COMMONWEALTH OF KENTUCKY
BOARD OF TAX APPEALS
FILE NOS. K13-R-31, K13-R-32

NETFLIX, INC. **APPELLANT**

V. **ORDER NO. K-24900**

FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE **APPELLEE**

An evidentiary hearing in this consolidated appeal was held before this Board on October 21, 2014. The parties filed post-hearing briefs. The Board requested the parties to file supplemental briefs on an additional issue, and a supplemental hearing was held on July 29, 2015. Upon its review of the record, the briefs, and the controlling statutory provisions, this Board enters the following findings of fact and conclusions of law.

BACKGROUND

At issue in this case are the Gross Revenues Tax (KRS 136.616); the Excise Tax (KRS 136.604); and, the Utility Gross Receipts License Tax for Schools (160.614(6)). The Department of Revenue has imposed each of these taxes upon Netflix's "streaming services," i.e., "a subscription based service that streams digital movie or television content over the public internet for viewing on either a television or an electronic device." (Joint Stipulation of Facts No. 10) The question presented is whether these streaming services are taxable under these provisions. The Gross Revenues Tax, KRS 136.616 (2), provides that a tax is imposed on the provider's gross revenues, "received for the provision of multichannel video programming

services…" The Excise Tax, KRS 136.604(1), provides that it is imposed on the "retail purchase of multichannel video programming service provided…" Finally, the Utility Gross Receipts license tax, KRS 160.614(6), provides that it "shall include the gross receipts derived from the furnishing of multichannel video programming service…" The definition of the term "multichannel video programming services," is set forth in KRS 136.602(8) as follows:

> "Multichannel video programming service" means programming provided by or generally considered comparable to programming provided by a television broadcast station and shall include but not be limited to:
>
> a) Cable service:
>
> b) satellite broadcast and wireless cable services: and
>
> c) internet protocol television provided through wireline facilities without regard to delivery technology.

A preamble to that statute also appears in KRS 136.600, which provides in pertinent part as follows:

> The General Assembly hereby finds that the enactment of the tax and distribution system created by KRS 132.825, 136.600 to KRS 136.660… [p]rovides enough flexibility to address future changes brought about by industry deregulation, convergences of service offerings, and continued technological advances in communications… .

The Department argues that the streaming services are "generally considered comparable to programming provided by a television broadcast station." The Department further cites to the preamble and argues that it shows the legislature's intent to include such services as streaming services. Netflix argues that streaming services are not comparable, because such service is not comparable to the linear type scheduled programming provided by a television broadcast station/cable TV or the live programming provided (news, award shows, sports). Netflix also argues that the term "multichannel video programming" is a specific term of art used in FCC

statutes and neither the federal government nor any other state that also uses that term, considers such streaming services to be included as "multichannel video programming."

For the period June 2012 through August 2012, Netflix reported, paid and seeks a refund of $259,610.57 for the Gross Revenues Tax and Excise Tax and further seeks a refund of $110,007.89 for the Utility Tax.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The task before this Board is to determine, by the plain meaning of Kentucky's statute, whether the legislature manifested an intention to include streaming services in the excise taxation scheme. During the hearing and in the briefs, the parties have focused on the same statutory language within the definition of "multichannel video programming service" — "programming generally considered comparable to programming provided by a television broadcast station," Netflix first argues that "multichannel video programming" has a special meaning under federal law and that it is not considered to be such a provider under federal law and thus, should not be considered to be such a provider under state law. Netflix presented a witness, Professor Lichtman of the U.C.L.A. School of Law, who spent a significant amount of time testifying as to what the term means at the federal level to the FCC in the federal statutes and regulations. (TR 11:09-11:32) He testified that the federal government does not regulate Netflix as a "multi-programming video distributor" under the federal statutes and regulations.

This Board, however, is bound by the words used by the Kentucky legislature. If the legislature had intended to utilize the federal meaning of the terms, and restrict its definition of "multichannel video programming service," to apply only to those considered to be multichannel service distributors under federal law, it would have so specified within the statute, as it has done

in other parts of the same statute. See e.g., KRS 136.602 (2)(a)(8) ("Mobile telecommunications service as defined in 4 U.S.C. sec. 124(7)"), and 136.602(6)(a) ("Charges for Internet access as defined in 47 U.S.C sec. 151"). When a Kentucky statute is modeled after a federal counterpart statute, the Kentucky courts state that they "must consider the way the federal act has been interpreted." See e.g., Harker v. Federal Land Bank of Louisville, 679 S.W.2d 226, 229 (Ky. 1984)("The Kentucky age discrimination statute is specially modeled after the Federal law.") This is not the case here. While certain wording has been borrowed from a federal regulatory statute, the purposes of the statutes differ completely, and they are not federal and state counterparts.

This Board cannot add the words of federal definitional limitation to this portion of the statute, nor does it find any of the information presented concerning the federal position to be persuasive in ascertaining the meaning of the words used by the Kentucky legislature in its taxation statute, when the legislature did not expressly incorporate the federal definition into the statute. As the Kentucky Supreme Court stated in Virgin Mobile v. Commonwealth of Kentucky, 448 S.W.3d 241 (Ky. 2014),

> When we must review a statute to determine the General Assembly's intent, the primary rule is to ascertain the intention from the words employed in enacting the statute, rather than surmising what may have been intended but was not expressed. It is neither the duty nor the prerogative of the judiciary to breathe into the statute that which the Legislature has not put there. (internal citations omitted) Id. at 249.

The Board concludes that if streaming services fit within the Kentucky statute's definition for "multichannel video programming," then Netflix would be a provider of "multichannel video programming services" for purposes of Kentucky tax law, regardless of its status under federal law for regulatory purposes. Neither party argued that the statutes in question were ambiguous, and this Board agrees that the plain meaning of the words used is

controlling in this case. In each instance, the tax in question is on receipts or revenues from "multichannel video programming services." "Multichannel video programming service" is defined in KRS 136.602(8) as follows, in pertinent part:

"Multichannel video programming service" means programming provided by or generally considered comparable to programming provided by a television broadcast station…

This Board finds that the Netflix streaming video service offers movie and television program content that the consumer can watch and that a television broadcast station/cable company also provides such content. The statutory question, however, is whether the Netflix "programming," is "generally considered comparable to programming" provided by a television broadcast station." The word "programming" is not defined in the statute. According to the dictionary, the term "programming" is defined as "the designing, scheduling or planning of a program." This Board concludes that the term "programming" is broader than, and encompasses the word "content." The Board further concludes that the term "programming" also includes or encompasses the manner in which the content is provided. Finally, the words "comparable to" mean generally considered "similar to or equivalent." The definition of "comparable" does not mean that the two items being compared have to be identical, but that the two items have similar features in common. (See The American Heritage Dictionary, Second College Edition for all definitions).

Netflix acknowledged that its programming is somewhat duplicated by cable companies when they offer their "on demand TV service," which is also a form of video service that a consumer can access in order to watch TV shows and movies at any time. The Netflix witness testified that this on demand video service, however, is only a small portion of what

broadcast TV stations and cable companies provide to consumers. (TR 11:26-11:29) This Board finds that this is where the similarity between streaming services programming and broadcast station/cable programming ends. The undisputed testimony presented was that Netflix does not provide any live programming, such as sports, news, and award shows, nor does it provide any linear programming, which means there is a set time schedule for the programming. (TR 10:36) While streaming services and the on demand TV services provided by a broadcast station/cable company may be somewhat similar, the Board finds that the on demand TV feature is only an incidental part of the broadcast and cable TV services programming, and is not enough to make streaming services "generally considered to be comparable" to the programming of broadcast/ cable TV within the meaning of the first portion of the statute.

In addition, the Board finds that the presentation of streaming video programming to the consumer differs from the presentation of broadcast TV/cable programming to the consumer. Netflix is only available over the internet in all instances. (TR 10:25) Netflix can be transmitted via the internet to stand alone devices such as tablets and computers and phones and no TV has to even be involved. Programming from a broadcast/cable TV station involves the use of a TV and the programming is immediately available when the consumer turns it on and selects a channel.

Even when Netflix has an agreement with a cable company or a TV manufacturer to provide access to Netflix on the TV, this access is via an application ("app") on the cable box or on the Smart TV. This app only allows the consumer to click on it and it will only take the consumer to Netflix streaming services, if the consumer has a separate subscriber relationship with Netflix and separate access to the internet. (TR July 29, 2015 at 9:35) In addition, when Netflix has a licensing agreement with a cable company for use of its app on the cable box, the

Netflix service does not become a part of the cable package or bundle for sale to the end consumer. The consumer pays Netflix directly for the service. (TR July 29, 2015 11:20)

Even though the Board finds that the Netflix programming is not "generally considered to be comparable" under the first portion of the statute, if the streaming services would fall within the specific statutory definition of "cable services," the streaming services would nevertheless be taxable. The statute further provides that "programming provided by or generally considered comparable to… shall include, but not be limited to cable services." Cable service is specifically defined to mean, "the provision of video, audio, or other programming service to purchasers, and the purchaser interaction, if any, required for the selection or use of the video or other programming service, regardless of whether the programming is transmitted over facilities owned or operated by the provider or by one (1) or more other communications service providers." KRS 136.602(1)

While both parties originally stipulated that streaming services are not cable services in the traditional sense of the word, if the legislature has defined the term "cable services" broadly enough, so as to include streaming services, then streaming services will be taxable as "cable services." See, e.g., Commonwealth of Kentucky v. Plowman, 86 S.W.3d 47 (Ky. 2002)("Building, in addition to its ordinary meaning, specifically includes…vehicle. As a matter of law, we hold that a bulldozer is a "vehicle" within the definition of a "building" under KRS 513.010 for purposes of the arson statute.") This Board determined after reviewing all of the statutory language in KRS 136.602, that the definition of "cable services" had to be reviewed as well in this case, in order for the Board's statutory analysis and the record to be complete. This Board directed the parties to file supplemental briefs and to attend a supplemental hearing in order to address the actual statutory definition of "cable services," which neither party had

previously analyzed.

At the supplemental hearing, Netflix argued that its services did not fall under the definitional "cable services" statute. The Department of Revenue, which had previously stipulated that streaming services were not cable services, would not expressly take the position that the services qualified as cable services within the statutory definition, but it also would not concede that Netflix was correct either. (TR July 29, 2015 10:54; 11:03; 11:08) At the hearing, the Department argued that this Board did not have to reach the question of whether the services fell within the statutory definition of cable services, but that it would defer to this Board, on such a ruling, and that such a ruling might be "plausible" or possible." This Board, which had determined that the "cable services" definitional statute had to be addressed, directed each side to analyze the statute. It would have been preferable for the Department of Revenue to have withdrawn its stipulation as to cable services, and to provide the Board with a complete written legal analysis of the statute, as it had been directed to do.

The Kentucky legislature's definition for "cable services," appears to track at least some of the language used in the Florida communications tax statute. Netflix acknowledged at the second hearing, that it does pay the communications tax on its streaming video services in Florida. (TR July 29, 2015 at 9:25) The Florida statute taxes "communications services," which are defined to include "video services." "Video services" are then defined in Florida as follows:

"Video service" means the transmission of video, audio or other programming service to a purchaser, and the purchaser interaction, if any, required for the selection or use of a programming service, regardless of whether the programming is transmitted over facilities owned or operated by the video service provider or over facilities owned or operated by another dealer of communications services… The term includes basic, extended, premium, pay-per-view, digital video, two-way cable and music services." Fla.Title XIV Chapter 202.11 (1) and (24)

Similarly, the Kentucky "cable services" definition provides as follows:

"Cable service" means the provision of video, audio, or other programming service to purchasers, and the purchaser interaction, if any, required for the selection or use of the video or other programming service, regardless of whether the programming is transmitted over facilities owned or operated by the provider or by one (1) or more other communications service providers. Included in this definition are basic, extended, and premium service, pay-per-view service, digital or other music services, and other similar services."

(emphasis added to show differences between Florida and Kentucky statutes)

While the Florida provision and the Kentucky provision appear to be quite similar, the provisions differ in two significant ways. First, the Kentucky legislature inserted the words "communications service providers," into the definition. Under the "cable services" definition, the transmission must be over facilities owned or operated by the provider of the video service or by one or more other "communications service providers." Netflix does not own facilities for transmission, so under the statute, the transmission would have to be over facilities owned by a "communications service provider." The term "communications services" is also a defined term within the statute. KRS 136.602 (2)(b) provides that "communications services does not include information services." In other words, the internet service provider, upon which Netflix relies for all of its transmission, is not a "communications service provider" within the meaning of the statute. This Board concludes that the insertion of this language removes streaming services from the definition of "cable services" in Kentucky. Second, the Florida statute specifically taxes "video services," and within the definition of "video services," it specifically includes "digital video." The Kentucky statute does not specifically tax "video services," nor does it include "digital video" in the definition of cable services.

While the legislature in Kentucky did set forth a preamble in which it noted the intent to

"provide enough flexibility to address future changes brought about by industry deregulation, convergences of service offerings, and continued technological advances in communications," it is the specific language used in the enacted tax provisions which must control the imposition of the tax. As the Court noted further in the Virgin Mobile U.S.A case:

> The legislature could have spoken with regard to the collection of CMRS service charges in general terms broad enough to have enacted a statute flexible enough to accommodate even unforeseen technological or commercial developments… We cannot ignore or wish away the presence of the specific words that the legislature did use. Id.

The final rulings of the Department of Revenue, Nos. 2013-55 and 2013-56, are hereby reversed and the Appellant's claims for refund are granted.

FINAL ORDER

This is a final and appealable order. All final orders of this agency shall be subject to judicial review in accordance with the provisions of KRS Chapter 13B. A party shall institute an appeal by filing a petition in the Circuit Court of venue, as provided in the agency's enabling statutes, within thirty (30) days after the final order of the agency is mailed or delivered by personal service. The Board's statute, KRS 131.370(1), provides that the Circuit Court of venue for any party aggrieved by any final order of the Kentucky Board of Tax Appeals, except on appeals from a county board of assessment appeals, is the Franklin Circuit Court or the Circuit Court of the county in which the party aggrieved resides or conducts his place of business. Copies of the petition shall be served by the petitioner upon the agency and all parties of record. The petition shall include the names and addresses of all parties to the proceeding and the agency involved, and a statement of the grounds on which the review is requested. The petition shall be accompanied by a copy of the final order.

A party may file a petition for judicial review only after the party has exhausted all

administrative remedies available within the agency whose action is being challenged, and within any other agency authorized to exercise administrative review.

A petition for judicial review shall not automatically stay a final order pending the outcome of the review, unless:

(a) An automatic stay is provided by statute upon appeal or at any point in the administrative proceedings;

(b) A stay is permitted by the agency and granted upon request; or

(c) A stay is ordered by the Circuit Court of jurisdiction upon petition.

Within twenty (20) days after service of the petition of appeal, or within further time allowed by the Circuit Court, the Kentucky Board of Tax Appeals shall transmit to the reviewing court the original or a certified copy of the official record of the proceeding under review in compliance with KRS 13B.140(3).

DATE OF ORDER
AND MAILING: September 23, 2015

KENTUCKY BOARD OF TAX APPEALS
FULL BOARD CONCURRING

Cecil Dunn
Chair