



Flashpoint

Over-the-top complexity

Examining the potential tax implications
of streaming video distribution

In the beginning, there were movies and television. Film studios produced movies and licensed them to distributors or used their own distribution arms to reach viewers. On the television side, broadcast networks produced shows and distributed them to both their own stations and affiliates. In short, consumers didn't have much of a choice.

Fast forward to today, and the landscape has changed dramatically. With the mass availability of streaming services, televisions and movie theaters are no longer the only places consumers can view content. They can watch from any Internet-enabled screen—anywhere, anytime.

As a result, the market has expanded exponentially, and new players have inserted themselves into the value chain, not just as distributors, but as content producers, including many small, entrepreneurial companies or even

individuals. Streaming services have disrupted the film, television, and cable industries by offering subscriptions to content libraries that allow consumers to do an end-run around traditional distributors. At the same time, established players are fighting back by forming unlikely partnerships that share revenues in nontraditional ways.

Old business models have been permanently disrupted and new digital platform models have been—and will continue to be—developed to deliver over-the-top (OTT) content and

streaming services that can be blended with both social media and e-commerce. Digital platforms will enable interaction with and monitoring of viewers to enhance both product development and targeting. Content consumption is no longer a one-to-one transaction between a film studio or a network and a single customer. In fact, the very nature of what constitutes a transaction has shifted.

The tax implications of that shift are both profound and undeniably complex.

Key observations



Definitions count.

In the United States, certain indirect tax exemptions are tied to specific definitions of broadcasting, while the imposition of indirect tax varies based upon a state's definition of taxable services. There may be a need to account for indirect taxes on anything defined as digital sales.

Location, location, location?

With subscription-based OTT services, what constitutes the "where" of a transaction has become very murky. Globally we are seeing a shift to taxing electronic services based on the location of the consumer rather than that of the supplier. But how do you know the location of a consumer?

Tax policy is a work in progress.

Countries across the globe, as well as US jurisdictions, are struggling to keep pace with evolving business models. As a result, tax statutes may not neatly fit new technologies, and therefore tax policy is not always clear.

Nontraditional partnerships have nontraditional tax consequences.

Entering into a partnership or collaboration, or offering services in a new jurisdiction, could expand a company's indirect tax footprint to places it has never been before.

Definitions count

When considering how US jurisdictions impose sales taxes on OTT services, it is essential to categorize exactly what those services are and whether they constitute “broadcasting” or other exempt types of services. Because certain tax exemptions are tied to specific definitions of broadcasting, an understanding of what is and isn’t broadcasting is extremely important, as is consideration of how such rules may apply to these operations.

In the past, most programming was approved and regulated by the Federal Communications Commission (FCC). The FCC has historically had a higher level of involvement in network TV than in cable TV. Over the years, lobbying by companies has influenced the level of involvement the FCC has had in certain states. Many states that provide exemptions for broadcasting base their definition of what qualifies as broadcasting on FCC regulation of the

programming. In other states, the method of transmission is viewed as more impactful in determining taxability than the authority of the FCC to regulate.

Even with all the complexities associated with broadcasting and FCC oversight, it is only half the story. For US indirect taxes, the definition and imposition of tax on sales of digital goods and/or services vary. This issue requires a careful reading of each state’s definition of broadcasting, digital goods, and services—and there are 50 states, each going in a different direction.

Things don’t get any simpler on the global level where the critical term is “electronic services,” because nearly every country seeking to tax nonresident providers has defined this term slightly differently. In general, OTT services are likely to fall within this definition, and thus within the scope of local tax regimes.



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Location, location, location?

Much of sales and use tax law has developed around the notion of a transaction being delivered to, or used in, a specific jurisdiction or location. In the United States, when a company has achieved sufficient physical presence, or nexus in a particular state, it is required to collect indirect tax on retail sales in that state. But if a customer based in New York subscribes to a certain cable service and then watches a program from a hotel room in Georgia, where is that transaction taking place? Once you switch to digital distribution, the physicality of the transaction is lost and it becomes unmoored from location.

For US indirect tax purposes, depending on whether or not OTT distribution is considered to be a service, location may be where the service is performed or where the benefit of the service occurs. If a state considers OTT to be content or a digital good, however, location may mean where the OTT content is delivered to, or used by, a customer. There is also the question of whether that content is always “delivered”—or whether it should be considered “accessed,” which could result in very different tax consequences. Regardless of where the content is actually viewed, some US jurisdictions are moving toward using, for indirect taxation, the concept of principal place of use or the residential street address of a customer.

Outside of the United States, the big question is where value-added tax (VAT) should be levied on electronic services. Globally there is a shift underway from collecting indirect taxes at the location of the supplier to taxing electronic services at the location of the consumer.

This model for taxing electronic services already exists in a number of countries, including the 28 European Union (EU) member states. Many other countries already are or likely will follow suit and this is where things can get complicated, since each country has its own approach. For example, if a US OTT provider has customers in France, South Africa, or South Korea, this could be where the VAT should be paid, subject to exceeding certain local country thresholds. In comparison, if the customer is in Singapore or Brazil, based upon the existing legislation (as of June 2017), a US OTT provider would not need to register in either of these countries.

In short, this means that OTT providers may need to register and account for VAT (or an equivalent) and could have significant compliance obligations in the countries where their customers are based.

Location also becomes important outside the realm of transaction taxes. Where new digital technologies are being developed, where data storage and analytics are taking place, as well as transfer pricing agreements for sharing that data, all have tax implications and require careful tax planning. Content licenses also need to be monitored by jurisdiction to ensure that proper withholding on royalties is not overlooked.



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Tax policy is a work in progress

Getting a handle on how individual countries, states, and localities treat taxation of OTT content can be extremely challenging. As technology changes, the statutes and regulations have not always kept pace. In the United States, some jurisdictions have responded to the explosive growth of OTT and streaming services by enacting new indirect tax legislation or expanding existing statutes, while others are still struggling to catch up. In many of the larger US states, there tends to be more guidance, while in the smaller states their positions are more difficult to pin down.

Certainly taxation of OTT content distribution is inconsistent across states. For example, if a company streams content to a customer in California, it is not required to collect sales tax, but if it streams that same content to a customer in Ohio, it is required to do so. Streaming that same content to Florida results in a communication services tax, but not a sales tax obligation. And it is not just the states jumping in with sometimes arcane tax policy—it is also cities such as Chicago and its amusement tax.

On the global front, countries outside the United States are trying to figure out how to nail down their taxation positions for electronic services. At present, the laws regarding what (and who) is taxed differ from country to country, and this is not expected to change. For example, let's say you purchased an app on which you stream another company's content. What service should be taxed—the app or the content it streams—and who should be responsible for collecting the tax, the OTT provider or the seller of the app? Not every country will handle this situation in the same way so you need to look at the local rules.

Given the lack of clarity around the taxation of OTT content distribution, much of the law is subject to interpretation, particularly in regard to what constitutes an electronic service globally. But it is important to have a position and be able to support it.



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Nontraditional partnerships have nontraditional tax consequences

As the ecosystem evolves, more competition from nontraditional players (including producers of user-generated content) is arising, as well as more partnerships, collaborations between competitors, and co-distribution arrangements. All of these can have tax implications. Let's say you enter into a partnership with another company. This could cause you to broaden your indirect tax footprint in US jurisdictions where your own company has never had a footprint. For example, if you are based in New York and your partner is based in California, you may now have a filing responsibility in California.

Furthermore, the question of who in a partnership is responsible for sales tax collection is not always clear—and it changes based on the interactions between the companies. For instance, in the United

States, if a cable company sells a service to a customer in a particular state, it is typically responsible for collecting and reporting sales tax to the state. But if an OTT service streams its content via that same cable network, then who is responsible for sales tax collection? While generally speaking these details should be ironed out in contracts between the two parties, many smaller players or new, entrepreneurial market entrants may be unaware that these issues are important to negotiate up front.

These considerations are likely to be less applicable in a global indirect tax environment, although there is always a need to consider who the seller is for tax purposes—and joint ventures can increase the uncertainty in this respect.



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Let's talk

Competitive pressures have prompted media and entertainment companies to sprint toward the next innovation, including new OTT offerings that are often packaged, distributed, and sold in nontraditional ways. All of these can impact the taxability of a transaction, yet in their eagerness to be the first to market, companies often allow tax considerations to fall by the wayside. But that can expose them to significant risks. Those exposures only escalate when they expand globally without any up-front tax planning.

We've seen this movie before, and we know how it ends. If your business model is changing, tax policy, systems, and collection can't be an afterthought. In fact, having an effective approach and a defensible tax position are more important than ever to mitigate risk. Deloitte understands the intricacies of direct and indirect taxation for OTT offerings, and our professionals stay abreast of changing tax law in the United States, as well as internationally. We have a strong record of advising both start-up and existing OTT providers on these and many other issues, making us a recognized leader in this area. We can help you create the proper tax plan for your future. Let's talk.

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