

Alert 10-170



House Introduces Bill Addressing State Taxation of Digital Products

On June 30, Rep. Rick Boucher (D-Va.) and Rep. Lamar Smith (R-Tex.) introduced the Digital Goods and Services Tax Fairness Act¹ ("Digital Fairness Act") in the U.S. House of Representatives. The bill, in large part, is designed to provide greater certainty and simplicity to the taxation of digital goods and services, and purports to ensure that digital products and services are not taxed more heavily than products bought in "brick and mortar" stores. If enacted, the Digital Fairness Act could radically alter the sales tax treatment of electronic commerce, and signal a significant increase in federal involvement in the sales and use tax arena.

The Digital Fairness Act would impose some important limits on the manner in which states can tax digital goods or services. The bill includes a prohibition on multiple or discriminatory state or local taxes with respect to digital goods or services. The bill defines "multiple tax" as any tax imposed on the transaction where no credit is given for comparable taxes paid to other states.² It further defines "discriminatory tax" to include a tax that is imposed by a jurisdiction on a digital good or service that is at a higher rate than is generally imposed on or with respect to the sale or use of tangible personal property or of similar services that are not delivered or transferred electronically.³ In addition, the bill would put a total prohibition on any state or local taxes on the sale or use of certain specified digital services—namely, digital medical services, digital education services, and digital energy management services.⁴

The bill also includes a provision that would bar states from imposing a tax on the sale or use of a digital product through the expansive interpretation of existing sales and use tax provisions. Since 2007, at least a dozen states have proposed or enacted legislation to impose tax on digital goods and services. Often, the tax rates imposed on digital goods are higher than those for tangible personal property. The limitation on expansive interpretation found in the bill essentially states that a general sales or use tax imposed on tangible personal property, telecommunications service, Internet access service, or audio or video programming service, cannot be interpreted (by regulation, administrative ruling, or otherwise) as being imposed on the sale or use of a digital good or service.⁵ This limit on expansive interpretation, if enacted, would put an end to the trend whereby states that do not have statutes that directly provide for the taxation of digital goods or services have been, nonetheless, taxing such goods and services by applying new, expansive definitions of tangible personal property. Thus, if enacted, the bill would require states wishing to tax digital goods and services to enact legislation specifically imposing such a tax.

The Digital Fairness Act also includes a single-sourcing provision that would prohibit states from taxing the sale or use of digital goods and services if the "tax address" of the purchaser is not located in the state. "Tax address" is defined through reference to a series of rules contained in the sourcing definitions of the Streamlined Sales and Use Tax Agreement and the Mobile Telecommunications Sourcing Act. This sourcing rule is intended to prevent the taxation of a single sale of a digital good or service by multiple jurisdictions. Also, the bill specifies that taxes are only to be imposed on the sale, use, or provision of digital goods made directly to a customer rather than on purchasers for resale. In this manner, the bill aims to levy tax upon only the end-user of the product.

It is also noteworthy that the bill includes provisions that would mandate increased federal government involvement in state sales and use tax issues, through the enforcement and interpretation of the Act. First, the Commerce and Treasury Departments would be permitted to promulgate rules interpreting the provisions of the Digital Fairness Act. Second, federal courts would be granted jurisdiction over cases alleging violations of the Digital Fairness Act.

The Digital Fairness Act is not the only recent foray by Congress into the state sales and use tax arena. The Main Street

Fairness Act⁶ ("MSFA") was introduced July 1 by Rep. Bill Delahunt (D-Mass.). The MSFA would require an Internet retailer to collect sales tax on a purchase irrespective of whether the retailer has physical presence in a customer's state. As drafted, this proposed legislation would apply only to those 23 states that have codified the Streamlined Sales and Use Tax Agreement as law. (Georgia has agreed to become the 24th member of the SSUTA, effective January 2011.) Notably, the MSFA, if enacted, would authorize the Streamlined Sales Tax Governing Board, the body that oversees the states' implementation of and compliance with the Streamlined Sales and Use Tax Agreement, to establish an annual exemption amount for small retailers.

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For more information on the Digital Fairness Act (H.R. 5649) or the MSFA (H.R. 5660), please contact one of the authors, or the Reed Smith attorney with whom you regularly work. For additional information on Reed Smith's State Tax Practice, visit www.reedsmith.com/statetax.

1. Digital Goods and Services Tax Fairness Act, H.R. 5649, 111th Cong. § 2(2), (2010).
2. Id. at § 6(9).
3. Id. at § 6(8)(a)-(b).
4. Id. at § 4(d).
5. See Id. at § 4(c).
6. Main Street Fairness Act, H.R. 5660, 111th Cong. § 4, (2010).

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