exceed seven percent of gross revenues.

This bill would impose an excise tax on DBS providers in an amount equal to 6% of its gross revenues. In addition, the bill defines "gross revenue" to mean all revenue of

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DBS service providers, as determined in accordance with generally accepted accounting principles that is derived from the sale of DBS service in this state. The bill goes on to further specify what types of revenues are included and not included in the definition of "gross revenues."

**Satellite Estimated Revenues.** Based on 2010 data from satellite markets, the National Cable and Telecommunications Association, and 2007 Economic Census information, we estimated that DBS gross revenues for the calendar year 2010 were \$3,111 million. The estimated fiscal-year revenues for DBS service are as follows:

**Estimated DBS Revenues**

(In millions of dollars)

<u>Estimated DBS Revenues</u>	FY 2011-12 (1/2 yr)	FY 2012-13	FY 2013-14
<b>Total Revenue</b>	<b>\$ 1,603</b>	<b>\$ 3,270</b>	<b>\$ 3,334</b>

We estimate that revenue from DBS service will increase by 2 percent annually through 2013-14.

**REVENUE SUMMARY**

The proposed excise tax of 6% of the gross revenue from DBS service would be:

**FY 2011-12 (1/2 year)**

We assume an implementation date of January 1, 2012. The revenue impact from imposing a 6% tax on DBS service providers amounts to **\$96 million** (\$1,603 million X 6%).

**FY 2012-13**

The revenue impact from imposing a 6% tax on DBS service providers amounts to **\$196.2 million** (3,270 million X 6%).

**FY 2013-14**

The revenue impact from imposing a 6% tax on DBS service providers amounts to **\$200 million** (3,334 million X 6%).

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