

Resolution 2016-6

Opposing Digital Goods and Services Tax Fairness Act

Background

The taxation of digital goods and services (or goods and services delivered electronically) is an emerging issue. The latest version of the Digital Goods and Services Tax Fairness Act (H.R. 1643 and S. 851) (114th Congress) mandates which state is permitted to tax a sale of a digital good or service based on sourcing rules set out in the bill, and would also prohibit states from taxing digital goods and services differently from or to a greater extent than “similar” non-digital goods and services. On December 16, 2015, the Congressional Budget Office evaluated H.R. 1643 and estimated that “the cost—in the form of foregone revenues—to state and local governments would total about \$1 billion in at least one of the first five years after the mandate becomes effective and at least that amount in each subsequent year.”

Because the bill’s requirements permit a sale of a digital good or service to be taxed by only one particular state, generally the state where the customer takes delivery, but the bill does not grant to that state the authority to collect the tax from remote sellers, there is substantial support for the position that states will not be able to collect any tax at all on these sales. This is due to a Supreme Court’s ruling from 1992 that states can only impose sales type taxes or collection duties on catalog and mail order sellers of tangible personal property who have some kind of physical presence in the state (see *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)). While Congress has the power to remove this potential barrier, there is no provision in the proposed Digital Goods legislation to do so. Because digital goods and services, by nature, can easily be sold remotely, the bill would allow a substantial number of sellers to take advantage of the fact that the states’ “hands are tied,” and avoid taxes completely.

Further, the bill preempts taxes on digital goods and services that might apply differently or to a greater extent than taxes on “similar” non-digital goods and services. In addition to the problems that such a rule is likely to cause administratively — since there is no clear indication of what the term “similar” is intended to include — this is also a provision that is completely unwarranted. First, the Internet Tax Freedom Act already provides protection for goods and services sold through the Internet versus those same goods and services sold through some other means. Second, states may have sound policy reasons to treat what might be considered “similar” goods and services differently, depending on various factors including who is the seller, who is the buyer, what the good or service will be used for, etc., and the bill does not allow states to consider these factors. Third, there is absolutely no evidence that digital goods and services have been taxed in a discriminatory manner — in fact, they are generally taxed less than other goods and services. Fourth, this provision would give sellers of digital goods and services “most-favored taxpayer” status that may provide them with unwarranted advantages over other businesses.

In general, FTA opposes action by Congress and federal agencies that would abrogate, disrupt, or otherwise restrict states from imposing taxes that are otherwise lawful under the U.S. Constitution or from effectively administering those taxes. Congress should undertake an active program of consultation with states whenever it considers measures that would preempt state tax authority. States should be allowed to actively pursue uniformity and simplification measures as are necessary and would be effective in addressing the administrative burden in complying with the tax laws of multiple states.

While federal preemption of state taxing authority is an extreme action, preemptive legislation can, at times, promote simplification, uniformity, and taxpayer compliance, albeit at some cost to state sovereignty. FTA will evaluate proposed federal legislation that preempts state taxing authority against several criteria:

1. Has the preferred solution of uniform state action been pursued and exhausted?
2. Recognizing that the benefits of federalism will impose administrative burdens on commerce, is there disinterested evidence that the administrative burden and complexity posed by current state and local practices is impeding the growth of commerce?
3. Does the proposed preemption address administrative issues such as simplification, uniformity, and taxpayer compliance?
4. Can meaningful simplifications and uniformity be achieved through state action?
5. Would preemption disrupt state and local revenue flows and tax systems?
6. Would preemption cause similarly situated taxpayers to be taxed differently -- specifically, does the proposal create advantages for multistate and multinational businesses over local business?
7. Does the preemption support sound tax policy?
8. Does the preemption create unknown or potential unintended consequences?
9. Have state tax authorities and taxpayer representatives together agreed to a beneficial change in federal law?
10. Does the proposed preemption materially narrow the scope of state laws?

So long as the Digital Goods legislation does not provide authority to states to collect tax from remote sellers, and also contains an unwarranted tax preference for digital goods and services, the bill violates the principles above.

Resolution

The FTA opposes The Digital Goods and Services Tax Fairness Act. The bill would limit state taxation of digital goods and services and allow sellers who provide those goods and services remotely to effectively escape any tax or collection duty. The bill would also provide an unwarranted preference to digital goods and services vis-à-vis non-digital goods and services. Specific problems with the bill include:

- States are not granted any collection authority over sellers of digital products;
- The preemption extends beyond sales and use taxes;
- There are few tools or protections for the states and local jurisdictions to reduce the risk of tax avoidance;
- Despite its purported purpose, the bill is not limited to rate discrimination between specified digital products (e.g. digital movies, music, books) and their tangible equivalents;
- There is no recognition of the general use tax credit mechanism and federal constitutional tax-crediting principles to avoid multiple taxation; and
- There is no ability for state administrative agencies to issue binding regulations to implement the bill's provisions.

Any discussions of desired uniformity or model rules or definitions should take place either through existing channels such as the Multistate Tax Commission's uniformity projects or through cooperative and inclusive meetings of representatives of both state

governments and all affected taxpayers.

This resolution shall automatically terminate three years after the Annual Business Meeting at which it is adopted, unless reaffirmed or replaced in the normal policy process. Passed by unanimous voice vote by the membership on June 15, 2016.