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Research Report

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Interstate Broadcasters and Tax Policy in Oregon

I. Introduction

This report reviews the taxation of interstate broadcasters in Oregon and presents future policy options for apportioning broadcaster income to the state. The report also satisfies the requirement of SB 193 from the 2019 session that the Legislative Revenue Officer, in coordination with the Department of Revenue, study the operation of the statutory provisions governing the apportionment of business income of broadcasters. Within the industry, content is produced and is later provided to end-users often via distribution companies, with viewers paying distributors for access to content. Given Oregon's broad definition of interstate broadcasting, both content producers and distributors are classified as interstate broadcasters by Oregon statute. Oregon policymakers have debated in recent years how to appropriately apportion federal income to state income for corporations classified as interstate broadcasters by Oregon statute. Since 2014, Oregon has adhered to the commercial domicile method of apportionment, which apportions income based on the location of the direct customer's domicile. This method of apportionment will sunset at the end of tax year 2019 in the absence of legislation. This report describes the relevant details on industry structure, Oregon rules and laws related to broadcasting, and apportionment methods often used for this industry.

The report is structured as follows: first, a brief summary of key findings is provided. The subsequent section contains a description of current legal disputes to provide context for the core policy debate. Next, we discuss the differences between the industry definition of broadcasters and Oregon's statutory definition. This difference is especially important for the policy discussion that follows. The following section describes the revenue sources for these companies. The discussion then turns to a description of apportionment methods related to the core policy debate regarding broadcasters over the last several years in Oregon. Next, background is provided on the topic of nexus. While not formally part of the policy debate, nexus has a direct bearing on the revenue impacts used to inform policy decisions made by the Legislature. The final two sections of the paper pertain to revenue impacts and policy options.

Before turning to the policy in question, it may be helpful to review some corporate tax terminology.¹ For those unfamiliar with corporate taxation, here are some key terms relevant to the analysis in this paper:

- Nexus: when a corporation has a business connection to a state and can be subject to the state's corporate income tax, regardless of whether the state has such a tax
- Federal taxable income: the amount of income subject to income tax within the U.S.
- State taxable income: the share of federal taxable income that the state taxes

¹ Oregon administers a corporate excise tax and a corporate income tax. Most companies pay the corporate excise tax and that tax is the focus of this analysis. For the sake of brevity, the corporate excise tax is referred to as the corporate income tax.

- Apportionment: the method used to calculate the share of federal income that the state can tax
- U.S. Sales: the amount of a corporation's business sales in the U.S.
- Oregon Sales: the amount of a corporation's business sales attributable to Oregon
- Single Sales Factor Calculation: apportionment for Oregon is currently Oregon sales divided by U.S. sales; this is referred to as a Single Sales Factor
 - $Federal\ Taxable\ Income \times \left(\frac{OR\ Sales}{U.S\ Sales}\right) = Oregon\ Taxable\ Income$

II. Key Findings

Background

The method of apportionment for this industry has been at the heart of a policy debate within Oregon since at least 2014. Between 1989 and 2013, the apportionment ratio for interstate broadcasters was calculated according to an audience method, specifically, the ratio of Oregon audience divided by U.S. audience. For tax years 2014 through 2019, taxpayers subject to broadcaster statutes apportioned income using the commercial domicile method, which is based on the commercial domicile of what the MPA refers to as their direct customer. Broadly speaking, they have three types of such customers: distributors, advertisers, and direct subscribers. Under the commercial domicile method, sales are sourced to Oregon for apportionment purposes if the customer is domiciled in Oregon. For businesses, the headquarters location determines the location of the commercial domicile. For individuals, the customer's billing address is the domicile. An active policy discussion exists regarding whether industry should be taxed based on their viewing audience in Oregon, even if that audience is not an immediate customer of a company engaged in broadcasting, or on their immediate customers. Below is a summary of our key findings.

- The current statutory definition of 'broadcasting' is very broad and could have future implications for taxpayers that are unlikely to consider themselves broadcasters.
- The industry, which is comprised of the production and distribution of audio and video content has undergone significant changes in recent years. This provides another example of how the internet continues to be a source of dramatic change.
- The revenue impact of a policy change in broadcaster apportionment depends on assumptions of other factors related to the tax calculation.
- Regardless of apportionment method chosen, stakeholders may benefit from greater statutory direction on the calculations.

III. Status and Description of Pending Legal Actions

In 2014, when the Legislature was originally faced with the policy decision of changing the apportionment method for these taxpayers, there were many questions regarding the potential impacts. Consequently, the apportionment policy change during the 2014 session was made temporary to allow for more complete analysis of the policy implications. At the time, a significant difference of opinion between certain taxpayers and the Department of Revenue (DOR) existed regarding the application of existing law. As such, several taxpayers were in ongoing litigation with the department. Interest in these pending court cases was deemed relevant to evaluating and establishing any future tax policy changes.

Typically, the audit appeals process begins in DOR before moving to the Judicial Branch with the Magistrate division of the tax court and then to the Regular Division, depending on the desire of a party to appeal a decision. If the Regular Division decision is appealed, then the case can move to the Oregon Supreme Court. Given this process, the number of pending cases, and the possibility that any decisions may be fact specific, waiting until the cases are decided does not seem to be the optimal path for making policy decisions. To date, the only pending legal action in Oregon related to this industry with any published decision is the *Comcast* case. Additionally, the Oregon Supreme Court only ruled on some of the issues within the *Comcast* case and remanded other issues back to lower courts. While *Comcast* was moving through the court system, other related cases were put on hold pending the *Comcast* decision.

Comcast argued that although they are an interstate broadcaster, not all the company's sales should be subject to Oregon's special apportionment method for broadcasters. Instead, they argued only receipts related to broadcasting should use that apportionment method and other sales should be subject to Oregon's normal corporate apportionment calculations. DOR argued that statute indicates the statutory definition of gross receipts from broadcasting only excludes some receipts from the apportionment factor and that the general definition was broad enough to include other business activities the company engaged in during the regular course of business. Receipts exempted in statute include receipts not related to the broadcaster's regular business activities, receipts from the sales of tangible personal property, and receipts from the sale of real property. The Oregon Supreme Court ruled in favor of DOR and said that the language in statute was broad enough for all receipts in the normal course of business, excluding tangible personal property and real property, to be included in tax calculations.²

The table below notes which court cases address the policy questions noted above.³ The desire in recent years has been to allow time for the Judicial Branch to provide its

² *Comcast Corporation v. Department of Revenue*, 363 Or. 537 (2018)

³ The table describes major issues within these cases that deal with the policy question of broadcaster apportionment. The cases also include other issues unrelated to Oregon broadcaster apportionment.

interpretation of existing law.⁴ The resulting clarity would likely provide sufficient context for evaluating the impacts of changing the law. Of the eight cases contained in the table, seven deal with the issue of what makes a company an interstate broadcaster; four address the issue of which revenue sources would be subject to the broadcaster apportionment method; five address some aspect of nexus, asking the court to decide if Oregon can even tax the relevant company; and three deal with how the audience factor is determined. The next few sections of the report provide additional detail for each of these topics.

Cases								
Issues	A&E	ABC	Comcast	Comcast	NBC	NBC	Starz	Viacom
Who is an IB?		X	X	X	X	X	X	X
Which receipts apportioned by IB statutes?			X		X	X		X
Nexus	X	X			X	X		X
Determination of audience factor		X		X				X
Division	Magistrate	Magistrate	Regular	Regular	Magistrate	Magistrate	Magistrate	Magistrate
Tax Years	2010-15	2009-12	2007-09	2010-12	2011-13	2006-10	2011-13	2008-11

IV. Interstate Broadcaster Definition

One major area of disagreement present in the lawsuits mentioned above is regarding which businesses are engaged in interstate broadcasting in Oregon. Industry plaintiffs argue they are not interstate broadcasters, are not engaged in interstate broadcasting within Oregon, and are thus not subject to Oregon’s special apportionment rules regarding broadcasters. DOR argues that Oregon’s definition of broadcasting includes these companies and the companies are subject to the special interstate broadcaster apportionment rules outlined in statute. At the heart of this disagreement is the difference in the traditional industry definition of broadcaster and Oregon’s statutory definition of broadcaster.

The industry term ‘broadcaster’ refers to national networks that were traditionally, and still are, available to customers via conventional methods. These networks include ABC, CBS, NBC, and FOX and are referred to as ‘national broadcast networks’ by industry. Oregon’s definition of interstate broadcaster differs from this industry definition and as such using the term ‘broadcaster’ in this policy discussion often adds confusion. Oregon statute defines broadcasting differently, specifically, in ORS 314.680 broadcasting is defined as, “the activity of transmitting any one-way electronic signal by...conduits of communication”. Oregon statute then defines an interstate broadcaster to be a “taxpayer that engages in the for-profit business of broadcasting to subscribers or to an audience located both within and without this state.”

⁴ Bold entries in the table indicate the concepts that were ruled on by the Oregon Supreme Court in *Comcast*.

Oregon's statutory definitions of broadcasting and interstate broadcasters were established in 1989 and indicate that any one-way signal transmitted into the state as part of for-profit business could be subject to the broadcaster apportionment statutes. At the time, the widespread use of computers and the internet did not exist as it does today. For example, in 1989 there were primarily only cable and national networks operating in the television market. In 1989 the technological landscape was clearly much different than it is today. This is another example of the extensive impacts the internet continues to have on this industry.

Given the technological changes that have occurred since 1989, today there are many industries in which one-way signals are being used within Oregon. In the video production market, today there are many direct-to-consumer options available. Some examples of the direct-to-consumer model include HBO Now and Disney Plus. These methods presumably use one-way signals to get content to end-users. One-way signals are also being widely used in sectors other than the television market. Streaming or accessing news, video games, e-books, apps, podcasts, etc., presumably all use one-way signals to provide content to users within Oregon. In its current form the statutory definition of 'broadcasting' is quite broad and could include many companies that likely do not view themselves as broadcasters. A relevant question for policymakers moving forward is whether the definition of broadcasting should be changed to reflect today's markets and industries.

V. Industry Structure and Revenue Sources

Given the structural changes that took place in this industry over the last thirty years, it is important to outline how industry operates today to examine appropriate taxation and related policy changes. Today companies producing television content receive revenue from three general sources including: (1) from licensing content to be distributed by cable, satellite, and/or telecom operators, (2) selling national advertising time, and/or (3) selling subscriptions held by direct subscribers. The figure below depicts a simplified view of the broadcasting industry. In the chart, there are three categories of production and consumption activities, with examples of each type listed below the heading. At the beginning of the production process, content is produced by three broad categories of organizations including (1) national networks, (2) cable networks, and (3) consumer direct companies. Next, the produced content is distributed for viewing via cable, satellite, telecom, and internet distribution channels.⁵ Viewers, the end-users of the content, view the programming content in exchange for a subscription fee.

⁵ National network programming is also available via digital antenna.

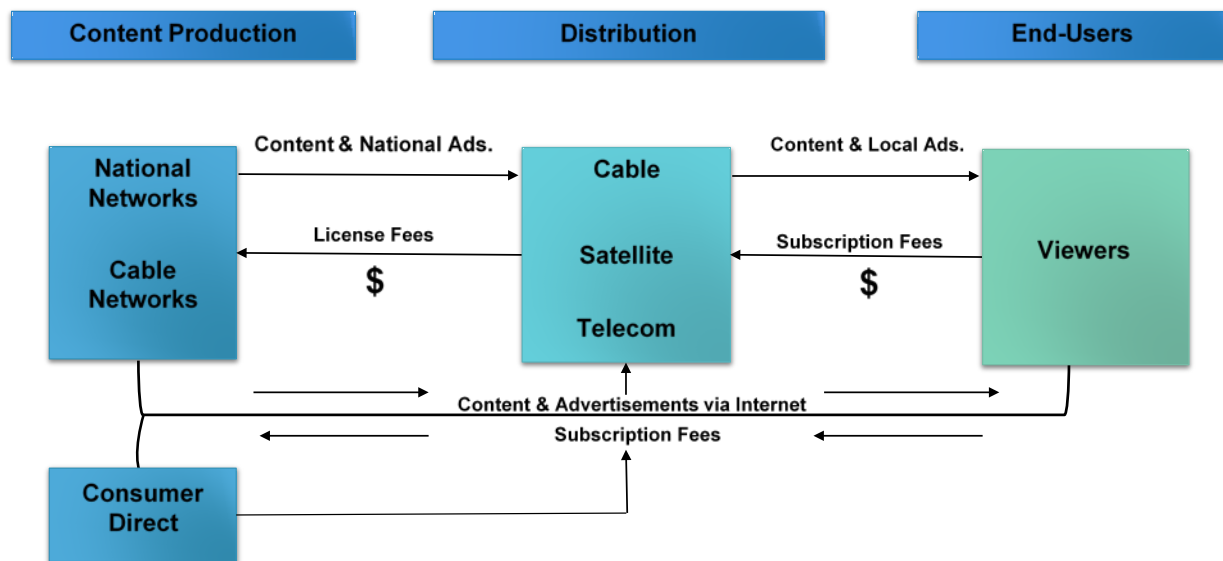


Figure 1: Flow of funds and content within the television industry.

For our discussion related to this topic, we avoid the word broadcaster where possible, given the different industry and statutory definitions. Instead, we refer to ABC, CBS, NBC, and FOX as ‘national networks’. Other television channels which are typically available via cable (or similar) subscription are referred to by industry as ‘national cable networks’. We refer to these networks as ‘cable networks’ throughout the report. Examples of such networks include Comedy Central, MTV, SyFy, A&E, ESPN, Freeform, etc.

National networks are typically referred to as ‘broadcasters’ within the industry, and include ABC, CBS, FOX, and NBC. These national networks often produce content within an in-house production arm of the company. However, in other cases the company may purchase content externally. Next, national networks license this content to distributors in exchange for a licensing fee. Some networks are also developing direct-to-consumer revenue streams, allowing viewers to subscribe directly to the national network for content. Content creators license content to distributors in exchange for licensing fees. They also sell national advertising time as part of this licensing agreement and receive additional revenue from those sales.

Cable networks follow a similar production process. Like the national networks, cable networks may produce content or purchase content for production. Cable networks typically include channels available *only* through a subscription, whereas national networks are typically available via antenna with no subscription. Cable networks license their content to distributors in exchange for a license fee. Then distributors provide licensed content to viewers in exchange for subscription fees. Cable networks also sell national advertising time on their channels as an additional source of revenue.

Distribution is used within the industry to transfer content to viewers in exchange for subscription fees. Distribution can be split into four broad categories: cable, satellite, telecom, and internet. Examples of cable distributors include Spectrum, Comcast, and Crestview Cable Communications. Satellite distribution is provided by Direct TV and Dish Network. Verizon and AT&T are both telecom operators within this national market. Internet distribution generally takes two main forms. Often networks and distributors provide access to their content via internet distribution in addition to their traditional methods of distribution. Additionally, internet distribution also occurs via 'traditional' internet distributors such as Amazon, Netflix, and Hulu.

With recent technological advances, consumer direct production and distribution is becoming increasingly popular. In this category of production, content is produced and provided to viewers in exchange for subscription fees. Several types of licensing agreements and business models are in place in this evolving section of the industry. This growing area is especially important for considering future policy options as many consumer direct models are expected to be released in upcoming years.

Netflix is a prominent example of this type of service. Netflix produces both original and licensed content. Netflix original productions would fall into the consumer direct production category. Netflix produces these shows in-house and provides them directly to viewers in exchange for a subscription fee. These shows and movies are often referred to as 'Netflix Originals' and are only available via Netflix.

Netflix also engages in internet distribution of externally produced and aired content. For example, the television show *Frasier* is currently available on Netflix but was originally produced by NBC. This type of example would fall into the top category of content producers shown in figure 1, since NBC produced the content and then licensed it to be distributed via Netflix, an internet distributor, to finally arrive for viewing by end-users. A national network produced the show and then allowed the content to be distributed via the internet by Netflix. Similar business models are currently available through Hulu and Amazon Video, in addition to original content creation in which both companies are also engaged.

VI. Oregon's Apportionment Methods

To understand policy options related to the taxation of this industry in Oregon, a brief background on apportionment in Oregon is presented. Over the past few decades, corporate apportionment has undergone several changes in Oregon, moving from an equal-weighted 3-factor formula based on payroll, property, and sales to apportionment that relies solely on sales. Broadly speaking corporate sales can be separated into two categories of sales: tangible property or services/intangibles. Since the creation of the corporate income tax in Oregon, tangible property has been apportioned by a method known as 'market-based sourcing'. Up until tax year 2018, the sale of intangible goods was apportioned by a method known as 'cost-of-performance', where sales were assigned to the state in which the plurality of production costs were incurred. Beginning

in 2018, Oregon adopted market-based sourcing for all corporate sales, both tangible and intangible.

To date, Oregon has used two methods of apportionment specifically for interstate broadcasters. Prior to 1989, the industry did not have specific apportionment rules in statute, so receipts were sourced using the cost-of-performance method in place at the time. Industry expressed concern that the cost-of-performance apportionment method was unfair, especially to television and radio stations located near state borders. For example, under that method a station located in Portland, and thus close to the Washington/Oregon state border, would be required to count *all* the sales of the station as attributable to the state where the *plurality* of production costs took place. This led to Portland stations being potentially taxed in Oregon on their sales to customers located in Washington. To address this issue, the 1989 Legislature adopted the audience method of apportionment, which was used until 2014.

During the 2014 session, MPA argued that the apportionment method for interstate broadcasters should be based on the location of their immediate customers and not necessarily the viewing audience in Oregon. Oregon had since moved away from the three-factor apportionment method described above, in favor of the single sales factor, which required corporations to apportion income to Oregon based on the portion of total sales that occurred within Oregon.⁶ In 2014, industry argued apportionment based on the location of distributors, advertisers, and direct subscribers was more consistent with Oregon's single sales factor apportionment method used for other industries.

In 2014, HB 4138 switched Oregon's method of apportionment for interstate broadcasters from the audience factor method of apportionment to the commercial domicile method of apportionment. This change was enacted on a temporary basis for tax years 2014 through 2016. The bill also required the Legislative Revenue Office to produce a report evaluating the impact of this change. Similar legislation was passed in 2018 with SB 1523 and in 2019 with SB 193, extending the temporary commercial domicile method of apportionment through tax year 2019.

Under the audience factor of apportionment, the sales factor for interstate broadcasters is, "determined by the ratio that the taxpayer's in-state viewing or listening audience bears to its total United States viewing or listening audience".⁷ DOR's rules regarding this factor indicate that the viewing audience should be determined by third-party rating services such as Arbitron, Nielsen, or other similar service. Often, companies operating in this industry pay for, or are provided per contract agreements, ratings data related to viewership or number of subscribers with access to the content. If a company does not provide ratings data to DOR or if the ratings data are unavailable or nonapplicable based on specific taxpayer circumstances, then DOR uses the ratio of, "the population

⁶ Although Oregon changed policy to a single sales factor apportionment percentage in 2005, interstate broadcasters are subject to special apportionment rules and were still using the audience method of apportionment as of 2013.

⁷ See OAR 150-314-0465. These rules are also available in the appendix of this report.

of the broadcast area located within this state bears to the population of the broadcast area in all states”.

Under the audience method of apportionment, the location of end-users viewing the content is relevant for the apportionment factor calculation. Industry maintains that difficulty exists when determining the location of end-users. For example, industry states that some licensing contracts provide networks with a flat fee in exchange for licensing content. Other arrangements may include variable fees based on viewing, but not include information about the location of end-users. In both cases, industry asserts depending on the licensing agreements with distributors they sometimes have little to no information on the location of viewers. Alternatively, some contracts may include information on viewers including frequency of viewing and location of viewer. Since these stipulations are contract-specific, industry argues they may have difficulty providing consistent data on end-user behavior.

However, DOR rules indicate that available ratings data are used to determine this factor and maintains that industry has access to this data. According to DOR, the audience factor is used unless no ratings data are provided by the taxpayer, in which case DOR defaults to the population ratio as stipulated by rule. The population ratio may also be used in cases where DOR determines that the ratings data provided by a company are inadequate or improperly represent the taxpayer’s viewing audience. For example, statute requires that a taxpayer provide either audience *or* subscriber information. If a taxpayer uses a mixture of audience and subscribers within its audience ratio, this may not accurately represent the taxpayer’s true audience and DOR may disallow the use of this for apportionment. DOR may also use population in cases where industry provides information on audience that cannot be substantiated by third-party sources.

Under the commercial domicile method of apportionment, the location of each customer is used for sourcing receipts in the apportionment formula. Broadly speaking, national and cable networks operating in this industry have three types of customers: (1) distributors, (2) advertisers, and (3) direct consumers. Distributors buy programming from some networks to show on television stations or air on radio stations. Advertisers purchase air-time from national and cable networks to advertise their products in hopes of increasing sales. Networks also sell content directly to viewers for personal viewing. MPA states that this type of customer is the fastest growing source of revenue for national and cable networks. As technology continues to improve, selling directly to customers will likely make up an increasingly large share of MPA’s customer base.

The apportionment formula under the commercial domicile method includes gross receipts from broadcasting in the numerator if, “the commercial domicile of the customer is in this state or, in the case of an individual, the customer is a resident of this state”. Thus, the sales of distributors, advertisers, and direct subscribers domiciled in Oregon comprise the numerator of the apportionment factor under the commercial domicile

method. Revenue from companies and subscribers domiciled outside the state are not included in the numerator.

Nationally, a mixture of apportionment strategies for broadcasters are employed by states. Some states have industry-specific apportionment rules for broadcasters, while others rely on apportionment methods used generally for services and/or intangible personal property. In states where industry-specific rules exist, the two commonly used apportionment methods for broadcasters are the audience and commercial domicile methods described above. States without industry-specific rules typically use their default apportionment method for intangibles, typically market based sourcing or cost of performance methods. Additionally, some states tax different revenue sources using a mixture of the apportionment methods described above.

VII. Economic Nexus

*Legal Background*⁸

The concept of “nexus” refers to whether a state has jurisdiction to tax an individual or corporation.⁹ In the context of this report, the question is whether interstate broadcasters have nexus with Oregon and are thus required to file corporate excise tax returns in Oregon. At one time, physical presence was a key factor for a company triggering nexus within a state and this was reflected in the law. However, as technology and economies changed over time, companies were increasingly able to maintain significant operation in states without explicit physical presence in the form of location or employees. Over time, the standard for establishing nexus transitioned away from physical presence and toward economic nexus.¹⁰ The concept of economic nexus allows for states to tax companies that have no physical presence in a state but do financially benefit from the taxing state’s economy. An overview of the evolution of nexus provides context for the discussion of Oregon’s taxation of interstate broadcasters.

In 1992, the U.S. Supreme Court held in *Quill Corporation v. North Dakota*, 504 U.S. 298, 309 (1992) that states could not require out-of-state corporations to collect sales and use tax from in-state customers unless the company had physical presence in the state. (Quill was shipping goods into the state to fulfill orders from catalogs it had mailed into the state and North Dakota wanted to require Quill to collect tax.) Essentially, the *Quill* decision made physical presence a necessary condition for taxation under sales and use tax. The holding in *Quill* was based on Court’s interpretation of the Commerce

⁸ This synopsis and the discussion of litigation elsewhere in this report are intended to provide context for the reader. They are not intended as legal analysis or opinion. Readers seeking legal advice should consult with an attorney.

⁹ Stated another way, the question is whether a tax applies to an activity with “substantial nexus” in a state. Substantial nexus is one element of a still-valid four-part test for whether a tax provision violates the dormant Commerce Clause of the United States Constitution. *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

¹⁰ Economic and substantial nexus are often used interchangeably in this context.

Clause of the U.S. Constitution. Conversely, the *Quill* Court held the opposite for the Due Process Clause of the U.S. Constitution, namely that physical presence was not necessary to satisfy concerns related to fairness of taxation.

In the years following the *Quill* decision, many states had ongoing litigation with courts often holding that physical presence was not necessary for determining a state's ability to tax a company. These cases represented a shift toward economic nexus standards across the United States. Notably, while *Quill* remained good law, state courts upheld taxation schemes that lacked physical presence and the United States Supreme Court did not interfere. In other words, despite opportunities to weigh in, the Court in some instances declined to hear cases that appeared to conflict with *Quill*.

A significant state court case decided after *Quill* was *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993). In this case Geoffrey was a Delaware corporation created to hold and license trademarks and intangible property of the company Toys "R" Us. The South Carolina Supreme Court held that the intangible property in use in South Carolina was enough to establish a minimum connection between the state and the company, as required by the Due Process Clause of the US Constitution and that the company had substantial nexus with South Carolina under the Commerce Clause. The *Geoffrey* court relied on the due process analysis in *Quill*, which looked for purposeful availment of a state's economic forum. The court also observed that *Quill* did not extend the physical presence requirement to income taxes (as *Quill* involved sales and use taxes) and held that the presence of intangible property alone was enough to establish substantial nexus between a state and a company. The United States Supreme Court denied certiorari, that is, it declined to review the case, and the state court holding in *Geoffrey* stood.

In 2018, the United States Supreme Court finally addressed the question of nexus without physical presence and the ongoing viability of *Quill* in *Wayfair v. South Dakota*. 138 S. Ct. 2080 (2018). *Wayfair* explicitly overturned *Quill* and established that physical presence was not required to establish nexus. The *Wayfair* decision did not newly establish economic nexus as a standard, since this standard had been used continuously at the state level. Instead, the *Wayfair* Court made clear that physical presence is not a necessary requirement to establish nexus.

Also in 2018, the Oregon Supreme Court decided *Capital One Auto Finance Inc., v. Department of Revenue* 363 Or. 441 (2018). This case is relevant to the discussion of interstate broadcaster nexus because it addresses whether companies lacking physical presence in Oregon are subject to corporate taxation. As mentioned previously, some of the ongoing litigation related to the broadcaster statutes deals with whether companies without physical presence in Oregon but with Oregon viewers are subject to taxation. *Capital One* held that although the bank did not have physical presence in Oregon, the bank did receive income tied to Oregonians and as such the company was required to

pay the corporate income tax in Oregon.^{11[2]} The Oregon Supreme Court affirmed the Oregon Tax Court, which had found economic nexus based on the bank having taken advantage of the economic milieu of the state to make a profit. The topic of economic nexus is directly tied to the discussion of interstate broadcaster taxation in Oregon and *Capital One* provides a recent example of the court finding economic nexus in cases where physical presence is not present.

Industry and DOR Perspectives

Whether these companies have nexus in Oregon is another major area of disagreement between DOR and MPA. Industry argues in several cases that companies had no physical presence in the state during the contested tax years, and thus did not have nexus and were not subject to the corporate income tax in Oregon. DOR's perspective is that physical presence is not required for economic nexus, which the state has been using as a standard for several years.¹²

Prior to the 2014 change in legislation, DOR and industry disagreed about nexus. Many companies that Oregon statute would define as broadcasters were not filing an Oregon corporate tax return. This failure to file and nexus disagreement led to DOR audits and related litigation that is still ongoing.¹³ With the passage of the 2014 legislation, MPA members agreed to file in Oregon using the commercial domicile method of apportionment. Although there are disputes ongoing in court regarding nexus during previous tax years, it is possible that the *Wayfair* decision may have an impact on how stakeholders view nexus.

DOR maintains that nexus existed for broadcasters during the years prior to and following the policy changes related to broadcaster apportionment. DOR began filing enforcement within this industry when they realized not all companies that Oregon statute defined as broadcasters were filing within the state. The disagreement between DOR and industry regarding nexus is present in almost all the ongoing litigation. However, industry today does not contest nexus under the commercial domicile method of apportionment. It is unclear whether nexus will be an issue moving forward if Oregon's apportionment method for interstate broadcasters is changed.

¹¹ Oregon has two distinct corporate tax systems in place, the corporate excise tax and the corporate income tax. The corporate excise tax is paid by businesses for the privilege of doing business in Oregon. The corporate income tax is paid by companies that receive income derived from sources within Oregon. Most companies pay the corporate excise tax however the *Capital One* decision required banks which were affiliates of a group filing a consolidated return to pay the corporate income tax.

¹² For a detailed description of DOR's substantial nexus guidelines, please see OAR 150-317-0020.

¹³ The ongoing lawsuits mentioned in this report are related to pre-2014 years. As such, nexus is a central concept in many of these cases.

DOR asserts broadcasters meet the substantial nexus requirements outlined in OAR 150-317-0020.¹⁴ According to this rule, a company can have substantial nexus in Oregon without having physical presence in Oregon if the company regularly takes advantage of Oregon's economy for income producing activity. OAR 150-317-0020 (3) describes many potential conditions that taxpayers may undertake, which could trigger substantial nexus within the state. DOR maintains that the economic nexus standards supported by their substantial nexus rule have been in place since the early 1990s.

VIII. Estimated Revenue Impacts and Policy Options

A central task for the Legislature is to set tax policy, which includes determining the appropriate method of apportionment for these companies. Notwithstanding historical methods and the current legal disputes, the objective is to establish a method of taxation that achieves the desired policy goals while having the capacity to accommodate the dynamic nature of expected changes within the industry. An important consideration for the Legislature is the revenue impact of any policy decision. Below, we describe the relevant revenue impact estimates in detail.

Since 2014 when the apportionment method for broadcasters changed from audience to commercial domicile, corporate tax returns have included a checkbox for taxpayers to indicate whether they are an interstate broadcaster. The instructions for this form indicate that a taxpayer who is an interstate broadcaster should include information on their total receipts from broadcasting, gross receipts sourced to Oregon under the commercial domicile method of apportionment, and gross receipts sourced to Oregon under the audience method of apportionment. Once the data arrived at DOR, analysis of the returns and related information indicated that taxpayers may be confused by what 'interstate broadcaster' means. This confusion falls in line with the difference between statutory and industry definitions of broadcaster as well as the ongoing litigation related to this issue. DOR reached out to taxpayers requesting additional information in many cases to collect data on receipts related to broadcasting, as mentioned above.

At the end of the temporary period established by HB 4138 in during the 2014 session, the Legislative Revenue Officer provided a report to the legislature about the new method of apportionment, as required by statute.¹⁵ The expectation was that this report would facilitate a review of interstate broadcaster apportionment methods during the 2017 legislative session and the report was shared with the legislators in March 2017. The findings of the report highlighted several areas of uncertainty and disagreement that existed between industry representatives and DOR as of 2017. To facilitate policy analysis related to this initial report, DOR attempted to collect data on interstate broadcasters filing within Oregon. As of the 2017 LRO report, there were eleven data

¹⁴ OAR 150-317-0020 provides DOR's substantial nexus guidelines. Please see these administrative rules for additional details on the substantial nexus guidelines in Oregon, other than those described in this report.

¹⁵ To access this report, please [click here](#).

points available for analysis (a combination of taxpayers and tax years). Broadly speaking, three major areas of uncertainty emerged from LRO's research on this topic: (1) lack of clarity regarding who is an interstate broadcaster, (2) nexus, (3) which revenues are subject to apportionment based on broadcaster statutes.

During the 2018 session, SB 1523 temporarily extended this method of apportionment for interstate broadcasters for tax years 2017 and 2018. The goal of this temporary extension was to provide time for pending legal cases related to this issue to make their way through the court system in Oregon. In the 2019 session, many of these cases were still pending in the court system. As such, SB 193 temporarily extended this method of apportionment for one year, applying to tax year 2019, and requiring this report by the LRO.

Currently, DOR has compiled information from the years 2014 to 2018¹⁶, with information on 74 taxpayer-year combinations. The number of taxpayers identified as broadcasters increased steadily during this time period. These taxpayers are believed to be broadcasters after review of data and related statutes by DOR. After requesting additional data from taxpayers, DOR was able to compile full information (total gross receipts from broadcasting, gross receipts under commercial domicile method, gross receipts under audience method) on roughly 60% of the 74 taxpayer-years mentioned above.

If nexus is assumed to not exist under the audience apportionment method, then the change in apportionment method from audience to commercial domicile results in an estimated total of \$5 million additional dollars to the state during the 2014-2018 period. This equates to a little over \$1 million of increased revenue annually. This estimate is consistent with the revenue impact of the 2014 legislation and industry's perspective at the time.

Assuming that nexus exists under both apportionment methods, almost all observations indicate that moving from audience to commercial domicile results in a lower tax liability for the taxpayer. Compiling these revenue changes across time and scaling the estimate to represent the 100% of identified interstate broadcasters indicates that the policy change had an estimated \$40 million decline over the time period. This estimate equates to roughly \$10 million lost annually, holding everything else constant. The difference in estimates depending on assumptions highlights how nexus is central to estimating the direction and magnitude of the revenue impact.

To determine the revenue impact for upcoming biennia for potential policy changes, we must first determine what the baseline case is for comparison. Currently, without action from the legislature, the temporary commercial domicile method of apportionment will sunset and apportionment will revert to the audience method in 2020. As such, at the

¹⁶ Tax returns from 2018 are still being processed so numbers from 2018 do not yet reflect the population of broadcaster taxpayers for that tax year.

time of this report and looking forward, the audience method of apportionment forms our baseline. There are at least three policy options that may be taken into consideration, in no particular order.

One option for the Legislature is to not pass legislation and return to the audience method of apportionment. This option would result in no revenue impact, as compared to the baseline assumption of current law returning to the audience method in 2020. An important consideration for continuing without legislation in 2020 is that the definition of broadcasting remains very broad. It is likely that due to this broad definition appeals could increase in number if statutes are kept as-is. Also, there may be some issues related to the audience method that may be learned from the ongoing legal cases.

A second policy option for the Legislature is to make permanent the commercial domicile method of apportionment that is currently in use for tax years 2014-2019. Recall, the commercial domicile method sources receipts to states based on the location of the immediate customer's domicile. Our baseline for comparison is the audience method of apportionment that will go into effect in the absence of legislation. If instead, the Legislature enacts a permanent commercial domicile method of apportionment, analysis to date suggests the state could see a decrease in revenue of \$10 million annually, relative to the baseline audience method.

A third policy option for the Legislature is to repeal the statutes related to broadcaster apportionment. If the Legislature were to eliminate the broadcaster statutes entirely then the default method for intangibles would apply to this industry. Currently, Oregon uses the marked-based method for sourcing sales and DOR's rules related to this topic adopt model regulations recommended by the Multistate Tax Commission (MTC). These rules indicate that for companies providing a service to an audience should apportion multistate income based on that audience. Thus, the estimated revenue under this method would likely be similar to that of the audience method of apportionment.

One important difference between market-based sourcing and industry specific provisions is that only receipts related to broadcasting would be apportioned under market-based sourcing. Based on the *Comcast* case, under the audience method all receipts of a broadcaster are apportioned by audience factor (except tangible personal property and real property, which are explicitly excluded in statute). By moving to the market-based system the income subject to audience apportionment only includes income related to broadcasting.

IX. Conclusions

The commercial domicile method of apportionment has now been in place long enough to allow the use of data from multiple tax years to shed significant light on policy impacts. An important note is that the perspective through which the analysis is viewed, and the assumptions made regarding areas of disagreement, significantly influence revenue estimates. As detailed in this report, depending on nexus assumptions made,

the estimated revenue impact of moving from audience to commercial domicile can be either negative or positive, with differences in magnitude also present. As the Legislature considers policy options, it is likely helpful that the *Wayfair* decision is available. There may be ongoing debate concerning all the implications of *Wayfair*, but if it adds clarity for all stakeholders on the issue of nexus, the implications for revenue impacts are that much clearer.

The definition of an interstate broadcaster is also particularly significant for future policy decisions. As noted above, the number of taxpayers identifying as such steadily increased between 2014 and 2018. While part of this increase is likely driven by changes within the industry (e.g. mergers and acquisitions), it is also likely that an increasing understanding of Oregon's statutory definitions related to broadcasters has played a role in the increase and will continue to do so in the future. The broad definition of broadcasting used in Oregon statute adds a level of uncertainty to any policy impact estimate. For example, there are likely to be business entities that do not consider themselves interstate broadcasters but may get caught up in future DOR audit activity, as described above. Based on the broad definition, it is possible that future appeals regarding tax due to DOR under broadcaster statutes will increase as well. It is important to note that LRO has no knowledge of potential DOR actions. Instead, LRO views the current definition as quite broad and considers this breadth significant to future policy discussions.

The changes that have occurred in the audio and video production and distribution industries are another example of significant structural changes enabled by the maturing of the internet. Over time, the revenue streams of companies in this industry have been affected by widespread internet use. While today there is much talk in the general media of people 'cutting the cord', the viewing of content still requires an internet connection. Internet availability combined with new internet-based distribution systems are leading to a mix-and-match of sorts between content creation and delivery to consumer. These ongoing changes suggest that a dominant source of revenue for these businesses may eventually come from the consumer direct model. This source may eventually obviate the need for apportionment because the revenue can be directly sourced to the consumer's state of residency (i.e. the intended viewing market). There have been several industry changes in recent years that speak to this point. To the extent possible, considering future movement in this industry while crafting tax policy is ideal to ensure that the chosen policy is forward looking.

Lastly, additional statutory direction may be of value, regardless of which apportionment method the Legislature chooses. For example, current law for tax year 2020 dictates the use of the audience method. DOR rules indicate that population may be used when audience estimates are not available. An option for cable networks may be using the share of households that pay for cable or satellite television, as opposed to the entire population. One policy option would be allowing filing entities that include national and cable networks to apportion revenue streams using population or cable ratios where appropriate. Additionally, statutory guidance regarding the measurement of audience for

apportionment ratios may also provide clarity to stakeholders and reduce future disagreement between industry and DOR. Statute states that audience may be used and cites particular sources of relevant information, but there may be room for additional clarity. Similarly, there may be additional avenues for clarification or modification if the Legislature chooses to continue with the commercial domicile approach.

X. Appendix

Early History of Interstate Broadcasting

In the 1950s, television stations or networks were the customers of commercial broadcasters. At the time, three national broadcasters (ABC, CBS, NBC) sold programming content to television stations. The broadcaster would 'broadcast' the content via uplink transmission to a satellite. The satellite would then send the content to the television station via downlink transmission. At that point, the television stations would air this programming content to viewers, transmitting the content through radio waves. Thus, in the early widespread use of television, television stations were the customers of national (interstate) broadcasters.

Initially, households accessed television using antennae, paying no regular fee associated with viewing programming. Television stations sold advertising time and used that revenue to pay interstate broadcasters for licensing programming content. During the 1960s and 1970s, the television market was primarily dominated by affiliate stations of CBS, NBC, and ABC, with some larger cities sometimes also offering independent stations and/or public broadcasting stations (Mitchell Stephens, NYU, accessed 2019).

Around 1960, the US saw the development of Community Antenna Television (CATV) systems, which allowed Americans connected to the system to receive all channels available in the nearest city. During the 1970s the creation of networks designed specifically for distribution to the cable system began, examples including HBO, C-SPAN, and ESPN. Once these were created, households paid cable services for access to these additional channels, while antenna still provided access to some channels outside of the cable system.

Since the 1970s many technological advances have taken place and as such, the industry composition has changed. Now, the consumer base for broadcasters is more varied than in the 1970s. Broadcasters produce content that is sold either to cable operators (Comcast, Charter Communications), satellite operators (Direct TV, DISH), telecom companies (AT&T, Verizon), subscription services (Hulu, Netflix), or directly to consumers (HBO Now, CBS All Access). Broadcasters receive revenue from the licensing of this content and may also receive revenue from advertising and/or direct-to-consumer services.

DOR Rules for Sales Factor of Interstate Broadcasters- Audience Method¹⁷

Department of Revenue

Chapter 150

Division 314

INCOME TAXATION GENERALLY GENERAL PROVISIONS

150-314-0465

Sales Factor for Interstate Broadcasters

(1) In general, if a taxpayer broadcasts to subscribers or to an audience that is located both within and without this state and the broadcaster is taxable in another state under the provisions of ORS 314.620, then the interstate broadcaster is required to use an audience factor to determine the amount of gross receipts from broadcasting attributable to this state.

(2) The audience factor for television, radio, or network programming shall be determined by the ratio that the taxpayer's in-state viewing or listening audience bears to its total United States viewing or listening audience. In the case of television, the audience factor shall be determined by reference to the rating statistics as reflected in such sources as Arbitron, Nielsen or other comparable resources or by the average circulation statistics published annually in the Television and Cable Factbook, "Stations Volume" by Television Digest, Inc., Washington, D.C., provided that the source selected is consistently used from year to year for such purpose. In the case of radio, the audience factor shall be determined by reference to rating statistics as reflected in such sources as Arbitron, Birch/Scarborough Research, or other comparable resources, provided that the source selected is consistently used from year to year for such purpose.

(3) If none of the forgoing sources are available, or if available, none is in form or content sufficient for such purposes, then the audience factor shall be determined by the ratio that the population of the broadcast area located within this state bears to the population of the broadcast area in all states.

(4) Gross receipts from live telecasts and films in release to or by a cable television system shall be attributed to this state in the ratio (hereafter "audience factor") that the number of subscribers located in this state for such cable television system bears to the total number of subscribers of such cable television system in the United States. If the number of subscribers cannot be accurately determined from the records maintained by the taxpayer, the audience factor ratio shall be determined on the basis of the applicable year's subscription statistics published in Cable Vision, International Thompson Communications, Inc., Denver, Colorado, if available, or, if not available, by other published market surveys.

¹⁷ Note, DOR does not have administrative rules on the commercial domicile method of apportionment because the statute was sufficiently clear.

(5) If none of the foregoing resources are available, or, if available, none is in form or content sufficient for such purposes, then the audience factor shall be determined by the ratio that the population of the area served by the cable system service located within this state bears to the population of the area served by the cable system in all states in which the cable system has subscribers.

(6) To the extent that the gross receipts from such live television broadcasting, film, or radio programming, as determined pursuant to paragraphs (2) through (5), include receipts derived from broadcasts to audiences located outside the United States ("foreign-based receipts"), the total gross receipts against which the audience factor shall be applied shall be modified so that such foreign-based receipts are not used to affect the amount of receipts that are to be apportioned to the state. Such modification shall consist of deducting from total receipts, prior to the application thereto of the audience factor, that amount of receipts derived from broadcasts to audiences located outside the United States.

Example: XYZ Television Network Co. has gross receipts from all broadcasting of films of \$1 billion of which a total of \$200,000,000 was derived from advertising receipts and license fees attributable to releases of its films in foreign television markets and \$800,000,000 attributable to the United States market. Assume that the foreign countries into which its programming has been telecast or sold or licensed for telecast would have jurisdiction to impose their income tax upon XYZ Television Network Co., then its in-state gross receipts attributable to its telecasting activity would be determined as follows: $\$1,000,000,000 - \$200,000,000 (\$800,000,000) = (\text{audience factor})$.

(7) Receipts from the sale, rental, licensing or other disposition of audio or video cassettes, discs, or similar medium intended for home viewing or listening shall be included in the sales factor as provided in OAR 150-314-0429 and 150-314-0431.

Statutory/Other Authority: ORS 305.100

Statutes/Other Implemented: ORS 314.684

History:

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