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(Original Signature of Member)

112TH CONGRESS
1ST SESSION

H. R. _____

To promote neutrality, simplicity, and fairness in the taxation of digital goods and digital services.

IN THE HOUSE OF REPRESENTATIVES

Mr. SMITH of Texas (for himself and _____) introduced the following bill; which was referred to the Committee on _____

A BILL

To promote neutrality, simplicity, and fairness in the taxation of digital goods and digital services.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Digital Goods and
5 Services Tax Fairness Act of 2011".

6 **SEC. 2. FINDING.**

7 The Congress finds that it is appropriate to exercise
8 congressional enforcement authority under section 5 of the
9 14th amendment to the Constitution of the United States

1 and Congress' plenary power under article I, section 8,
2 clause 3 of the Constitution of the United States (com-
3 monly known as the "commerce clause") in order to en-
4 sure that States and political subdivisions thereof do not
5 discriminate against providers and consumers of digital
6 goods and digital services by imposing multiple, excessive
7 and discriminatory taxes and other burdens on such pro-
8 viders and consumers.

9 **SEC. 3. MULTIPLE AND DISCRIMINATORY TAXES PROHIB-**
10 **ITED.**

11 No State or local jurisdiction shall impose multiple
12 or discriminatory taxes on or with respect to the sale or
13 use of digital goods or digital services.

14 **SEC. 4. RETAIL, SOURCING, AND OTHER LIMITATIONS AND**
15 **RULES.**

16 (a) **RETAIL LIMITATION.**—Taxes on or with respect
17 to the sale of digital goods or digital services may only
18 be imposed on or with respect to a sale to a customer.

19 (b) **TAXPAYER LIMITATION.**—Taxes on or with re-
20 spect to the sale of digital goods or digital services may
21 only be imposed on and collected only from a customer
22 or a seller.

23 (c) **SOURCING LIMITATION.**—

24 (1) **IN GENERAL.**—Taxes on or with respect to
25 the sale of digital goods or digital services may be

1 imposed only by the State and local jurisdictions
2 whose territorial limits encompass the customer's tax
3 address.

4 (2) MULTIPLE LOCATIONS.—If the sale of dig-
5 ital goods or digital services is made to multiple lo-
6 cations of a customer, whether simultaneously or
7 over a period of time, the seller may determine the
8 customer's tax address or addresses using the ad-
9 dress or addresses of use as provided by the cus-
10 tomer.

11 (3) SELLER HELD HARMLESS.—A seller that
12 relies in good faith on information provided by a
13 customer to determine the customer's tax address or
14 addresses shall not be held liable for any additional
15 tax based on a different determination of the cus-
16 tomer's tax address or addresses.

17 (d) LIMITATION ON EXPANSIVE INTERPRETATION.—
18 No tax on or with respect to the sale or use of tangible
19 personal property, telecommunications service, Internet
20 access service, or audio or video programming service may
21 be construed by any regulation, administrative ruling, or
22 otherwise, to be imposed on or with respect to the sale
23 or use of a digital good or a digital service. For purposes
24 of this Act, a transaction involving a digital good shall
25 be characterized solely as a transaction involving the pro-

1 vision of a digital service unless the transaction results
2 in the transfer or delivery of a complete copy, with the
3 right to use permanently or for a specified period, of the
4 digital good that is the subject of the transaction. No tax
5 on or with respect to the sale or use of a digital good may
6 be construed by any regulation, administrative ruling, or
7 otherwise, to be imposed on or with respect to the sale
8 or use of a digital service. The limitations provided by this
9 subsection shall not apply to any construction of a statute
10 that was approved by a judicial interpretation of that stat-
11 ute on or before the date of the enactment of this Act.

12 (c) TREATMENT OF BUNDLED GOODS AND SERV-
13 ICES.—

14 (1) IN GENERAL.—Subject to paragraph (2), if
15 charges for digital goods or digital services are ag-
16 gregated with, and not separately stated from,
17 charges for other goods or services, then the charges
18 for digital goods or digital services may be taxed for
19 purposes of this Act at the same rate and on the
20 same basis as charges for the other goods or services
21 unless the seller can reasonably identify the charges
22 for the digital goods or digital services from its
23 books and records kept in the regular course of busi-
24 ness.

1 (2) CHARGES FOR DELIVERY AND TRANS-
2 PORT.—If the charge for a digital good or digital
3 service is aggregated with, and not separately stated
4 from, a charge for electronically delivering or trans-
5 porting the digital good, or providing the digital
6 service, to the customer, then the seller may either
7 apply paragraph (1) or treat the service of electronic
8 delivery or transport as a non-severable and inci-
9 dental component of the digital good or digital serv-
10 ice.

11 (f) TREATMENT OF DIGITAL CODE.—The tax treat-
12 ment of the sale of a digital code shall be the same as
13 the tax treatment of the sale of the digital good or digital
14 service to which the digital code relates. The sale of the
15 digital code shall be considered the sale transaction for
16 purposes of this Act.

17 **SEC. 5. DEFINITIONS.**

18 In this Act:

19 (1) CUSTOMER.—

20 (A) IN GENERAL.—Subject to subpara-
21 graph (B), the term “customer” means a per-
22 son that purchases a digital good or digital
23 service, for a purpose other than resale.

24 (B) END USER.—For the purpose of deter-
25 mining a place of primary use under paragraph

1 (2)(A), the term “customer” means the “end
2 user” (as such term is used in section 124 of
3 title 4, United States Code) of the purchased
4 digital good or digital service.

5 (2) CUSTOMER’S TAX ADDRESS.—The term
6 “customer’s tax address” means—

7 (A) with respect to digital goods or digital
8 services that are sold to a customer by a pro-
9 vider of mobile telecommunications service that
10 is subject to being sourced under section 117 of
11 title 4, United States Code, or for which the
12 charges are billed to the customer by such pro-
13 vider, and delivered or transferred electronically
14 by means of such provider’s mobile tele-
15 communications service, the customer’s place of
16 primary use, as defined in section 124 of such
17 title;

18 (B) if subparagraph (A) does not apply,
19 and if the digital good or digital service is re-
20 ceived by the customer at a business location of
21 the seller, such business location;

22 (C) if neither subparagraph (A) nor sub-
23 paragraph (B) applies, and if the location where
24 the digital good or digital service is received by

1 the customer is known to the seller, such loca-
2 tion;

3 (D) if none of subparagraphs (A) through
4 (C) applies, the customer's address that is ei-
5 ther known to the seller or, if not known, ob-
6 tained by the seller during the consummation of
7 the transaction, including the address of the
8 customer's payment instrument if no other ad-
9 dress is available;

10 (E) if an address is neither known nor ob-
11 tained as provided in subparagraph (D), the ad-
12 dress of the seller from which the digital good
13 or digital service was sold; and

14 (F) notwithstanding subparagraphs (A)
15 through (E), for digital goods that are delivered
16 or transferred, or digital services that are pro-
17 vided, to a person other than the customer, in-
18 cluding advertising services, the location of de-
19 livery, transfer, or provision if known or, other-
20 wise, the customer's address determined under
21 subparagraph (D) or (E).

22 (3) DELIVERED OR TRANSFERRED ELECTRONI-
23 CALLY; PROVIDED ELECTRONICALLY.—The term
24 “delivered or transferred electronically” means deliv-
25 ered or transferred by means other than tangible

1 storage media, and the term “provided electroni-
2 cally” means provided remotely via electronic means.

3 (4) DIGITAL CODE.—The term “digital code”
4 means a code that conveys only the right to obtain
5 a single type of digital good or digital service.

6 (5) DIGITAL GOOD.—The term “digital good”
7 means any good or product that is delivered or
8 transferred electronically, including software, infor-
9 mation maintained in digital format, digital audio-
10 visual works, digital audio works, and digital books.

11 (6) DIGITAL SERVICE.—

12 (A) IN GENERAL.—The term “digital serv-
13 ice” means any service that is provided elec-
14 tronically, including the provision of remote ac-
15 cess to or use of a digital good.

16 (B) EXCEPTION.—

17 (i) IN GENERAL.—The term “digital
18 service” does not include telecommuni-
19 cations service, Internet access service, or
20 audio or video programming service.

21 (ii) AUDIO OR VIDEO PROGRAM-
22 MING.—The term “audio or video pro-
23 gramming” means programming provided
24 by, or generally considered comparable to

1 programming provided by, a radio or tele-
2 vision broadcast station.

3 (iii) VIDEO PROGRAMMING.—The term
4 “video programming” shall not include
5 interactive on-demand services (as defined
6 section 602(12) of the Communications
7 Act of 1934 (47 U.S.C. 522(12)), pay-per-
8 view services, or services generally consid-
9 ered comparable to such services regardless
10 of the technology used to provide such
11 services.

12 (7) DISCRIMINATORY TAX.—

13 (A) IN GENERAL.—The term “discrimina-
14 tory tax” means any tax imposed by a State or
15 local jurisdiction—

16 (i) on or with respect to the sale or
17 use of any digital good or digital service at
18 a higher rate than is generally imposed on
19 or with respect to the sale or use of tan-
20 gible personal property or of similar serv-
21 ices that are not provided electronically;

22 (ii) on or with respect to any seller of
23 digital goods or digital services at a higher
24 rate or by incorporating a broader tax base
25 than is generally imposed on or with re-

1 spect to sellers in transactions involving
2 tangible personal property or involving
3 similar services that are not provided elec-
4 tronically, except that this clause shall
5 apply only to the extent that the higher
6 rate or broader tax base is attributable to
7 the fact that such person sells digital goods
8 or digital services;

9 (iii) that is required to be collected
10 with respect to the sale or use of digital
11 goods or digital services by different sellers
12 or under other terms that are disadvanta-
13 geous to those applied in taxing the sale or
14 use of tangible personal property or of
15 similar services that are not provided elec-
16 tronically; or

17 (iv) on or with respect to any sepa-
18 rately stated amount that is charged by
19 the seller of a specific digital good or dig-
20 ital service, and is directly related to elec-
21 tronically delivering or transferring that
22 good or service, at a higher rate than is
23 generally imposed on or with respect to de-
24 livery charges, or shipping and handling
25 charges, on tangible personal property.

1 (13) APPLICATION.—For purposes of this
2 paragraph, all taxes, tax rates, exemptions, de-
3 ductions, credits, incentives, exclusions, and
4 other similar factors shall be taken into account
5 in determining whether a tax is a discrimina-
6 tory tax.

7 (8) GENERALLY IMPOSED.—A tax shall not be
8 considered “generally imposed” if it is imposed only
9 on specific services, specific industries or business
10 segments, or specific types of property.

11 (9) MULTIPLE TAX.—The term “multiple tax”
12 means any tax that is imposed on or with respect to
13 the sale or use of a digital good or a digital service
14 by a State or local jurisdiction, for which such State
15 or local jurisdiction gives no credit with respect to
16 a tax that was previously paid on or with respect to
17 the sale or use of such digital good or digital service
18 to another State or local jurisdiction, unless the ter-
19 ritorial limits of the jurisdiction imposing the earlier
20 tax and the jurisdiction imposing the later tax both
21 encompass the same tax address of the customer.

22 (10) PURCHASE FOR RESALE.—A digital good
23 or digital service is purchased for the purpose of re-
24 sale if such good or service is purchased for the pur-
25 pose of reselling it, or for using it as a component

1 part of or integration into another digital good or
2 digital service that is to be sold to another person,
3 and includes the purchase of a digital good or digital
4 service for further commercial broadcast, rebroad-
5 cast, streaming, restreaming, transmission, retrans-
6 mission, licensing, relicensing, reproduction, copying,
7 distribution, redistribution, or exhibition of the dig-
8 ital good or digital service, in whole or in part, to
9 another person.

10 (11) SALE AND PURCHASE.—The terms “sale”
11 and “purchase”, and all variations thereof, shall in-
12 clude lease, rent, and license, and corresponding
13 variations thereof.

14 (12) SELLER.—The term “seller” means a per-
15 son making sales of tangible personal property, dig-
16 ital goods, digital services, or other services, and
17 does not include a person that provides, on behalf of
18 another person, order taking, order fulfillment, bill-
19 ing, or electronic delivery or transfer service with re-
20 spect to the sale of a digital good or a digital serv-
21 ice.

22 (13) STATE OR LOCAL JURISDICTION.—The
23 term “State or local jurisdiction” means any of the
24 several States, the District of Columbia, any terri-
25 tory or possession of the United States, a political

1 subdivision of any State, territory, or possession, or
2 any governmental entity or person acting on behalf
3 of such State, territory, possession, or subdivision
4 and with the authority to assess, impose, levy, or
5 collect taxes.

6 (14) TAX.—The term “tax” means any charge
7 imposed by any State or local jurisdiction for the
8 purpose of generating revenues for governmental
9 purposes, including any tax, charge, or fee levied as
10 a fixed charge or measured by gross amounts
11 charged, regardless of whether such tax, charge, or
12 fee is imposed on the seller or the customer and re-
13 gardless of the terminology used to describe the tax,
14 charge, or fee. Such term does not include a tax on
15 or measured by net income or an ad valorem tax.

16 **SEC. 6. FEDERAL JURISDICTION.**

17 Notwithstanding section 1341 of title 28, United
18 States Code, and without regard to the amount in con-
19 troversy or citizenship of the parties, a district court of
20 the United States has jurisdiction, concurrent with other
21 jurisdiction of courts of the United States and the States,
22 to prevent a violation of this Act.

23 **SEC. 7. EFFECTIVE DATE; APPLICATION.**

24 (a) GENERAL RULE.—This Act shall take effect on
25 the date of the enactment of this Act.

1 (b) APPLICATION TO LIABILITIES AND PENDING
2 CASES.—Nothing in this Act shall affect liability for taxes
3 accrued and enforced before the date of the enactment of
4 this Act, or affect ongoing litigation relating to such taxes,
5 except as provided in section 4(d) of this Act.

6 **SEC. 8. SENSE OF CONGRESS.**

7 It is the sense of Congress that each State shall take
8 reasonable steps necessary to prevent multiple taxation of
9 digital goods and digital services in situations where a for-
10 eign country has imposed a tax on such goods or services.

11 **SEC. 9. SAVINGS PROVISION.**

12 If any provision or part of this Act is held to be in-
13 valid or unenforceable by a court of competent jurisdiction
14 for any reason, such holding shall not affect the validity
15 or enforceability of any other provision or part of this Act.

Resolution 2011 - 1 Digital Goods and Service Tax Prohibition

Background

The taxation of digital goods and services (or goods and services delivered electronically) is an emerging issue. The Digital Goods and Services Tax Fairness Act of 2011 (H.R. 1860 and S. 971) have been introduced in Congress; these bills would preempt state and local taxation of numerous transactions.

The rules in the bills differ from rules already established for these transactions in the Streamlined Sales Tax Agreement. The legislation grants advantages to large businesses over small in-state businesses. Further, the bills contain numerous technical deficiencies that include:

- Sourcing rules have many terms that are either not defined or are insufficiently defined;
- No nexus rules are provided to establish state tax jurisdiction; and
- Rules exempting “intermediaries” from having to collect taxes open tax avoidance opportunities.
- This legislation is particularly objectionable in that it restricts a state’s ability to impose tax on its own citizens on activity within its own borders.

As established through other resolutions, FTA strongly 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. FTA believes Congress should undertake an active program of consultation with states as it considers measures that would preempt state tax authority. Finally, states should actively pursue such uniformity and simplification measures as are necessary and effective to address concerns of administrative burden in complying with the tax laws of multiple states.

While federal preemption is generally to be resisted, 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) 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? (2) Does the proposed preemption address issues of simplification and complexity? (3) Can meaningful simplifications and uniformity be achieved through state action without preemption? (4) Would preemption disrupt state and local revenue flows and tax systems? (5) Would preemption cause similarly situated taxpayers to be taxed differently; specifically, does the proposal create advantages for multistate and multinational businesses over local business? (6) Does the preemption support sound tax policy? (7) Does the preemption create unknown or potential unintended consequences? (8) Have

state tax authorities and taxpayer representatives together agreed to a beneficial change in federal law?

The Digital Goods and Services Tax Fairness Act of 2011 fails all eight of these principles.

Policy

The FTA opposes The Digital Goods and Services Tax Fairness Act of 2011. 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 in the normal policy process. Passed by the membership during the annual business meeting on June 15, 2011.

Robert D. Atkinson
President and Founder
Information Technology and Innovation Foundation (ITIF)

Hearing on H.R. 1860, the “Digital Goods and Services Tax Fairness Act of 2011”

Before the
Subcommittee on Courts, Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives

May 23, 2011

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Chairman Coble, Ranking Member Cohen and members of the subcommittee, I appreciate the opportunity to discuss the importance of creating a fair tax system that eliminates multiple and discriminatory taxes on digital goods and services. I commend you for addressing this important issue, and I want to applaud Chairman Smith and Ranking Member Cohen for bringing this measure forward.

I am the president and founder of the Information Technology and Innovation Foundation (ITIF). ITIF is a nonpartisan research and educational institute whose mission is to formulate and promote public policies to advance technological innovation and productivity. Recognizing the vital role of technology in ensuring American prosperity, ITIF focuses on innovation, productivity, and digital economy issues.

Across the nation, state and local governments are increasingly imposing taxes on the sale of digital goods and services. Unless Congress creates a national framework to ensure consistency and fairness in the tax code, there is a risk that digital goods purchased and downloaded in one state will be taxed at higher rates than related physical goods or that digital goods will be taxed multiple times by different tax jurisdictions, such as the state government of the buyer, the state government of the seller, and the local government tax authorities. With thousands of different tax jurisdictions in the United States—each with their own definitions and tax rates—buyers and sellers face an increasingly complex and unfair tax system.

While states and localities may look to discriminatory or duplicative taxes on digital content as a way to create short-term gains in tax revenue, these policies discourage investment in the digital economy, increase the cost of doing business online, lower national productivity, and ultimately hurt businesses and consumers. Congress is wise to consider legislation such as the Digital Goods and Services Tax Fairness Act of 2011 that would eliminate unfair and discriminatory regulations that would tax digital goods differently than physical goods. Such legislation would recognize the importance of digital goods and services to the national economy and help ensure a fair, consistent and non-discriminatory tax system.

Government Should Encourage, Not Discourage, the Sale of Digital Goods and Services

Digital goods and services account for an important, and growing, role in the U.S. economy. Digital goods are goods that are delivered electronically; digital services are services provided electronically, including access to digital goods. This testimony is about taxation of digital goods and services, such as music tracks downloaded off of iTunes, not physical goods and services purchased online, such as CDs ordered off of Amazon.com.

The sale of digital goods, such as downloadable software, music, movies, games, and books, continues to increase. In 2010, for example, U.S. online retailers sold 1.17 billion digital music tracks totaling \$1.5 billion in revenue. Similarly, e-book sales in the United States reached \$1 billion and are expected to almost triple by 2015.¹ Amazon carries almost 1 million titles available for download on its Kindle e-book reader and has found that when it carries both a physical and digital edition of a book, it sells six Kindle books for every ten physical books.² On mobile devices, U.S. consumers downloaded almost 1.6 billion free and paid apps in 2010 generating approximately \$1.6 billion in paid app revenue.³

The growing digital goods and services economy has significant benefits for the United States. Dematerialization—using bits instead of atoms—allows digital activities to be much less energy-intensive and have a smaller impact on the environment than creating, moving, and storing physical goods. For example, the CO₂ emissions associated with purchasing a CD from a retail store is approximately 3200g, compared to only 400g for an album purchased and downloaded online.⁴ Downloading music or movies instead of purchasing them at a store eliminates many energy consuming activities such as driving to a store, shipping from the wholesaler to the retailer, and producing the physical media and media cases.

In addition, workers and consumers are benefiting from the increasingly digital U.S. economy. Among the 100 most popular websites in 2009, online-only companies comprised the overwhelming majority: 94 percent of the top web sites were for online-only companies versus only 6 percent were for “brick-and-clicks”.⁵ Most of these websites were for search, social networking, and entertainment sites. These sites receive billions of dollars in online advertising revenue and employ hundreds of thousands of employees. For example, in 2007, the top five search engines (Google, Yahoo!, AOL, Microsoft, and Ask.com) together employed close to

40,000 individuals and generated roughly \$30 billion in revenue.⁶ Yet employment figures do not fully capture the full value of non-retail Internet-only companies to the economy. These firms tend to have high revenue-to-employee ratios, meaning that they are able to create a disproportionate amount of value from their employees. For example, in 2007, the top five search engines generated \$790,000 worth of revenue per employee, far exceeding the revenue per employee ratios of the average firm.⁷

Digital content and services also cost less for consumers. Producing and distributing digital content can cost less for sellers, and these savings are passed on to consumers. For example, for books produced in digital form rather than in print, publishers can save by eliminating printing, storage, and shipping costs and reducing their design and marketing costs. Consumers have seen big savings: the average price of a hardback book is approximately \$26 compared to around \$13 for an e-book on the iPad or Kindle.⁸ Similarly consumers save on the purchase of digital music: the average price for a digital album is \$9.99 for a digital album on iTunes versus around \$14 for a CD.⁹ Since digital content costs less than the physical equivalent, some state and local governments may be tempted to impose higher taxes on these items.

Congress Should Not Let the Narrow Interests of States Outweigh the Broad Interests of the Nation

Across the nation, most states are facing a budget crisis as the recession has caused a steep decline in state revenue. Forty-eight of the fifty states faced a budget shortfall cumulatively totaling \$196 billion in 2010, or approximately 29 percent of overall state budgets.¹⁰ Not surprisingly, in the face of such fiscal woes, states are searching for new opportunities to increase state revenue and many have set their sights on the taxation of digital goods and services.

As shown in Figure 1, more than 20 states currently collect taxes on digital goods. These states have created these taxes either by statute or administrative changes to the tax code. Of these, 13 states have enacted sales tax statutes specifically to tax digital goods or services, including: Indiana, Kentucky, Mississippi, Nebraska, New Jersey, North Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, Wisconsin, and Wyoming.¹¹ At least four states—Minnesota, North Dakota, Ohio and Oklahoma—have made it clear that they do not subject intangible items, such as digital goods and services, to sales tax in their tax codes.¹²

Network externalities are the effects on a user of a product or service of others using the same or compatible products or services. Positive network externalities exist if the benefits are an increasing function of the number of other users. The classic example is telephone service, which becomes more valuable to a user if more people are connected. Indeed, telephone network externalities have long been recognized and have been a major rationale behind universal service policies. Similar network externalities exist with digital goods and services. In this case, as taxes increase the cost of digital goods and services, these price increases will lower demand and thus lower the supply of digital goods available to consumers and raise the price. It lowers the supply of digital goods because higher prices lower consumption which in turn lowers digital goods industry revenues. It raises prices because digital goods are characterized by extremely low marginal costs (e.g., the costs of providing one additional copy to a consumer). With fewer consumers, average costs must be higher to cover fixed costs of producing the product.

It is important to enact this legislation now while these state tax statutes are relatively nascent, as once states begin to create discriminatory or multiple tax laws for digital goods, Congress will find the situation increasingly difficult to remedy. For example, states may try to game the system by creating discriminatory or multiple tax laws that will be grandfathered in, giving them special tax advantages. We have seen similar problems in the past with state tax laws on Internet access.¹⁴

Policymakers Should Promote a Fair and Non-Discriminatory Tax System

Policymakers should avoid erecting unfair or unreasonable barriers to the growth of the Internet and the digital economy. The Digital Goods and Services Tax Fairness Act of 2011 would prevent states and local governments from jeopardizing our national interests in promoting a healthy digital economy to create a short-term boost in state and local tax revenue. The legislation does not compromise states' rights. States are still free to tax digital goods under the proposed legislation; however, state and local tax jurisdictions would adhere to a common framework which would prevent them from imposing multiple or discriminatory taxes on digital goods.

First, the proposed legislation would clarify which jurisdiction has the right to tax digital goods and services. Without clear guidelines, multiple tax authorities can impose taxes on a single transaction. Imagine the following scenario: a traveler from Houston downloads a movie in the Denver airport from Amazon.com, a company headquartered in Seattle. In this example, at least three states—Texas Colorado and Washington—all could claim that they have the right to tax this transaction. Resolving this dilemma fairly and consistently requires a national framework for “sourcing” the sale of digital goods and services (i.e. determining where the sale is taxable). The proposed legislation would clarify that a particular transaction is attributable only to a single physical address (and corresponding tax authority).

The Digital Goods and Services Tax Fairness Act does not address whether an out-of-state seller is required to collect sales tax. In 1992, the U.S. Supreme Court ruled in *Quill Corp. v. North Dakota* that states cannot require a retailer to collect sales and use taxes for in-state customers unless the retailer has “nexus”, e.g., a physical presence in their state.¹⁵ The Supreme Court reasoned that with over 6,000 different tax jurisdictions in the United States, taxes on out-of-state businesses “might unduly burden interstate commerce.”¹⁶ State and local governments would like to require out-of-state sellers to collect and remit sales taxes on e-commerce transactions (of both physical and digital goods). In an effort to gain Congressional approval for taxing out-of-state e-commerce sales, states have made a concerted effort to develop a streamlined taxing system. In 1998, the National Governors Association adopted a policy that expresses the willingness of states to simplify their sales taxes with the expectation that, in exchange, the federal government would provide these states with the authority to require larger out-of-state sellers, including Internet vendors, to collect sales taxes for the states. In November 2002, 44 states and the District of Columbia approved the Streamlined Sales and Use Tax Agreement (SSUTA), a framework for a simplified state sales and use tax system. The SSUTA includes uniform tax definitions, uniform and simpler exemption administration, rate simplification, state-level administration of all sales taxes, and uniform sourcing (e.g., where the sale is taxable).¹⁷ As of May 10, 2010, twenty-three states—comprising 33 percent of the country’s population—have passed SSUTA legislation and legislation was pending in at least 10 other states.¹⁸ Congress is correct to address the issue of nexus in separate legislation.¹⁹

Second, the proposed legislation would prohibit states from imposing discriminatory taxes on digital goods and services. This provision is needed to ensure that states do not impose protectionist taxes that limit e-commerce by unfairly raising the price of digital goods and services. Imposing higher taxes on digital goods—which are often consumed from out-of-state sellers—distorts the market by encouraging consumers to purchase physical goods (which are often consumed from in-state sellers and normally costs more than digital goods) instead of digital goods. This fear is not unwarranted. All states at one point or another have given in to pressure from brick-and-mortar businesses and have passed legislative or regulatory provisions that limit the right of consumers to purchase certain products and services online. For example, it is illegal in all 50 states for a consumer to purchase a car directly from the manufacturer, including over the Internet. States have also imposed restrictions on the ability of consumers to purchase contact lenses online. Such laws have been put in places in many states in response to the pressures from many in-state industries. The goal of public policy should not be to protect or insulate any business or industry from changes in the marketplace. Public policy should certainly focus on ensuring that individuals who lose their jobs have access to skills training and other assistance to transition into new jobs, but it should not try to erect barriers to protect existing businesses that may lose out to digital competition.

Conclusion

The Digital Goods and Services Tax Fairness Act of 2011 would set a national framework to ensure fair and equitable taxation of digital content by creating consistent rules for determining which jurisdiction has taxation authority, disallowing multiple and discriminatory taxes, creating consistent definitions, and ensuring that other taxes, such as those applied to telecommunications services, cannot be inappropriately extended to cover digital goods and services. By creating a fairer and more consistent tax system for digital goods, this legislation will help promote and sustain our growing digital economy.

Endnotes

1. James McQuivey, "eBooks Ready to Climb Past \$1 Billion," Forrester, November 8, 2010, http://blogs.forrester.com/james_mcquivey/10-11-08-ebooks_ready_to_climb_past_1_billion.
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