

July 1, 2010

Federal Framework for Digital Taxation Introduced - Don't (Unfairly) Tax My Download

On June 30, 2010, Rep. Rick Boucher (D-VA) and Rep. Smith (R-TX) introduced HR 5649, the Digital Goods and Services Tax Fairness Act of 2010 (the Act). The legislation, when enacted, will create a framework for state and local taxation of digital goods and services, and will prohibit multiple and discriminatory taxation of such goods and services. The purpose of the bill is to foster consistency in state sales and use taxation of electronically delivered goods, such as software, music, movies and books, and services such as cloud computing.

The bill does not seek to prohibit taxation of digital goods and services. Rather it would set guidelines for any state or local jurisdiction that sought to impose such tax providing certainty to the consumers of digital goods and services. By doing so, the bill would prevent multiple jurisdictions from each claiming the ability to tax the same transaction and would ensure that tax rates applicable to such transactions are not higher than the rate generally imposed on sales of goods.

The following is a summary of the bill's main provisions that are central to achieving its stated goal of creating "a consistent framework for taxation," preventing "multiple taxation," and providing "greater certainty and simplicity" so as to avoid impeding electronic commerce and the sale of digital goods and services.¹

Prohibition Against Multiple or Discriminatory Taxes

Similar to the Internet Tax Freedom Act (ITFA), which places a moratorium on multiple or discriminatory taxes on electronic commerce, the Act provides that "[n]o State or local jurisdiction shall impose multiple or discriminatory taxes on or with respect to the sale or use of digital goods or services."² While ITFA expires in 2014, the Act would impose a permanent prohibition on multiple or discriminatory taxes imposed upon digital goods and digital services.

Under the Act, "multiple tax" means any tax imposed on the transaction where no credit is given for comparable taxes paid to other states for the same transaction.³ A "discriminatory tax" is one which is imposed by a State or local jurisdiction "on or with respect to the sale or use of any digital good or service at a higher rate than is generally imposed on or with respect to the sale or use of other tangible personal property or involving similar services that are not delivered or transferred electronically."⁴ The bill also includes as discriminatory a tax on any *seller* of digital goods or services at a higher rate or "by incorporating a broader tax base" than that generally imposed on sellers of similar services or

¹ Digital Goods and Services Tax Fairness Act, H.R. 5649, 111th Cong. § 2(2). (2010).

² Digital Goods and Services Tax Fairness Act, H.R. 5649, 111th Cong. § 3 (2010).

³ *Id.* at § 6(9).

⁴ *Id.* at § 8(a),(b).

© 2010 Sutherland Asbill & Brennan LLP. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

transactions involving tangible personal property, but only “to the extent that the higher rate or broader tax base is attributable to the fact that such person sells digital goods or digital services.”

Sutherland Observation: Since 2007, 12 states have moved legislation to impose taxes on digital goods and services. Of these, no two approaches have been the same. Complicating matters further are state efforts to tax digital goods and services under historic communications tax provisions – often at rates significantly higher than the rate imposed on the sale of tangible goods. Local jurisdictions are also moving to impose taxes on the digital world. Mounting budget pressure has and will continue to lead these jurisdictions to tax digital goods and services at rates greater than those imposed on tangible goods.

Single Sourcing Regime

The Act provides a single set of rules regarding which state or local jurisdiction may impose a tax on the sale of a digital good or service. This set of rules is based on determining the customer’s “tax address” and limiting any imposition of tax to the state or locality that encompasses that tax address. “Tax address” is defined in a series of default rules tied to the sourcing provisions of the Mobile Telecommunications Sourcing Act and the Streamlined Sales and Use Tax Agreement. These rules protect vendors of digital goods and services from claims that a single transaction is subject to tax in more than one jurisdiction.

Clarified Treatment of Bundled Goods and Services

Section 5 of the proposed bill establishes a bundling rule for tax treatment of bundled digital goods or digital services. Where charges for digital goods or services are aggregated with charges for other goods and services, and are not separately stated, the tax on the digital goods and services may be applied at the same rate and basis as the other goods and services unless the seller can reasonably identify a separate charge for the digital goods or services from its books and records kept in the regular course of business.

Eliminates Retroactive Imposition by Regulation or Administrative Ruling

An important feature of this bill is section 4(c), which limits administrative interpretation of tax laws as a means of taxing digital goods and services. This provision is aimed at limiting states’ the ability of states to rely on administrative proclamations to declare that digital goods and services are taxable as tangible personal property where there is no statutory authority for that position. The protection does not apply with respect to judicial determinations made prior to June 30, 2010, the date of introduction of this bill in the House. Thus, state and local tax agencies will be prohibited from declaring that digital goods are taxable as tangible personal property without specific legislative authority.

Sutherland Observation: At least 11 states currently take the position that digital content is taxable as tangible personal property even though their statutes provide no authority for this position. These states have surprised vendors on audit or have coerced companies to collect tax in an effort to avoid out-of-pocket liability. The legislation would prohibit taxation by administrative determination – instead requiring that a state’s digital tax policy be set by the state legislature.

Prohibits Taxes on Digital Medical, Educational, or Energy Management Services

In recognition of the critical role that medical, educational, and energy management digital services will play in future economic growth, these products are exempt from all state and local taxes. The bill includes a definition of each of these services and exempts them from state and local tax.

Taxation Limited to End Users

Taxes may only be imposed upon the sale, use, or provision of digital goods made directly to a *customer*, which is defined as a person purchases a digital good or service for a purpose other than resale. This provision is intended to eliminate the “pyramiding” of taxes on a digital good at various points in its commerce stream. Without this protection, digital business inputs are subject to tax in some states, resulting in the same digital good being taxed more than once.

Federal Jurisdiction Expressly Granted

The proposed legislation grants jurisdiction to federal district courts, regardless of the citizenship of the parties or the amount in controversy, to hear any claim of violation of any provision of the proposed statute.

Sutherland Observation: As states struggle to address growing budget shortfalls, there will be continued pressure to expand the transaction tax base to digital goods and digital services. Establishing a national framework for taxation of digital goods and services will facilitate rational taxation and prevent such goods and services from being subject to discriminatory taxation.



If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Michele Borens	202.383.0936	michele.borens@sutherland.com
Jeffrey A. Friedman	202.383.0718	jeff.friedman@sutherland.com
Stephen P. Kranz	202.383.0267	steve.kranz@sutherland.com
Marc A. Simonetti	212.389.5015	marc.simonetti@sutherland.com
Eric S. Tresh	404.853.8579	eric.tresh@sutherland.com
W. Scott Wright	404.853.8374	scott.wright@sutherland.com
Diann L. Smith	212.389.5016	diann.smith@sutherland.com
Zachary T. Atkins	404.853.8312	zachary.atkins@sutherland.com
Michael L. Colavito	202.383.0870	mike.colavito@sutherland.com
Miranda K. Davis	404.853.8242	miranda.davis@sutherland.com
Jonathan A. Feldman	404.853.8189	jonathan.feldman@sutherland.com
Lisbeth A. Freeman	202.383.0251	beth.freeman@sutherland.com
Natanyah Ganz	202.383.0275	natanyah.ganz@sutherland.com
Charles C. Kearns	202.383.0864	charlie.kearns@sutherland.com

SUTHERLAND

Jessica L. Kerner	212.389.5009	jessica.kerner@sutherland.com
Pilar Mata	202.383.0116	pilar.mata@sutherland.com
Lindsey L. Napier	404.853.8304	lindsey.napier@sutherland.com
J. Page Scully	202.383.0224	page.scully@sutherland.com
Melissa J. Smith	202.383.0840	melissa.smith@sutherland.com
Maria M. Todorova	404.853.8214	maria.todorova@sutherland.com
Mark W. Yopp	212.389.5028	mark.yopp@sutherland.com