

# Daily Journal

## **Proliferation of streaming video services could lead to increased regulations and taxes on OTT providers**



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The biggest media trend of the last decade was the widespread adoption of over-the-top, or OTT, streaming services such as Netflix that provide their video content over the internet. While these OTT services were once viewed as an alternative to traditional cable-based media, they have largely supplanted those providers as more consumers have cut the cord on their cable services in favor of the OTT platforms. Many established media companies have gotten in on the act as well: for instance, HBO and Disney have ported most if not all of their content to companion streaming services.

This trend is likely to continue -- and, in fact, accelerate -- in this decade. With advancing streaming technology, more broadband internet, and shifting viewing habits (e.g., viewers are now conditioned to binge-watch entire seasons of their favorite programs instead of waiting for weekly episodes at a set time), OTT services are poised to become the dominant paradigm in the future. But with the rise of digital content, there are a range of potential new legal issues that come with it, namely, the specter of increased targeted regulation, attempts to extend existing regulations to cover OTT services, or both.

For instance, in 2015, Chicago became the first city to tax streaming services. Through its "amusement tax," or so-called "Netflix tax," the city charges residents a 9% tax on OTT services. Florida recently passed a similar tax on all streaming services within the state. Also, in 2018, several cities in Missouri sued Netflix and other OTT providers to try to bring those services under the umbrella of the state's Video Service Providers Act, enacted in 2007 and originally intended, as the name suggests, to apply to traditional cable services. See *City of Creve Coeur v. Netflix, Inc., et al.*, Case No. 4:18-cv-01495 (E.D. Mo. 2019).

Here in California, several dozen cities have tried in recent years to update their Utility User Tax, or UUT, ordinances, normally directed at telephone and cable services, to cover video streaming services as well. And while the interest in bringing those OTT services under the auspices of those cities' existing regulations is understandable, because of diminishing revenues from cable

as more consumers convert to streaming, it raises a number of questions about the legality of such actions.

As a threshold matter, there is a question of whether streaming services fall under the definition of "video services" typically set forth in UUT ordinances in the first place. After all, many of those ordinances were enacted long before the proliferation of OTT services, and were not directed at, nor did they contemplate, video streaming over the internet. For example, the primary dispute in *City of Creve Coeur* is whether the OTT services fall under the definition of "video services provider" as the legislature there intended when the law was passed in 2007. This is an issue that often arises when a government or regulatory body tries to expand a regulation or statute directed at existing technology to later-developed technology.

Beyond that threshold issue, California cities' attempts to tax OTT services could also implicate the state and federal constitutions. For instance, those taxes could violate California's Proposition 218, which amended California's Constitution to require any new taxes to be approved by a majority of the voters. California Constitution, article XIII, section C. They could also violate the federal constitution's due process clause (insofar as there is an insufficient nexus between the state and the taxed activity) and commerce clause (by placing an undue burden on interstate commerce). Finally, they may also violate the Internet Tax Freedom Act, which prohibits discriminatory taxation on the public's use of the Internet.

For illustrative purposes, Chicago's above-described Netflix tax was able to traverse at least some of these challenges. In *Labell v. Chicago*, a citizen taxpayer suit challenging the tax, the trial court found, for instance, that the "amusement tax" satisfied the commerce clause, which requires a proposed tax to fairly apportion the taxable amount attributable to in-state activity, because it was applied only to users who had identified a billing address located within the city's limits. See *Labell v. Chicago*, 2015-CH-13399 (Ill. Cir. Ct. 2015). According to the court, this allowed the city to apportion taxed activity (those occurring within the city) from non-taxed activity (occurring outside the city) in a way that satisfied constitutional muster. Similarly, the tax did not violate the Internet Tax Freedom Act because it did not, according to the court (as well as the reviewing court), discriminate between services that were offered through the Internet and "similar services provided through other means[,]" primarily because the courts concluded that the other forms of "amusement" cited by the plaintiff in that case, such as live theatrical, musical, and cultural performances, were not similar to the services provided by OTT providers. *Id.*; *Labell v. Chicago*, No. 1-18-1379, 2019 WL 6258401 (Ill. App. Ct. 4th Dist. Sept. 30, 2019). Of course, the circumstances under which Chicago's Netflix tax was imposed, as well as the regulatory schemes under which it is in place are not identical with the UUT modifications proposed by cities in California, making a true apples-to-apples comparison difficult. It nevertheless presents a useful case study for the issues that are likely to be litigated during a legal challenge to a tax statute or regulation.

At bottom, there remain open questions surrounding increased regulations on OTT providers, as well as credible legal challenges to them. But such attempts at increased regulation could simply be an unavoidable consequence of the shifting media landscape, which brings along with it increased legal risk for OTT providers. And while companies such as Netflix likely want to tell

these cities (and other states) to chill on increased regulation, this trend is not likely to abate soon.

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