The Tennessee Advisory Commission on Intergovernmental Relations

226 Anne Dallas Dudley Blvd., Suite 508
Nashville, Tennessee 37243-0760
Phone: (615) 741-3012
Fax: (615) 532-2443
www.tn.gov/tacir

MEMORANDUM

TO: Commission Members

FROM: Cliff Lippard
Executive Director

DATE: 6 September 2019

SUBJECT: Cord Cutting and Local Revenue—Final Report for Approval

The attached Commission report is submitted for your approval. It was prepared in response to a request at the January 26, 2018, commission meeting from then-Chairman Mark Norris, who asked the Commission to study the effects of cord cutting on cable television, satellite television, streaming video services, and local government revenue in Tennessee. The report examines factors affecting the market for video services, whether changes in this market are affecting local government revenues, and whether changes to the state's tax and fee structure and its cable television franchising laws are warranted. Since the draft report was presented at the last meeting, two maps have been added showing which states apply sales tax to these services and which states authorize cable franchise fees to be collected.

The trend toward cord cutting will likely continue. But predictions of cable and satellite's imminent demise may be premature, and industry analysts expect that the shift away from these services will be gradual.

Although cable, satellite, and streaming each offer video entertainment for personal consumption, there are several variations in the taxes and fees that apply to them in Tennessee. Tennessee is one of 17 states that apply sales tax to all three of these video services. Although cable and satellite receive partial sales tax exemptions, both are subject to higher state sales tax rates than streaming for at least a portion of each customer's monthly bill, which partially offsets the effect of these exemptions.

Providers of cable service—but not satellite or streaming—are also required to obtain cable franchise agreements for the areas in which they provide service, under federal and state law. These agreements grant cable providers the privilege to offer cable service in designated franchise areas and, crucially, the authority to build and maintain communications networks needed to provide that service in public rights-of-way.

Local governments commonly receive compensation from cable providers through their franchise agreements. This compensation includes franchise fees, which are capped at 5% of gross revenue from cable service. Other compensation may include support for public, educational, and governmental (PEG) programming or in-kind contributions such as providing fiber capacity or free service to government buildings.

Franchise fees in particular will be affected by changes in the market for cable services because they are based on a percentage of providers' gross revenue. Although they have continued to increase on a statewide basis, the rate of increase appears to be slowing in recent years. Most local governments allocate these fees to their general funds; however, several appear to be using them to fund services, including education, that have maintenance of effort requirements.

A review of other states' laws identified several alternatives to Tennessee's current tax and franchise fee framework. Because each of these alternatives would either impose costs on the state or its local governments or increase taxes on cable's competitors that don't deploy infrastructure in public rights-of-way, because franchise fees originated as a means to compensate local governments for cable providers' use of public rights-of-way, because the Federal Communications Commission's recent rule changes could reduce compensation some local governments receive from cable franchise agreements, and because the effective combined state and local sales and use tax rates that currently apply to cable, satellite, and streaming in Tennessee are already similar to each other, **the report doesn't recommend any immediate changes to Tennessee's cable franchising laws or its tax and fee structure.** However, because it is likely that revenue from cable franchise fees will decrease if industry trends continue, **the report instead recommends that local governments should consider no longer using this revenue to fund government services that have maintenance of effort requirements.**

Numerous concerns raised by commission members, providers, local officials, and others interviewed warrant further study, in part because no state appears to have a comprehensive, ready-made solution to them. Each of the issues identified are described in the report, which proposes that the Commission evaluate these issues in the update to its 2017 broadband report required by the Tennessee Broadband Accessibility Act, which is due in January 2021.