



**Testimony to the
House Ways and Means Committee
of the Texas Legislature
Submitted on Behalf of the
Institute for Policy Innovation (IPI)**

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My name is Tom Giovanetti, and I'm the President of the Institute for Policy Innovation (IPI). IPI is a non-profit public policy think tank. We do not have clients, we do not lobby, and we do not endorse or oppose specific legislation.

We are therefore testifying today for informational and background purposes on this issue of competitive disparities caused by state tax policy.

I'd like to make several points in the brief time I have available this morning, and I'm happy to take any questions or engage in discussion afterward at the Committee's direction.

1. There is a currently in Texas a competitive disparity caused by state tax policy

You're probably all aware of the issue that terrestrial video providers such as cable and IPTV providers find themselves at a competitive disparity because they are subject to both up to a 2% local sales tax, and up to a 5% state or local franchise fee. This means that a 7% additional tax is added to the bills of their customers, and this tax is NOT added to the bills of satellite or DBS customers.

Now, obviously there's the issue of fairness here, since cable, satellite DBS and IPTV companies sell virtually identical commodities, and also the problem this causes the providers when they advertise their bundles at a certain price, but the final price to the

customer ends up being much higher because of all the taxes and fees that federal, state and local government have added on.

2. There are important policy reasons why state tax policy should not create competitive disparities

But there's not only the obvious issue of fairness here, but there's also an important policy reason why this should be addressed.

It's an important policy principle that *like products and services should be taxed and regulated alike*. If one thing can be substituted for another, they should both be taxed and regulated similarly. Government policy should be neutral among competitors, allowing them to compete on a level playing field. We want winners and losers determined in the marketplace, determined by who best delivers value and service to consumers. We don't want winners and losers determined by disparities in tax policy.

Think of a market economy like a computer simulation. In a market economy, we're constantly posing questions to the market, and getting answers in return. A few years ago the market was asked the question "Will consumers use the Internet to make airline and hotel reservations directly without going through travel agents?" Well, we all know how that worked out. Today almost everyone uses services like Orbitz or Travelocity or Kayak or Hotels.com to make their travel reservations.

But what if Texas had slapped a \$50 tax on Internet travel transactions? Do you think that would have biased the outcome? Consumers would have continued to use travel agents and would not have made the move to Internet travel sites, because of the disparity caused by the unfair tax. But the important point is that bad government policy would have caused the market to deliver a distorted result. We would have gotten the wrong answer from the market because of a distortion caused by government policy. And that's not good. We want accurate answers and accurate results from the market, unbiased by government distortions.

For Texas to cause or to allow a similar distortion by saddling some video technologies with a 7% tax burden that other video technologies don't have to bear also distorts the results from the marketplace. It's a way of government influencing who wins and who loses the competition in the marketplace.

3. There are ways to address this disparity other than simply new or higher taxes

Some parties would propose that you address this disparity by slapping a new, additional tax on the satellite providers. That's one way to do it, and it's the most obvious way to do it, and it's a justifiable way to do it, but that's not what I'm advocating today.

As an organization that champions low taxes, we're not completely comfortable advocating new or higher taxes. My point today is that the disparity should be addressed. Our preferred way to do so, which will cause many in this room great consternation, would be to lower the state-mandated franchise fee. These fees, which are supposedly justified as compensation for disruptions in right-of-way and infrastructure, have instead simply become revenue sources for local governments. It is primarily these higher-than-necessary franchise fees that cause the disparity we're talking about, and to reduce these franchise fees would be a tax cut to Texas consumers, since these fees are simply passed-thru to them on their bills. Reducing these franchise fees would help eliminate the disparity and cut taxes for Texas consumers without reducing Texas state revenue. It would indeed have revenue implications for local governments, which I understand have a strong lobby here in Austin.

On the other hand, EVERY tax cut benefits Texas consumers at the expense of government revenue. If we're going to put Texas taxpayers first, we shouldn't let the local government thirst for tax revenues trump our attempts to have fair and reasonable tax policy.

The franchise fee was raised to 5% in the course of implementing the statewide video franchise legislation. I testified in favor of that legislation, but at the same time I noted that raising the franchise fee to 5% was unjustified, and was only being raised to 5% in order to obtain the support of local governments for the legislation. There was (and is) no real justification for a 5% franchise fee; it was just a deal. The right thing to do now is to lower it to about 2%.

The answer to every problem in Texas shouldn't be higher taxes. Sometimes it should be lower taxes. Thus far Texas policymakers have seen the wisdom in keeping Texas taxes low, and that's part of the reason why the Texas economy has outperformed almost every other state in the last few years.

[By the way, this issue of communications taxes is a significant problem in Texas. Do you know that Texas taxes communications at levels as high as "sin" taxes such as alcohol and cigarettes? By what rationale have we chosen to tax an important technology industry at punitive, "sin tax" levels? Can you imagine putting sin taxes

on nanotechnology, or on green technology? People would recognize that as foolish, but we do it in communications. A long-term policy goal in Texas should be to lower taxes on communications, rather than to see Texas video and phone customers as an easy source for tax revenue. Remember, it's Texas taxpayers who pay all taxes.]

4. Texas has the right to address this disparity

The satellite DBS industry will argue that state attempts to address this disparity violate the Constitution, specifically the Commerce Clause. They're staking their case on the idea that anything their industry does is interstate commerce, and thus states have no right to tax or regulate it.

While it is true that both DBS and cable/IPTV providers are primarily engaged in interstate commerce, both competitors also have substantial in-state activities that make them subject to state regulation and tax. DBS companies, like cable companies, maintain local receiving equipment, lease capacity on local fiber lines, employ thousands of employees in the state using branded trucks and equipment, use local streets and alleyways for installations, repairs, and partner with local in-state retailers. DBS, like cable and IPTV, have substantial in-state activities.

IPI has argued in other places that this is not the case. Specifically, we filed a brief in Ohio, a copy of which is included as part of my written testimony. The Ohio Court of Appeals agreed with those arguments.

The U.S. Supreme Court has also repeatedly rejected Commerce Clause challenges based on situations where competing interstate businesses are nonetheless engaged in substantial in-state activities.

DBS providers will also argue that attempts to address the disparity are discriminatory. But this argument should not hold so long as any policy changes are proportional and designed simply to address a disparity caused by other government policies.

Conclusion

Today, among all the states, Texas has one of the very best economies in the country, and a major reason is our overall low and generally sensible tax policy. When considering changes to Texas' tax policy, we should resist the temptation to think that

every change should result in more revenue from someone, because that's less money in the hands of Texas taxpayers.

Clearly, some effort to eliminate the tax disparity between satellite DBS and other video providers is warranted, and IPI will be happy to work with all interested parties to find the best way to remedy this problem. But we would urge against an assumption that the right way to solve the problem is of necessity a new or higher tax on Texas consumers.