STATEMENT BY NETFLIX, INC.
SALES TAX RULE 027

I am Diane Holman, Senior Sales Tax Manager for Netflix, Inc. Netflix thanks the Idaho State Tax Commission (the "Commission") for this opportunity to comment on proposed draft Rule 027. Netflix submits this statement to assist the Commission both to understand Netflix's video streaming service and to address properly video streaming in its Rule 027.

Netflix provides a video streaming *service* ("Streaming Service") we believe is *not* subject to the Idaho Sales Tax. In proceedings before the Idaho Senate considering HB 598 (now adopted as Idaho Code § 63-3616), the Tax Policy Specialist for the Commission, Mr. McLean Russell, admitted as much when he testified that it was certainly debatable as to whether Netflix' Streaming Service would be taxable even after the passage of HB 598. According to Mr. Russell, a statutory clarification was needed to end that debate.[1]

The legislature chose not to refine HB 598 to tax Streaming. Thus, the Commission lacks the authority to change that result and impose a tax on Streaming under the guise of Rule 027.

By way of further explanation, Netflix's Streaming Service has been and remains nontaxable in Idaho, regardless of the enactment of Section 63-3616, because Streaming constitutes a service and services are not subject to Idaho sales tax. Like in any service transaction, Netflix retains custody and control of its content and the entire Streaming process from beginning to end, including which content to acquire, retain, and offer to subscribers, how long such content will be made available, and what technology and the location of the equipment to be used to stream the content to subscribers. For example, Netflix employs an integrated network of remote Internet servers (Caches) to store and stream content, over which Netflix, not the subscriber, exercises complete control as to which Cache or Caches are to be used. In addition, Netflix subscribers obtain more than just the right to view video content, including Netflix's encoding of the content for use with various subscriber devices (such as an iPad, Roku, Xbox), access over the Internet to Netflix's on-line library of thousands of movies and TV shows and use of Netflix's website software to search for and select specific content by various categories, and the benefit of Netflix's unique user interface that employs complex computer algorithms to present individual content choices based on a subscriber's preferences. In fact, subscribers pay a monthly subscription fee for the Streaming Service regardless of whether the subscriber views any content at all. Finally, Netflix's content is streamed in real time to the subscriber, not downloaded or transferred to the subscriber's device, such that the subscriber does not obtain possession of or control over the content even temporarily. All of these factors support that Netflix unquestionably provides a service, not the sale or rental of digital products.

[1] Idaho Senate Local Government & Taxation Committee meeting minutes, March 19, 2014.

100 Winchester Circle Los Gatos, CA 95032 Phone 408-540-3700 Fax 408-540-3737 www.netflix.com

Because Netflix's Streaming is a nontaxable service, Netflix believes it would not be proper for the Commission to simply lump video streaming into the category of taxable "digital products" or to tax "digital subscriptions" of video streaming, as proposed in draft Rule 027 (at sections 06 and 07). First, Netflix does not believe that 63-3616 even applies to its Streaming Service, and thus the adoption of this legislation should not be viewed by the Commission as affecting Streaming's status as a nontaxable service. Section 63-3616 is intended to change the tax rules for "computer software". Streaming is not "computer software" either in common vernacular or under the definition adopted by the new statute. The new statute defines "the term "computer software" [to] mean[] any computer program, part of a program or any sequence of instructions for . . . information stored in an electronic medium."[2] Streaming customers obtain the Service to view movies not software. Second, even if the statute were applicable somehow to Streaming, no such treatment of video streaming is authorized or proper under the express language of Section 63-3616. The statute is intended to exclude software delivered electronically and remotely accessed, defined therein to mean software accessed by users over the Internet, where the user has only the right to use or access the software by means of a "service" or other agreement. Assuming Streaming Service is software (which it isn't), Netflix's Streaming Service would squarely fit within this exclusion. The statutory *exception* from the new exemption for software that constitutes digital *products* reflects and should be viewed by the Commission as the legislature's recognition that such digital products have long been treated as taxable tangible personal property in Idaho, as noted by Mr. Russell in his testimony on HB 598. According to Mr. Russell, video streaming was not viewed by the Commission as necessarily taxable before, nor should it be under the Commission's Rule 027. Third, in view of the Department's expressed concessions concerning the reach of the new statute, it is not the role of the Commission to try and 'fix" the statute's ambiguity by adopting an administrative rule that video streaming is now clearly a taxable digital product under its Rule. The interpretation of an ambiguous statute is and remains the province of the courts, and such ambiguity must be resolved in favor of the taxpayer.

As a policy matter, because Netflix's content is streamed in real time, such that the subscriber neither obtains possession of or control over either the streaming technology or the content itself, and the content is not actually transferred or downloaded to the subscriber, video streaming is not factually anything like renting a video on DVD or even downloading a video electronically, for which a customer does obtain possession and actual right to use.

Moreover, we note that Netflix's position is consistent with the position taken by other states which impose sales tax on Streaming only when the state's tax statute explicitly authorizes such taxation or broadly applies to services, but not on the basis of selling or renting tangible personal property. When a tax agency recently tried to expand a tax statute by fiat, arguing that streaming is or resembles the sale of tangible personal property, that effort failed. A Louisiana District Court last month held that transactions like video on demand and pay per view do not involve the sale or rental of tangible personal property but rather constitute the provision of a nontaxable service.[3]

[2] The full statute reads: "the term 'computer software' means any computer program, part of a program or any sequence of instructions for automatic data processing equipment or information stored in an electronic medium."
[3] *Jefferson Parish v. Cox Commc'ns*, Louisiana, L.L.C., No. 706-766 (Jefferson Parish 24th Judicial Dist. Ct., June 11, 2014) (Pitre, J.).

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In closing, Netflix reminds the Commission that it has complied fully with its obligation to collect and remit state sales tax on its rental of DVD videos in Idaho, providing several hundred thousand dollars in tax revenue to Idaho each year. But Netflix objects, and believes that it would be unfair, and adverse to Netflix's ability to compete and develop new and innovative technologies, to tax video streaming while excluding from tax almost all other types of cloud services and online information database subscriptions, and even more disadvantageous to Netflix were the Commission to similarly exclude cable, satellite or television broadcasts. The Commission should instead continue to recognize video streaming, and particularly Netflix's Streaming Service, as a nontaxable service distinct from the sale or rental of digital products, and to foster, not burden, the development of new and innovative technologies in electronic commerce, such as video streaming, as the Idaho legislature intends.

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