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**DAN GLICKMAN
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Monday, June 23, 2008

The Honorable Linda T. Sanchez, Chairman
The Honorable Chris Cannon, Ranking Member
Subcommittee on Commercial and Administrative Law
House Judiciary Committee
United States House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

Re: Hearing on H.R. 5267, the Business Activity Tax Simplification Act of 2008

Dear Chairman Sanchez and Ranking Member Cannon:

On behalf of the Motion Picture Association of America (“MPAA”)¹, I thank you for the opportunity to submit this statement for the record for the June 24, 2008 hearing on H.R. 5267, the “Business Activity Tax Simplification Act of 2008.”

I. Introduction

The MPAA strongly supports H.R. 5267 and respectfully urges your approval of this legislation for consideration by the full Congress. The MPAA believes that a bright-line physical presence standard is the appropriate jurisdictional standard for state business activity tax purposes. In recent years, an increasing number of states have asserted that a business’s mere economic presence in a state is sufficient to subject that out-of-state business to the state’s direct business tax. Due to the lack of clear judicial guidance on this issue, states have started taking varying, inconsistent and often aggressive positions with respect to the particular activities that may cause an out-of-state business to become subject to tax. This has created an environment of uncertainty and unpredictability for multistate businesses, especially businesses in the film and media-related industries when such businesses have no physical presence in the state.

This issue is of particular concern to the MPAA because of the aggressive actions taken by states in recent years against film companies, and related entities, such as broadcasters. For

¹ MPAA members companies include Paramount Pictures; Sony Pictures Entertainment Inc.; The Twentieth Century Fox Film Corporation; Universal City Studios LLLP; Walt Disney Studios Motion Pictures; Warner Bros. Entertainment Inc.; and associate member CBS Corporation.

example, states have asserted business activity taxes against film and broadcasting companies claiming “economic nexus” on the following:

- Asserting that an out-of-state broadcaster should be subject to business activity tax in a state solely because the company’s broadcast signals are viewed by residents in the state;
- Asserting that the digital transmission of movies to in-state customers creates nexus for an out-of-state film company for business activity tax purposes; and
- Asserting that an out-of-state film company should be subject to business activity tax if the company licenses brands, names, characters or other trademarks to unrelated third parties, who subsequently manufacture and sell merchandise bearing the licensed trademark into the state.

These examples are illustrative and only represent a few of the many state tax jurisdictional issues currently faced by the film and broadcast industry due to inappropriate state actions.

II. H.R. 5267 Provides the Appropriate Solution

Detailed below are some of the more aggressive positions taken by states that are aimed at taxing out-of-state film companies and broadcasters and the arguments advanced by states to support these positions. The MPAA believes that a physical presence nexus standard is the more appropriate jurisdictional standard for state business activity tax purposes. The provisions to modernize Public Law 86-272 contained in H.R. 5267, including the physical presence nexus standard provisions, are both fair and necessary because they are consistent with notions of where income is earned, ensure that businesses are only paying tax to those states that have provided the businesses with meaningful benefits, and represent the application of existing federal law to modern day business transactions.

Broadcast Programming. Some states have asserted that out-of-state broadcasters should be subject to business activity taxes solely because these companies’ broadcast signals are received by in-state viewers or listeners. States have tried to justify the taxation of these out-of-state broadcasters on the basis that the out-of-state broadcasters are exploiting the in-state market because the programming is seen and/or heard by individuals in the state. However, this rationale fails to recognize the basic business model employed by most broadcasters. Specifically, broadcasters do not generate revenue from viewers or listeners. Rather, broadcasters receive revenue from advertisers that purchase air time and, in the case of cable programmers, from cable operators that carry the programming. The advertisers and cable operators are essentially the “customers” of the out-of-state broadcaster, not the in-state viewers or listeners who are the customers or potential customers of the advertisers and the cable operators. Thus, broadcasters are not “exploiting” the local market when programming is aired for individual viewers or listeners in a state. Further, broadcasters should only pay tax where

they earn income, and, as discussed in more detail below, income is only earned where a business is physically located.

Remarkably, the states' position is inconsistent with the U.S. federal income tax treatment of foreign broadcasters. In fact, the issue of whether the United States may impose federal income tax on a foreign broadcaster that has no physical presence in this country has been litigated, and federal courts have held that the United States cannot impose such a tax.² This holding is reinforced by the "permanent establishment" standard that the United States, along with most other countries, has adopted in its bilateral tax treaties. The permanent establishment standard requires taxpayers to have a fixed place of business (i.e., a physical presence) through which the business of the enterprise is wholly or partly carried on in order for a foreign country to impose an income tax on the business's profits. If states continue to assert positions that contradict these well-established longstanding federal tax principles, it could be potentially disastrous for America's interstate and international economy. On the other hand, the physical presence standard in H.R. 5267 is consistent with the standard used for the U.S. federal income tax treatment of foreign broadcasters, and would only tax out-of-state broadcasters that have a physical presence in the state.

Use of Trademarks in State by Unrelated Third Parties. Several states have attempted to assert taxing jurisdiction over out-of-state film companies that license brands, names, characters or other trademarks to unrelated third parties who then manufacture and sell merchandise bearing the licensed trademarks, for instance, within the state. A recent survey of state tax departments revealed that more than 30 states take the position that the licensing of trademarks to either an affiliated or unrelated entities with a location in the state would create nexus for corporation income tax purposes.³ These states are overreaching and attempting to tax income that is earned outside of the states' borders.

Film companies do not earn their income in the states where merchandise bearing their trademarks is sold by third parties, rather they earn their income where they actually engage in business activities (i.e., where they have property and employees). The physical presence nexus standard contained in H.R. 5267 would ensure that income is only taxed in those states where the income is earned.

Digital Transmission of Movies. Some states have asserted that out-of-state film companies should be subject to business activity tax if the out-of-state company sells digital films to in-state customers who download the films over the Internet. States assert that they are entitled to tax these out-of-state sellers because the state has provided an in-state market for the digital product. However, state governments maintain a "viable marketplace" for the benefit of their constituents, the in-state customers, and not for the benefit of out-of-state sellers. Further, the imposition of a business activity tax on an out-of-state seller simply cannot be justified on the basis that the government has provided some nebulous and incidental benefit. Rather, the benefits and protections provided by a taxing jurisdiction must be meaningful to warrant the

² See *Commissioner of Internal Revenue v. Piedras Negras B. Co.*, 127 F. 2d 260 (5th Cir. 1942).

³ *Special Report: 2008 Survey of State Tax Departments*, 15 Multistate Tax Rep't 4 at S-28 (April 25, 2008).

imposition of a business activity tax. Businesses only receive these meaningful benefits and protections (e.g., education, roads, police and fire protection, water and sewers) in the jurisdictions where they are actually located due to the presence of a labor force or property. Further, as previously discussed, businesses should also only pay tax to those states where income is earned, and income is simply not earned where a business's customers are located. Thus, businesses should only pay tax to those jurisdictions where they are physically present. H.R. 5267 would promote fairness by ensuring that businesses are only taxed by those jurisdictions that have provided meaningful benefits and protections, and in those jurisdictions where income was earned.

In the context of digital downloads, we should also point out some of the peculiar results that can arise if Public Law 86-272 is not modernized for today's economy and modern technologies. For example, if an out-of-state film company conducts in-state solicitation activities aimed to promote the sale of DVDs (i.e., tangible personal property), the orders for which are accepted and shipped or delivered from outside the state, this in-state solicitation would be protected under current law by Public Law 86-272. On the other hand, if an out-of-state film company were to conduct the same in-state solicitation activities to promote digital downloads (i.e., intangible property) for the very same film, these solicitation activities would not be protected by Public Law 86-272. This example clearly demonstrates why the provisions of Public Law 86-272 must be modernized, as provided in H.R. 5267, to protect the solicitation of orders for services and intangible property. Figures released by the Motion Picture Association in May indicate that more than 2.5 billion movie files were downloaded worldwide during 2007. As our economy continues to shift towards intangibles and services, it is important that these sectors of the economy be afforded the important protections of Public Law 86-272.

III. Conclusion

The MPAA believes that it is necessary for Congress to provide clear guidance to the states in the area of state tax jurisdiction and put a stop to the aggressive actions being taken by the states. In the absence of Congressional action, these state actions will likely have a chilling effect on interstate commerce. H.R. 5267 would provide a much needed bright-line physical presence standard that is both fair and reasonable, and would modernize Public Law 86-272 to account for the current state of our economy. As states continue to attempt to maximize revenues, they will likely become even more aggressive in their attempts to tax out-of-state businesses making the need for Congressional action all the more urgent. Therefore, the MPAA strongly urges your approval of H.R. 5267 for consideration by the full Congress.

Sincerely,



Dan Glickman
Chairman and Chief Executive Officer
Motion Picture Association of America