LAW360 Tax Authority
a LexisNexis® company

Portfolio Media. Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

How Streaming Video Cos. Are Challenging New Taxes

By **Timothy Yoo** (April 28, 2020, 5:03 PM EDT)

Timothy Yoo

With millions of Americans sheltering at home indefinitely during the current pandemic, companies such as Netflix Inc. that provide their video content over the internet have seemingly become "essential" services to most. After all, where would we be without "Tiger King" — or, for those with young children, "Frozen 2" — to distract us from the world's uncertainty?

Of course, the ubiquity of video streaming services in our lives is actually the continuation of a trend that began in the last decade, with consumers shifting in droves from traditional cable-based media services to over-the-top, or OTT, streaming services as their preferred form of media consumption.

As a natural and perhaps unavoidable consequence of this paradigm shift, more cities and states are trying to recapture the revenue lost from taxing traditional cable providers (and their diminishing subscriber bases) by issuing new taxes or trying to apply old taxes to the new technology. For instance, in 2019, Florida introduced a new "communications services tax" directed at OTT services. And in February, a bill was introduced in Maine's Legislature that could make that state the latest to tax streaming services.

In challenging such attempts, OTT services have two principal arguments: (1) The taxes do not apply to them; and (2) the taxes are unlawful. While this area is unsettled, two recent cases — one pending and one decided — provide useful guideposts for where those challenges are headed, and whether they are likely to succeed.

First, in City of Creve Coeur v. Netflix Inc. et al., a case currently pending in Missouri state court, 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, ostensibly, to apply to traditional cable services.[1]

As is often the case when a government or regulatory body tries to expand a regulation or statute directed at existing technology to later-developed technology, one of the key disputes is whether the new services fall under the definition of "video services provider" codified by the Legislature when the law was originally passed. This seems to be a strong point: Since the Legislature failed to clearly manifest an intent to include OTT services in its definition of video service providers, any ambiguity in the text should be construed strongly against the taxing authority.[2]

The OTT services in City of Creve Coeur have argued that they are expressly excluded from the statute's definition of video service providers.[3] The challenged statute says that "video service" does not include "any video programming provided solely as part of and via a service that enables users to access content, information, electronic mail, or other services offered over the public internet."[4]

Naturally, the question is whether the OTT services deliver their content over what the statute means by "public internet," a question the parties must litigate. The takeaway is that there will usually be room to argue that the tax statute does not apply when cities (or states) try to apply

an old tax to new technology — a byproduct of the usual lag between emerging technology and the legislation directed at covering it.

The second exemplar case, Labell v. Chicago,[5] illustrates that challenges to a tax statute's legality could be a more difficult approach. As background, in 2015, Chicago extended its amusement tax — originally applied only to ticketed live entertainment performances and events — to cover video streaming services as well. The resulting so-called "Netflix tax" imposes a 9% tax on OTT services for residents with a billing address within the city.

In challenging the legality of this tax on behalf of taxpayers in the city, a citizen group argued among other things that the tax (1) violated the state and federal constitutions, including the Commerce Clause,[6] and (2) violated the federal Internet Tax Freedom Act, or ITFA, which prohibits discriminatory taxation on the public's use of the internet, namely, by taxing services provided through the internet differently than similar services provided in other ways.

After discovery, the trial court granted summary judgment on behalf of the city, concluding among other things that the city's amusement tax as applied to OTT services was reasonably apportioned, because it was applied only to users who had identified a billing address located within city limits, allowing the city to distinguish lawfully between taxed activity (i.e., those occurring within the city) and non-taxed activity (i.e., those occurring outside the city).[7]

The court also disagreed that the tax violated the ITFA. According to the court, the challenged tax did not discriminate between services that were offered through the internet and "similar services provided through other means," primarily because it concluded (perhaps dubiously) that the other forms of "amusement" cited by the plaintiff, such as live cultural performances, were not sufficiently similar to the services provided by OTT services, such that any disparate tax treatment would be illegal.[8]

In affirming the trial court's conclusions, the appellate court stressed that "[s]o long as there exists a situation in which a statute could be validly applied, a facial challenge [to a statute's constitutionality] must fail,"[9] underscoring a reluctance by the courts to declare unlawful a statute or tax ordinance — a material consideration for would-be litigants. On March 25, the Illinois Supreme Court denied a petition for leave to appeal in Labell, effectively ending the legal challenge to Chicago's Netflix tax.[10]

In sum, as an ineluctable consequence of the shifting media landscape, OTT services can expect to be targeted with increased regulations and taxes moving forward. After all, it is natural to expect cities and states to seek to recapture the revenue lost from cable operators' shrinking user bases.

In those scenarios, a stronger position, it seems, than challenging the legality of a statute or ordinance is to leverage the inevitable lag between old laws and new technology, and argue that those laws do not apply to them in the first instance.

Timothy B. Yoo is a principal at Bird Marella PC.

[1] See City of Creve Coeur v. Netflix Inc. et al., Case No. 4:18-cv-01495 (E.D. Mo. 2019).

[2] This is supported by the legislative history of the statute. In its legislative findings, the Missouri General Assembly made specific reference to "all video service providers, including new entrants and incumbent cable operators[,]" RSMo. Sec. 67.2679, which suggests — via expressio unius est exclusio alterius — that "video service provider" was intended to be limited to cable operators.

[3] City of Creve Coeur v. Netflix, ECF No. 10.

[4] RSMo. Sec. 67.2677(14) (emphases added).

[5] Labell v. Chicago, 2015-CH-13399 (Ill. Cir. Ct. 2015).

[6] To satisfy the Commerce Clause, a proposed tax has to, among other things, fairly apportion the taxable amount attributable to in-state activity. Complete Auto Transit Inc. v. Brady, 430 U.S. 274, 279 (1977); see also Goldberg v. Sweet, 488 U.S. 252, 261 (1989).

[7] Labell v. Chicago, May 24, 2018 Opinion and Order at 6.

[8] Id. at 4.

[9] Labell v. Chicago, No. 1-18-1379, 2019 WL 6258401, at *4 (Ill. App. Ct. 4th Dist. Sept. 30, 2019).

[10] Labell v. Chicago, No. 125581, 2020 WL 1488318 (Mar. 25, 2020).
