

DIGITAL GOODS AND SERVICES TAX FAIRNESS ACT OF 2011

HEARING
BEFORE THE
SUBCOMMITTEE ON COURTS, COMMERCIAL
AND ADMINISTRATIVE LAW
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
ONE HUNDRED TWELFTH CONGRESS
FIRST SESSION
ON
H.R. 1860
MAY 23, 2011
Serial No. 112-137

Printed for the use of the Committee on the Judiciary



Available via the World Wide Web: <http://judiciary.house.gov>

U.S. GOVERNMENT PRINTING OFFICE

66-538 PDF

WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
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DIGITAL GOODS AND SERVICES TAX FAIRNESS ACT OF 2011

MONDAY, MAY 23, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS,
COMMERCIAL AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 4:05 p.m., in room 2141, Rayburn House Office Building, the Honorable Dennis Ross (acting Chairman of the Subcommittee) presiding.

Present: Representatives Ross, Cohen, and Johnson.

Staff Present: (Majority) Daniel Flores, Subcommittee Chief Counsel; Travis Norton, Counsel; Johnny Mautz, Counsel; Allison Rose, Professional Staff Member; Ashley Lewis, Clerk; John Coleman, Intern; (Minority) James Park, Subcommittee Chief Counsel; and Norberto Salinas, Counsel.

Mr. ROSS. Good afternoon. The Subcommittee will come to order.

Pursuant to this notice, this is a legislative hearing on H.R. 1860, the “Digital Goods and Services Tax Fairness Act of 2011.”

Before we begin, I would like to pass along Chairman Coble’s regret that he could not be here today. And, also, the Chairman of the full Committee, Lamar Smith, intended to be here and express his strong support for the bill, but his flight back from Texas has delayed him.

With that, I will recognize myself for an opening statement.

Digital goods and services are increasingly important in our modern American economy. The digital platform not only makes consumption of entertainment media more convenient for consumers, but it also improves the efficiency of society as a whole. Data no longer need to be printed out and mailed to another location for processing. They can be delivered through cloud computing or e-mail. And more students have access to a college education by logging into remote classrooms hosted on Web-based applications.

Advances in digital technology have also resulted in advances in the mobile telecommunication industry. Rather than carry around a wad of plastic supermarket value cards in your wallet, you can now download an inexpensive application to your smart phone that will store all of your cards and make them available for scanning upon the touch of a button.

A December, 2010, study revealed that consumers prefer to receive breaking news via smartphone more than on any other platform, including the Internet and television.

State governments are generally free to set their own tax policy, but they may not do so in a manner that burdens interstate commerce. Transactions involving digital goods and services are unique. Imagine you are sitting at Dulles Airport in Virginia waiting for a flight back to Florida. You download a music file from Apple, which is headquartered in California. The music is sent to you via a server in Oklahoma. Which of these States should be permitted to tax this transaction? Without a clear national rule, all four States may attempt to tax the transaction.

There is already some confusion among States concerning where the sale of digital goods takes place. Every State has an incentive to claim that the sale took place in its borders and therefore subject that transaction to its own sales tax. As a result, some transactions risk being taxed several times over. Confusing tax policies not only gets passed on to the consumers in the form of higher prices, but it also slows down innovation. A Federal framework for taxation of digital goods will relieve the potential burden on interstate commercial that a patchwork of State laws may impose.

I am pleased to be a co-sponsor of the Digital Goods and Services Tax Fairness Act. I look forward to hearing testimony from the witnesses today concerning this important legislation.

[The bill, H.R. 1860, follows:]

112TH CONGRESS
1ST SESSION

H. R. 1860

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

IN THE HOUSE OF REPRESENTATIVES

MAY 12, 2011

Mr. SMITH of Texas (for himself, Mr. COHEN, Mr. COBLE, and Mr. HASTINGS of Florida) introduced the following bill; which was referred to the Committee on the Judiciary

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
10 and Congress’ plenary power under article I, section 8,

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

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

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

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

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

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

22 (c) **SOURCING LIMITATION.**—

23 (1) **IN GENERAL.**—Taxes on or with respect to
24 the sale of digital goods or digital services may be
25 imposed only by the State and local jurisdictions

1 whose territorial limits encompass the customer's tax
2 address.

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

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

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

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

11 (e) TREATMENT OF BUNDLED GOODS AND SERV-
12 ICES.—

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

24 (2) CHARGES FOR DELIVERY AND TRANS-
25 PORT.—If the charge for a digital good or digital

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

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

15 **SEC. 5. DEFINITIONS.**

16 In this Act:

17 (1) CUSTOMER.—

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

22 (B) END USER.—For the purpose of deter-
23 mining a place of primary use under paragraph
24 (2)(A), the term “customer” means the “end
25 user” (as such term is used in section 124 of

1 title 4, United States Code) of the purchased
2 digital good or digital service.

3 (2) CUSTOMER'S TAX ADDRESS.—The term
4 “customer's tax address” means—

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

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

20 (C) if neither subparagraph (A) nor sub-
21 paragraph (B) applies, and if the location where
22 the digital good or digital service is received by
23 the customer is known to the seller, such loca-
24 tion;

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

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

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

20 (3) DELIVERED OR TRANSFERRED ELECTRONI-
21 CALLY; PROVIDED ELECTRONICALLY.—The term
22 “delivered or transferred electronically” means deliv-
23 ered or transferred by means other than tangible
24 storage media, and the term “provided electroni-
25 cally” means provided remotely via electronic means.

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

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

9 (6) DIGITAL SERVICE.—

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

14 (B) EXCEPTION.—

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

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

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

10 (7) DISCRIMINATORY TAX.—

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

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

20 (ii) on or with respect to any seller of
21 digital goods or digital services at a higher
22 rate or by incorporating a broader tax base
23 than is generally imposed on or with re-
24 spect to sellers in transactions involving
25 tangible personal property or involving

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

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

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

24 (B) APPLICATION.—For purposes of this
25 paragraph, all taxes, tax rates, exemptions, de-

1 ductions, credits, incentives, exclusions, and
2 other similar factors shall be taken into account
3 in determining whether a tax is a discrimina-
4 tory tax.

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

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

20 (10) PURCHASE FOR RESALE.—A digital good
21 or digital service is purchased for the purpose of re-
22 sale if such good or service is purchased for the pur-
23 pose of reselling it, or for using it as a component
24 part of or integration into another digital good or
25 digital service that is to be sold to another person,

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

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

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

20 (13) STATE OR LOCAL JURISDICTION.—The
21 term “State or local jurisdiction” means any of the
22 several States, the District of Columbia, any terri-
23 tory or possession of the United States, a political
24 subdivision of any State, territory, or possession, or
25 any governmental entity or person acting on behalf

1 of such State, territory, possession, or subdivision
2 and with the authority to assess, impose, levy, or
3 collect taxes.

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

14 **SEC. 6. FEDERAL JURISDICTION.**

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

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

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

24 (b) APPLICATION TO LIABILITIES AND PENDING
25 CASES.—Nothing in this Act shall affect liability for taxes

1 accrued and enforced before the date of the enactment of
2 this Act, or affect ongoing litigation relating to such taxes,
3 except as provided in section 4(d) of this Act.

4 **SEC. 8. SENSE OF CONGRESS.**

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

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

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

○

Mr. ROSS. I will recognize the Ranking Member from Tennessee, Mr. Cohen, for an opening statement.

Mr. COHEN. Thank you, Chairman Ross. I am pleased to be here, especially as this particular subject matter is one that I have worked on in the past and look forward to working with Chairman Smith and see it come to fruition this year.

Since I have become a Member of Congress, I have consistently favored easing State and local tax burdens that threaten to impede consumers' access to the digital economy. I have supported making permanent prohibition on discriminatory State and local Internet access taxes and have backed a temporary moratorium on discriminatory State and local taxation of wireless communication services.

H.R. 1860 is of a piece with these other measures. It is similar. This legislation, of which I am the lead Democratic co-sponsor, creates a single national framework to govern the taxation of digital commerce by State and local jurisdictions, limiting inconsistency and confusion for consumers and business. Importantly, the Act prohibits State and local jurisdictions from imposing multiple or discriminatory taxes on the sale or use of digital goods and services, making sure those digital goods and services are not taxed differently than other forms of goods and services. This prohibition is helpful in ensuring that consumers, particularly low-income consumers, have access to innovative digital goods and services.

Under the framework established under H.R. 1860, State and local jurisdictions can only impose taxes on retail sales of digital goods or services and limit those taxes to a customer or a seller. This ensures that digital goods and services are not taxed during multiple stages of the transaction, particularly for instruments that merely facilitate the sale itself.

The Act also determines the appropriate taxing jurisdiction by limiting taxing authority to the jurisdiction encompassing the consumer's or customer's tax address. This will ensure the customer is not taxed by multiple States. And multiple States like to do that, but that is not necessarily good policy, nor is it fair to the consumer.

As I have said in previous hearings that the Subcommittee has held on State taxation issues, I am not unmindful of the needs of State and local governments to have authority and that there is a certain regard we have to pay in Congress to intervening State and local tax powers because State and local governments need to provide goods and services. But we should intervene when it is just and do it sparingly, and this is one of those times we should do that. This broader national policy overrides the traditional deference that Congress gives to State and local governments regarding their taxation policies.

The Constitution permits Congress to intervene under these circumstances. I can think of no better example when that is the case with respect to the multiple discriminatory and disparate tax treatment of digital goods and services of a fast-moving, borderless marketplace, and it crosses State and national boundaries thousands and perhaps millions of times a day.

This bill, H.R. 1860, addresses a clear need for a uniform national framework for determining which jurisdictions can tax digital goods and services and under which circumstances. I applaud

our Chairman, the distinguished Chairman Lamar Smith, for introducing H.R. 1860 and for the leadership he has shown on this issue, going back to the previous Congress; and I thank the Subcommittee acting Chairman, Mr. Ross, and Subcommittee Chairman, Mr. Coble, for their co-sponsorships of the bill.

I believe I am correct, Mr. Ross, you are co-chairman?

Mr. ROSS. Today I am.

Mr. COHEN. You are going to be. The doors to the church are open.

I urge my colleagues to support this legislation.

I yield back the remainder of my time.

Mr. ROSS. Thank you, Mr. Cohen.

Without objection, other Members' opening statements will be made part of the record.

[The prepared statement of Mr. Smith follows:]

Statement of Judiciary Committee Chairman Lamar Smith
Subcommittee on Courts, Commercial and Administrative Law
Hearing on "H.R. 1860: the Digital Goods and Services
Tax Fairness Act of 2011"
Monday, May 23, 2011, at 4:00 p.m.
Final (TN)

Daniel Webster once said that "an unlimited power to tax involves, necessarily, the power to destroy."

Government needs revenue to fund services necessary to protect life, liberty and property. But state tax policy should not destroy innovation and creativity.

Today we live in a digital world. Twenty years ago, if I wanted to listen to a Lyle Lovett song, I would have to go to the local record store downtown to buy a vinyl album to play on my turntable. Today, I can sit in the comfort of my living room and download a music file to play on my computer.

The trend toward digital goods extends beyond music. In 2011, Amazon announced that for the first time it sold more e-books over its Kindle platform than hardcover books, and it expects that trend to continue.

Even services are becoming digitized. More and more consumers and small businesses are using cloud computing to give employees access to data from anywhere in the world.

In addition to consumer convenience, digital goods and services benefit commerce by improving efficiency. Digitization has allowed small businesses to expand their markets beyond local communities without expensive transportation costs.

Digital goods involve little to no reproduction costs so they are less expensive than their tangible counterparts. And downloadable music files have a much lighter carbon footprint than the vinyl records of days past.

The fact that consumers increasingly prefer to consume goods and services in digital rather than tangible form should not prompt states to impose unfair taxes. State and local sales taxes should apply equally to goods or services regardless of the form in which they are consumed.

Unfortunately, some states have begun taxing digital goods at a higher effective tax rate than their tangible counterparts. Such policies hurt consumers and stifle innovation.

Earlier this month I introduced the Digital Goods and Services Tax Fairness Act of 2011 with Mr. Cohen, the Ranking Member of this Subcommittee.

The bill prohibits states from imposing a higher tax on digital goods and services than they impose on tangible goods and services. It also provides a uniform framework for determining what state may tax a transaction involving digital goods.

This legislation is consistent with the principles of the Internet Tax Freedom Act, which prohibits multiple or discriminatory taxation on e-commerce.

I am concerned that without a federal guidepost, states will impose unduly burdensome and confusing taxes on digital goods that will put American innovation at a competitive disadvantage relative to the rest of the world.

I look forward to working with Mr. Cohen to enact this important legislation.

#

Mr. ROSS. At this time, I would like to invite our panel to be seated and I will introduce you, after which we will allow you 5 minutes to summarize your testimony before we go into questions.

With us today is Mr. Rob Atkinson. He is the president and founder of Information Technology & Innovation Foundation, in Washington, D.C. He is the author of the forthcoming book, *The Global Race for Innovation Advantage and Why the U.S. is Falling Behind*. He has an extensive background in technology policy.

Before coming to ITIF, Mr. Atkinson was vice-president of the Progressive Policy Institute and director of the Progressive Policy Institute's Technology and New Economy Project. While at PPI, he wrote numerous research memorandum on technology and innovation policy, including e-commerce and innovation economics.

Our next witness is Mr. Russ Brubaker. He currently serves as Tax Policy Advisor to the Washington State Department of Revenue, where he has served for over 25 years in various tax administration positions. Notably, from 1992 to 2006, he served as the assistant director of the Legislation and Policy Division, a capacity in which Mr. Brubaker drafted bills and advised State officials on matters of tax policy. He is scheduled to be the next president of the Streamlined Sales Tax Governing Board.

Mr. Brubaker holds bachelors degrees in Political Science and English from Washington University and a masters in English from the University of Rochester.

Our third witness is Mr. Jim Eads. He is director of Public Affairs for Ryan, LLC, a tax services firm with a large transaction tax practice in the United States and Canada. He recently completed 2 years of service as the executive director of the Federation of Tax Administrators, where he worked with and represented the tax agencies of the 50 States, New York City, and the District of Columbia. His career includes over 35 years in State tax work and tenure in the private sector.

In addition, he has taught State tax law as an adjunct professor at the University of New Mexico School of Law. He holds a bachelor of science degree in business administration and a J.D. From the University of Arkansas.

I wish to welcome each of you. Each of the witnesses' written statements will be entered into the record in its entirety.

I ask that the witnesses summarize each of your testimony in 5 minutes or less. To help you stay within the time line, there is a timing light on your table. When the light switches from green to yellow, you will have 1 minute to conclude your testimony. When the light turns red, your 5 minutes has expired.

After the witnesses have testified, each Member will have 5 minutes to question the witnesses concerning their testimony.

With that, I now recognize our first witness, Mr. Atkinson. You are recognize for 5 minutes.

TESTIMONY OF ROBERT D. ATKINSON, PRESIDENT, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION, WASHINGTON, DC

Mr. ATKINSON. Thank you, Chairman Ross, Ranking Member Cohen. I appreciate the opportunity to come before you today to

talk about the importance of a creating a fair tax system for digital goods and services.

While States may look to discriminatory and duplicative taxes on digital content to create short-term gains in revenues, these policies would discourage investment in the digital economy, they would increase the cost of doing business online, they would lower national productivity, and they would ultimately hurt businesses and consumers. That is why we believe Congress is wise to consider legislation such as the Digital Goods and Services Tax Fairness Act.

When we look at the trends in digital goods, we see that they are growing dramatically. In 2010, there were almost

1.2 billion downloads of digital music tracks in the U.S., totaling \$1.5 billion in revenue. E-books sales have reached a billion dollars and are expected to be \$3 billion by the year 2015. These are important innovations that are driving important benefits to the U.S. Economy. One benefit is energy intensity. Getting a digital good online like a book consumes—or a CD—consumes about eight times less energy than getting the similar good going to the store and buying it.

Not only that, but consumers can save considerable amounts of money by consuming digital goods. Just look at the price of a typical hardback book, which is \$26. You can buy that same book as a digital book on an iPad or a Kindle for normally around just half of that—\$13.

So this is an important set of developments that are going to benefit U.S. consumers, and yet we shouldn't let the narrow interest of States override the national interests. And a State who wants to tax digital goods on a discriminatory basis or a multiple basis, they get all the financial benefit of that. In other words, they get more tax revenues. But the overall U.S. economy suffers the cost.

And the reason for that is because of what economists call network effects. The digital goods economy is not simply like a widget economy. If there are fewer digital goods consumed because of high taxes—and it is pretty clear the evidence shows that higher taxes would lead to less consumption of these—this does two things, in essence. One is, it lowers the demand for digital devices—let's say iPads or Kindles or devices of broadband—that people are going to use to consume those. But the other thing it would do, it would raise the price of digital goods; and the reason for that is because the marginal cost of digital goods are quite low. You spend a lot of money as a company building the digital good, creating it; and then selling the next copy is quite low. So if you are getting fewer sales, that means that you are getting less revenue overall in which to amortize your cost. Therefore, you have to raise prices on other consumers because of that. So, therefore, it is important that Congress act on this.

And, in fact, in the past we have seen States that have discriminatory taxes on digital activities. For example, there are many, many States now that have discriminatory taxes on Internet access. I am not talking about sales taxes on goods. I am talking about just Internet access. And I testified before this Committee I think perhaps 2 years ago on discriminatory wireless taxes. We see

many States have very, very high taxes on wireless access, much, much higher their sales tax.

So States can do this. They have shown they have done this in the past. And there is a particular I think reason why States might do this today, is that digital goods normally are consumed from outside the State.

I don't know, by the way, if there is a clock. I don't see a red light, green light.

Mr. ROSS. There is not one up there, is there? Then I will let you know.

Mr. ATKINSON. I guess I can talk as long as I want.

Mr. ROSS. You have a minute and fifteen seconds.

Mr. ATKINSON. Thank you. So I will wrap up.

One of the reasons I think States will have an incentive to do this is that, normally, a consumer will consume a digital good from anywhere in the country—in fact, anywhere in the world; and States might want to have higher taxes there so they incent their consumers to buy from local bricks and mortar companies.

Right now, States have a long and I would say sordid tradition of imposing protectionist laws on e-commerce. Right now, it is illegal in all 50 States to buy a car from the automobile producer. So while we can go online and buy a computer from Dell or HP, we can't go online and buy a car from General Motors, although we can do that in other countries. If you are in Brazil, you can go online and buy a car from General Motors, but you can't in this country because car dealers have gone to State legislators and they have been able to pass discriminatory protectionist laws.

So I think we have seen very clear evidence that States are willing to do these things that harm the overall digital economy; and, therefore, that is why we support this legislation that would not prohibit States from putting taxes on but clearly making sure the taxes are not discriminatory and not duplicative.

Thank you very much.

[The prepared statement of Mr. Atkinson follows:]

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

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



Figure 1: States Taxing Digital Goods, 2010

States and local governments that choose to tax digital content should not see this as a potential windfall for their tax bases. Tax rates on digital content should be equal to taxes on physical goods sales. State and local governments may argue that tax rates should be *higher* than on non-digital goods because digital goods cost less. Or they might argue that without a higher tax rate states might lose revenue. But this logic is fundamentally flawed. As agricultural productivity soared over the last fifty years and food prices have declined, states did not assess higher taxes on food in order to make up for lower tax revenues on food. If tax policy penalizes high-productivity industries, overall productivity and U.S. standards of living will increase more slowly.

Indeed, taxing digital goods increases the cost of online commerce and decreases the value of the Internet economy in the United States. The Internet economy is currently estimated to contribute approximately \$300 billion annually, or around 2 percent of GDP.¹³ States could impose discriminatory taxes because there is an asymmetrical distribution between the costs and benefits of taxes on digital goods. When states tax digital goods, they receive all of the financial benefit of the tax, but, because of network externalities, the nation as a whole suffers the net social cost of more expensive digital content and services.

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.

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Mr. ROSS. Thank you, Mr. Atkinson.
Mr. Brubaker, you are recognized for 5 minutes for an opening.

TESTIMONY OF RUSS BRUBAKER, NATIONAL TAX POLICY ADVISOR, WASHINGTON DEPARTMENT OF REVENUE, OLYMPIA, WA, ON BEHALF OF THE FEDERATION OF TAX ADMINISTRATORS

Mr. BRUBAKER. Chairman Ross, thank you for the opportunity to address the Subcommittee concerning the Digital Goods and Services Tax Fairness Act of 2011.

I am Russ Brubaker, testifying on behalf of the Federation of Tax Administrators. FTA's members are the Departments of Revenue in each of the 50 States, New York City, and the District of Columbia.

FTA strongly opposes many of the provisions in H.R. 1860. This legislation would create a large revenue loss for States and local governments. As structured, it would also create a major competitive sales advantage for large out-of-State businesses that sell goods and services

online. They will often have an opportunity to restructure their way out of tax, an opportunity most small businesses will not have.

The legislation will cause extensive litigation in Federal courts that will go on for years. Small businesses, whether Main Street shops or digital startups, are unlikely to have the resources to go to Federal court over a State tax matter.

FTA recognizes that Congress has an interest in making sure that there are no real impediments to interstate commerce. Current State tax law in this area does not create any. Digital goods and services are not even included in most State tax systems. The digital goods and services taxed by most States that tax them are the familiar books, videos, and music. This bill prohibits or preempts perfectly legitimate State tax authority. Intermediary provisions mean online travel companies will be agents, rather than sellers. They will not collect any hotel taxes. Many other intermediaries, often the only logical collectors of a tax, will not have to do so, and there will be no recourse to the seller.

Resale provisions would prevent application of my State's business and occupation tax when digital goods and services are licensed, even though no discriminatory or multiple taxes are imposed on these transactions.

Origin sourcing provisions mean banking services provided online by remote sellers could escape taxation. The same kinds of services provided by small instate banks would be subject to tax.

Discriminatory or multiple taxes are vaguely defined. We will be fighting for years over what those terms include.

We have been told in other testimony that the Mobile Telecommunications Sourcing Act is a good model for State and business cooperation. We agree. We agree it is a good model because there was a strong partnership between businesses and the States in developing it. There has been no such partnership here.

We do have models for such partnerships on digital goods and services. Within the Streamlined Sales and Use Tax Agreement, business worked with the States to adopt definitions and sourcing rules and bundling rules that the member States would be required to use in taxing these products and services.

Because we agreed to the changes business wanted, my State had to adopt a new imposition statute; and, as you know, adopting new tax impositions is not easy. Starting in 2007, the Washington

Department of Revenue staffed an intensive year-and-a-half study, legislatively mandated, with a committee of legislators, business, and government stakeholders and subject matter experts. Initial legislation was run in 2009, followed by the anticipated clarifying legislation the next year.

We continue to work with stakeholders by making refinements to the implementing rules and tax advisories. As we have done that, we have held no one liable for back taxes in unsettled areas where guidance is not yet available.

Ironically, H.R. 1860, will undo or put at risk much of that cooperative work. Definitions, sourcing rules, and bundling rules in this bill are different in key ways from what 21 full-member streamlined States have agreed to.

Another key difference, States and businesses participating in streamlined long ago agreed that canned software should be treated as tangible personal property, regardless of the manner of delivery. This bill would treat it as a digital good if delivered by electronic means. Neither the software change nor the prohibition on my State's business tax addresses multiple or discriminatory taxation of digital products and services, but they certainly do impinge on State sovereignty.

Finally, I want to address the undocumented fears that are being raised. We have not been provided actual evidence of significant discriminatory and multiple taxation of digital goods and services. Tax administrators, at least the ones I have come to know across the country, approach the taxation of digital goods and services with great caution. They know there is much to understand, and they have absorbed the lessons of the Internet Tax Freedom Act.

Mr. Chairman, that concludes my testimony. Thank you again for the opportunity to appear before the Subcommittee.

[The prepared statement of Mr. Brubaker follows:]

STATEMENT
OF
RUSS BRUBAKER
TAX POLICY ADVISOR
WASHINGTON DEPARTMENT OF REVENUE

ON BEHALF OF
THE FEDERATION OF TAX ADMINISTRATORS

BEFORE THE

SUBCOMMITTEE ON COURTS, COMMERCIAL AND
ADMINISTRATIVE LAW
OF THE COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES
ON
THE DIGITAL GOODS AND SERVICES TAX FAIRNESS ACT OF 2011

MAY 23, 2011

Introduction

Chairman Coble, Vice Chairman Gowdy, Ranking Member Cohen and members of the Subcommittee, thank you for the opportunity to address the Subcommittee concerning The Digital Goods and Services Tax Fairness Act of 2011 (H.R. 1860). I am Russ Brubaker, Tax Policy Advisor for the Washington Department of Revenue. Today, I am testifying on behalf of the Federation of Tax Administrators (FTA). FTA is an association of the tax administration agencies in each of the 50 States, the District of Columbia, and New York City.

Summary

FTA strongly opposes H.R. 1860 because the bill would create a permanently privileged category of sellers who sell goods and services delivered, transferred, or provided through electronic means. The bill does this by prohibiting or “preempting” taxes on:

- Very broadly defined sales of digital goods and services, designated as “purchases for resale,”
- Sales of digital goods and services if the tax is imposed on sales where the seller resides, (i.e. “origin” basis taxes) without providing remote collection authority,
- Sales of digital goods and services that are subject to specified rates of tax that are incorrectly characterized as “discriminatory” or “multiple” taxes, and

- Sales of digital goods and services by certain intermediaries including fulfillment companies, billing or electronic transfer service companies.

FTA recognizes that Congress has an interest in making sure that there are no real impediments to interstate commerce. Current state tax law, however, creates no such impediments. There is virtually no evidence that states are imposing taxes that discriminate against sales of digital goods and services or that the states are imposing multiple taxation on these items. Rather, such goods and services have been omitted under most state tax systems in years past, while similar goods, and only selected services, delivered through traditional means have been taxed. This bill establishes a Federal framework for the state taxation of digital goods and service. There simply is no genuine need that would warrant this extensive Federal legislation that reaches to the very limits of the Commerce Clause itself, effectively imposing limits on the taxation of purely local activity.

Because terms such as “resale” and “discriminatory” are both extremely broad and only vaguely defined in the bill, and because there is little room for them to be further defined through authoritative administrative guidance, the bill will inevitably result in expensive open-ended litigation that will prevent state tax collections for years and prevent authoritative guidance for businesses on their tax obligations. The bill will also interfere with the ability of state and local governments to develop equitable tax systems that match new sales and marketing techniques and will have negative fiscal impacts for these jurisdictions.

The bill, unlike other Congressional preemptive state tax legislation, is retroactive. Congress would be breaking new ground by authorizing the invalidation of existing state taxes.

Finally, digital goods and services represent a developing area of commerce. Where this industry is going and how it will develop is not yet well enough understood, even by the participants of this industry. Any kind of preemption at this time and of this type is both unwise and dangerous. This bill would establish immutable rules for digital goods and services without any real understanding of the implications of how these new regulatory rules will impact the states or the economic decisions of businesses providing these digital products. This is a complex and difficult area and the only way to address state taxation in an effective way is for the business community to work with the states to create a fair and mutually acceptable tax model that is both responsive to the needs of states and business and allows for flexibility in the future. Moreover, there are acceptable existing forums for this type of cooperation and even existing efforts to address some the issues included in this bill.

There Is No Multiple Taxation Under Current Law

Simply stated, there is currently little issue with multiple taxation on sales of digital goods or services that burden interstate commerce. For example, all states that impose sales and use taxes allow credits for taxes paid to other jurisdictions. This is a necessary

prerequisite for the tax to be deemed constitutional under existing law.¹ This principle is applied in the context of other state tax types as well. In fact, the proponents of this bill have identified no genuine threat of multiple taxation that would require this type of legislative response. In short, this bill is a solution looking for a problem.

Taxes on Digital Goods and Services are Generally Favorable, Not Discriminatory

Some states impose taxes on digital goods and services under the very same rules for taxing traditionally delivered goods and services and so have established parity in taxation between digital and non-digital products. About half the States do not impose taxes on digital goods and services, or do not impose tax if those goods and services are delivered electronically, even though they impose such taxes on other similar or traditionally delivered goods or services. In these states digital goods and services benefit from discrimination in their favor. For example, a state might impose sales tax on canned software purchased in a retail store on a disk, but not on the same software purchased and delivered electronically over the Internet. *The reality is that digital goods have largely escaped taxation up to this point* and have thus enjoyed a competitive advantage compared to non-digital products. Again the proponents of this bill have raised no genuine threat of discrimination that would require this type of legislative response.

Adverse Effects on Local Businesses and Preferential Treatment of Certain Industries

This legislation will give large multi-state businesses and Internet sellers a further competitive advantage over local businesses. Sellers who have a physical presence in a state (traditional retail sellers) will have to continue to collect or pay tax on sales of digital goods and services to customers in that state, as they do now. Multi-state and Internet sellers who do not maintain a physical presence in a state and who can deliver the digital good or service from a “remote location” (electronically) can avoid paying or collecting sales taxes already today.² This bill further ensures that sales made by these businesses *cannot, in many instances, be taxed in the state where the sale originates, that is, where the seller is located*. As a result, traditional “Main Street” sellers could be at a significantly worse competitive disadvantage than they are today compared to Internet and other types of remote sellers if these sellers structure their operations to avoid tax

Moreover, the focus of this bill is not some essential difference in a product or service, but rather in the way that the good or service is delivered. The bill provides protections and preferences for goods and services that are transmitted or provided electronically. So, for example, this bill imposes no limitations on how states can tax financial services

¹ See *Henneford v. Silas Mason Co.*, 300 US 577, 581, 57 S. Ct. 524 (1937) and *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 US 175, 194, 115 S. Ct. 1331 (1995). See also *State Taxation: Third Edition*, Walter Hellerstein, Chapter 18 (2009) in

² *Quill Corp. v. North Dakota*, 504 US 298, 112 S. Ct. 1904 (1992) (States may not impose a sales or use tax collection obligation on out-of-State sellers with no physical presence in the State).

delivered to an in-state customer by a local bank branch, but does impose limitations if that very same service is delivered to that same customer electronically.

Exclusion from Tax of Certain Businesses

It also appears that the bill would provide preferential treatment to certain kinds of businesses. The bill preempts the imposition of taxes (broadly defined) on digital goods and services that are imposed on anyone other than a "seller" or a "customer." Under the bill, a "seller" does not include certain intermediaries. This ignores the fact that these intermediaries provide services themselves that are likely to be deemed "digital services" under the bill. For example, a fulfillment company could perform a digital service of transmitting a digital good for the seller of that digital good. That separate digital service would be entirely excluded from tax because the fulfillment company is not a "seller." While it does not appear that this was the intent of the bill, not only does this "loophole" allow some types of businesses to avoid any tax on their goods or services but it would also allow corporations to restructure and take advantage of the same unintended benefit.

For example, Online Travel Companies (OTCs) may act as intermediaries in providing reservations for hotel and other local goods and services. That reservation service would be considered a "digital service" under the bill. That service would not be taxable at all under the "taxpayer limitation" since the OTC would not be a "seller" under the bill's definitions. This is an example of how the bill would impact current activities, but combined with the bill's sourcing rules and the lack of authority for states to impose tax on remote sellers, would make it possible for corporations to use controlled affiliated entities to perform certain intermediary services and avoid taxes in many cases.

This exclusion of intermediaries from any state tax poses a substantial risk for the future of state tax enforcement. Internet commerce has changed how business is done. Sales are often made through intermediaries who look very much like traditional sellers, and serve many of the same functions (advertising goods for sale, delivering goods, billing and collecting payments), but who never take title to the goods and services of third parties that they offer for sale on their web sites, and therefore would not be considered the "seller" under this bill. In many cases, the intermediary is the logical and most practical person to collect sales tax from the customer. In some cases, the intermediary may be the only person that can perform this function. To exclude them completely from any tax payment or collection obligation will effectively exclude a substantial, and quickly expanding, area of commerce from state tax.

Reduced State Revenues, Expensive Litigation, and Constitutional Questions

The bill will significantly impact state revenues, now and in the future, and will inevitably lead to very expensive and protracted litigation with the potential of Federal courts effectively legislating for the states. There is at least some question of whether the scope of the preemption in the bill is permissible under the Commerce Clause of the U.S. Constitution.

Reduced State Tax Revenues. The bill will have serious impacts on state tax revenues. For example:

- *Problems with Nowhere Sales.* The provisions of the bill that create a new tax advantage for digital goods and services, which benefit primarily large Internet sellers over local retailers, will also create a significant amount of sales activity that is not taxable by any state—otherwise known as “nowhere sales.” A state where the seller is located will not be able to tax the sale if the customer is outside the jurisdiction, because the bill would preempt that tax, and the state where the customer is located may not be able to tax the sale if the seller has no physical presence in the state. Conceptually, the destination based sourcing model in the bill may have merit, but ultimately this model cannot be considered as a national solution while the states are prohibited from imposing tax on sellers without a physical connection. Otherwise, sellers who deliver digital goods and services through electronic means will be able to avoid state tax through simple restructuring of their businesses and limiting of their physical presence. The consequence of this approach would be a further reduction in state tax revenues.
- *The “Resale” limitation and tax base erosion.* The bill seeks to eliminate tax on purchases for resale. The language describing purchases for resale is broad and not well defined. The bill will prohibit taxation of transactions and activities that many states tax today. For example, in the state of Washington the bill would entirely preempt business and occupation taxes imposed on licensing digital goods and services under the royalties classification, despite the fact these taxes do not discriminate against digital commerce or impose multiple taxes on the same transaction.
- *Retroactive impacts.* Unlike other preemption bills considered by Congress, this bill would apply to all existing taxes and thus place in jeopardy legally enacted state statutes. Additionally, the bill would not protect the states with respect to taxes imposed in past periods unless those taxes were both “accrued” and “enforced.” Both of which are undefined terms. As a result, it is clear to see that the retroactive aspects of this bill will have a negative impact on past, present, and future state tax collections.
- *Impact of restructuring to take advantage of the bill’s provisions.* As discussed above, because certain intermediaries are completely excluded from tax on their own digital goods and services, this limitation in combination with other provisions of the bill would make it possible for businesses to restructure in order to limit or avoid taxes in many cases.

Expensive Litigation. The bill will lead to years of litigation to try to resolve its terms. Unlike the typical statute passed by Congress, there is little ability for any administrative agency to further interpret the terms or provide guidance to address the kinds of questions that are bound to arise. Instead, the bill leaves it up to the Federal courts to resolve all questions solely through the long, expensive process of litigation. This will further cost the states, be a boon for litigators, and will further benefit large sellers over small ones.

More importantly, if a Federal court determines a particular tax to be “discriminatory,” the court may have to effectively usurp the typical legislative role of the states in order to provide a remedy. This is especially true since the bill requires a determination of the effective tax rate based on a whole range of taxes, fees and charges, not just the traditional sales and use taxes, so that a determination of whether there is any discrimination may involve multiple state laws and the weighing of different tax burdens such as credits, deductions, and similar items.

The bill’s focus on digital equivalents will further exacerbate these problems. As it reads today, the bill would require digital goods and services to be taxed at the same effective tax rate as their non-digital equivalents. This equivalency concept simply does not translate to the real world. For example, it is very simple to compare the sale of a music Compact Disc to the sale of an album in mp3 format. However, the comparison becomes more difficult when songs from the same album are streamed with other songs to a customer who has subscribed to a service that selects music for the customer based on their previous listening habits. Is the customer buying the song or the song picking? Many, if not most, digital goods and services are headed toward not having a tangible equivalent. Therefore, this bill will plunge the states, businesses, and the courts in an endless stream of litigation designed to prove individual products have digital equivalents and therefore are protected.

The kinds of questions that will undoubtedly require litigation will include:

- What is a resale? If a business purchases software that it uses and also provides access to customers to use, is this a resale? What if the business does not charge specifically for that access?
- What constitutes a digital equivalent?
- What exactly is a digital good? Is all software a “digital good” or only software that is delivered electronically?
- Can States treat software sold on a disk differently than software sold and delivered over the Internet?
- Since a service is a “digital” service by definition when it is “delivered electronically” does this allow sellers to convert traditional services into “digital” services simply by delivering a final report or other product by e-mail?
- How will products including both digital and non-digital components be treated?
- What does the term “generally imposed” taxes mean? That term is defined as a tax that is not imposed only on specific services, specific industries or business segments, or specific types of property. Defining these terms will lead to virtually endless litigation.
- The term “tax” includes fees. Does this mean every fee, even fees that are only specifically imposed on certain businesses or industries that are covered by the bill?
- The term “digital services” does not include telecommunications, but states define telecommunications differently as does the federal government in other areas. A significant number of “digital services” will use or be closely related to telecommunications services so this ambiguity is especially problematic.

These are just a few of the questions that will inevitably lead to litigation in Federal courts creating additional uncertainty and costs for the states.

Constitutional Questions. The bill would clearly preempt imposition of any tax on an in-state purchaser of digital goods or services if that purchaser can be said to have purchased the good or service for “resale.” Therefore, the state or local jurisdiction where the purchaser uses the good or service may not be able to impose a use tax on that purchaser, even where the good or service was also purchased from an in-state seller. Whether the imposition of a purely local tax on a purely local activity, in this case the use of the good or service, is the appropriate focus of Congress in the exercise of its Commerce Clause authority is doubtful. The bill’s proponents appear to recognize the questionable constitutionality of this bill, having included a savings clause that would preserve portions of the bill not found unconstitutional.

Sourcing Issues and the Problem with the “Resale” Limitation

Sourcing issues. The bill incorporates a destination based approach to the sourcing of digital goods and services. The language appears loosely based on language developed under the Streamlined Sales and Use Agreement (SSUTA) and adopted by 21 states. However, the bill is not identical to the SSUTA (see addendum), deviating from it in very significant ways. Therefore, the bill simply creates a new layer of regulation for businesses in these states. Moreover, these rules would entirely preempt states that source sales based on origin concepts. While there may be merit to establishing a uniform method of sourcing for digital goods and services, this bill is not the right way to achieve that result. Instead, the business community and states must work together to create a fair and mutually acceptable tax model that is responsive to the needs of states and business and considers the models that already exist. In fact, there are already acceptable existing forums for this type of cooperation and even existing efforts to address this issue.

Problems with the “Resale” Limitation. States may tax business purchases of goods and services for a number of reasons, even where it could be argued that the good or service is resold in some form or fashion. Because it is often very difficult to determine whether a good or service is actually resold, states typically use other “bright-line” criteria instead of simply relying on a term like “resale,” when allowing exemptions for business purchases. In contrast, the bill defines a “purchase for resale,” as any purchase of a digital good or service “for the purpose of reselling it,” or using it as component of another digital good or digital service. Moreover, resale includes any retransmission. This definition is woefully deficient and raises a number of questions. How is the seller to know whether the purchaser has a “purpose” of reselling the digital good or service? What if the purchaser’s “purpose” is to both use and resell the good or service? What if the resale is not in the ordinary course of purchaser’s business? Can a purchase for retransmission be treated as a resale even if the transfer is not part of an actual sale. (The use of the words “and includes” retransmissions in the definition seems to indicate that this is the case.)

The problem of distinguishing between the purchase of digital goods and services for “resale” is compounded with the bill’s adoption of a very broad definition of digital goods and services. “Digital goods and services” are delivered *or transferred* electronically,” as well as “electronically provided,” and include software, information maintained in digital format, digital audio-visual works, digital audio works and digital books, plus virtually unlimited types of services.

Bundling Assumption

The bill implies that sales of digital goods and services are not subject to retail sales tax unless bundled with a service or tangible personal property subject to sales tax. This is unlike Steamlined rules and rules in other states that allow a state to subject bundled sales to tax when the nontaxable product is bundled with the taxable digital good or service.

Mr. Chairman, that concludes my testimony. Thank you again for the opportunity to appear before the Subcommittee.

Addendum

Below is a list of differences between H.R. 1860 and the Streamlined Sales and Use Tax Agreement (SSUTA). Some of the differences are already covered in the written testimony even if they do not reference SSUTA.

1. SSUTA only applies to sales and use tax while the bill applies to any tax, charge, or fee other than net income and property taxes.
2. The definition of "digital good."
 - a. The bill includes software.
 - b. SSUTA does not include software as a digital good. In fact, it specifically states that prewritten software is tangible personal property, even when delivered electronically. SSUTA did this so the well-established tax treatment of software would not be disturbed.
3. The definition of "digital good."
 - a. The bill defines digital goods as only goods that are transferred or delivered, not provided, electronically.
 - (1) This appears to mean that downloaded music is a digital good, but streaming music is a digital service.
 - b. SSUTA defines digital goods as data, facts, information, sounds, and images whether they are transferred, delivered, or provided electronically (although SSUTA uses a broader definition of "transferred" to encompass delivered and provided).
 - (1) This means that downloaded music and streaming music are both digital goods (in most cases).
 - (2) How a song is accessed generally doesn't matter.
4. User rights are not addressed directly in the bill, but are addressed in SSUTA.
5. SSUTA does not interfere with state administration and state adjudication processes, while the bill does interfere through the establishment of federal court jurisdiction.
6. SSUTA is not retroactive. This bill is retroactive.
7. SSUTA excludes ancillary, telecommunication services, tangible personal property, and software from digital goods and services. The bill excludes tangible personal property, telecommunications service, Internet access service, and audio or video programming service.

Mr. ROSS. Thank you, Mr. Brubaker.

Mr. Eads, you are recognized for 5 minutes for an opening.

**TESTIMONY OF JAMES R. EADS, JR., DIRECTOR,
PUBLIC AFFAIRS, RYAN, LLC, AUSTIN, TX**

Mr. EADS. Chairman Ross, Ranking Member Cohen, thank you for your invitation to appear here today in support of H.R. 1860, the Digital Goods and Services Tax Fairness Act of 2011.

My name is Jim Eads. I am a director of Public Affairs for Ryan, a tax services firm that represents taxpayers. Our firm is headquartered in Dallas, with offices throughout the United States, in Canada, and in Europe.

I applaud you, Mr. Chairman, Chairman Smith, and Representative Cohen for your leadership on this issue. This bill would establish a national framework for State and local taxes imposed on digital commerce, precluding multiple and discriminatory taxation. Some might question whether this is a solution in search of a problem. Indeed, in a prior position, I might have suggested that. But, today, digital commerce is a rapidly growing segment of our economy. This legislation will provide certainty to the millions of consumers and businesses that purchase digital goods and services, the thousands of providers required to collect taxes on that commerce, and the State and local jurisdictions seeking to tax those goods and services.

Prior to my employment at Ryan, I was the executive director of the Federation of Tax Administrators. That role brought me before this Committee many times when it was considering various legislative proposals impacting State and local taxes.

While I am here today to testify in support of H.R. 1860, my approach to the consideration of these issues and possible solutions is the same today as it was then. Congress should respect State sovereignty and the need for State and local governments to administer their own fiscal issues. Congress should proceed cautiously in moving forward with any legislative measure impacting State and local tax authority.

As you consider this kind of legislation, please be thoughtful first as to the Nation's interest in a national and vibrant market, then cautious, deliberate, and mindful of the respective roles of government in our Federal system. While this was and is my opinion as to how these kinds of issues should be considered, I have come to believe that this measure strikes the right balance and demonstrates when congressional action is needed. The complexities that surface in today's Internet-based economy with digital transactions taking place all over global broadband networks transcending State boundaries cries out for a reasonable solution. Congressional action is needed to grant a jurisdiction the right to tax these goods when it is appropriate. This measure will provide consumers, sellers, and State governments and tax administrators with the certainty and the stability that they are seeking.

A little over a year ago, then-Governor Douglas of Vermont testified on behalf of the National Governors Association at a hearing of this Subcommittee entitled, State Taxation: The Impact of Congressional Legislation on State and Local Government Revenues. At that hearing, he

outlined four principles to consider when it was appropriate for Congress to enact legislation of this sort.

His testimony suggested that any Federal legislation in this area should, first, do no harm, preserve flexibility, be clear, and find the win-win. By do no harm he meant legislation should not disproportionately or unreasonably reduce existing State revenues. In suggesting the preservation of flexibility, he meant that States should not be unduly hindered in their own pursuit of reforms by Federal legislation that restricts their authority to act. By being clear, he meant that the legislation should avoid ambiguity or the need for expensive and time-consuming litigation. Finally, the Governor suggested that Congress should find the win-win. He noted that the goal of all legislation should be to find a balance that improves the standing of all stakeholders.

I believe that the provisions of H.R. 1860 are consistent with each and every one of these principles and, as such, is worthy of your enactment.

The other main provision of this legislation is to preclude expansion of utility-type taxes. Given the wide range of providers of goods and services, these kind of taxes can indeed be inequitable in our digital economy.

In summary, the economy of the 20th century is different than the economy of the 21st century. States cannot address all these issues on their own, and Federal legislation is needed.

Thank you for your invitation to speak here today, and I would be pleased to answer any questions that you might have.

[The prepared statement of Mr. Eads follows:]

Written Testimony
of
James R. Eads, Jr.
Director, Public Affairs
Ryan, LLC

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

House Committee on the Judiciary
Subcommittee on Courts, Commercial and Administrative Law

May 23, 2011

Chairman Coble, Ranking Member Cohen, and members of the Subcommittee, thank you for this opportunity to be here today to testify in support of H.R. 1860, the “Digital Goods and Services Tax Fairness Act of 2011.” My name is Jim Eads and I am a Director of Public Affairs for Ryan LLC, a leading tax services firm headquartered in Dallas with offices throughout the United States in Canada and in Europe. I applaud Chairman Smith and Rep. Cohen for their leadership on this issue.

This bill would establish a national framework for state and local taxes imposed on digital commerce, precluding multiple and discriminatory taxation of digital goods and services. Some might question whether this is a “solution in search of a problem,” indeed in a prior position, I might have even suggested that myself, but today digital commerce is a rapidly growing segment of our economy and the inherent complexities that surface in how digital commerce is transacted and taxed, this measure is both timely necessary. It will provide certainty to the millions of consumers and businesses that purchase digital goods and services, the thousands of providers required to collect state and local taxes on digital commerce, and the state and local jurisdictions seeking to tax digital goods and services.

Prior to my employment at Ryan, I was the Executive Director of the Federation of Tax Administrators. That role brought me before this committee many times as it was considering various legislative proposals impacting state and local taxes. While I am here today to testify in support of H.R. 1860, my consideration of the issues and possible solutions to the problems is the same regarding the appropriate role of Congress when you are considering legislation

impacting state and local taxes. Congress should respect state sovereignty and the need for state and local governments to administer their own fiscal issues and proceed cautiously in moving forward with any legislative measure impacting state and local tax authority. I suggest that your appropriate role as you consider this kind of legislation is to be thoughtful first as to the nation's interest then cautious, deliberate and mindful to the respective roles of federal and state governments.

While this was and is my opinion as to how these kind of issues should be considered, I have come to believe that this measure strikes the right balance and demonstrates when Congressional action is clearly needed to resolve some of the complexities that surface in today's Internet based economy where digital transactions take place over global broadband networks transcending numerous state boundaries. In fact, to provide the certainty needed for state and local jurisdictions seeking to tax digital commerce, Congressional action is needed to grant a jurisdiction the right to tax digital goods and services even when the activity may not have actually taken place within that jurisdiction's borders. Without Congressional action, there is uncertainty as to whether the state and local governments have the legal right to tax these transactions. This measure will provide consumers, sellers and state governments and tax administrators with the certainty and stability as to the revenue streams that they are seeking.

A little over a year ago, Governor Douglas of Vermont testified on behalf of the National Governor's Association at a hearing entitled "State Taxation: The Impact of Congressional Legislation on State and Local Government Revenues." At that hearing he outlined four principles to evaluate when it was appropriate for Congress to enact legislation addressing state and local tax issues. His testimony suggested that any federal legislation in this arena should do no harm, preserve flexibility, be clear and find the win-win. The specifics behind those principles are outlined below.

"Do no harm" – any legislation should "not disproportionately reduce existing state revenues."

"Preserve flexibility" – in discussing how states are addressing their budget gaps, the role of government is being analyzed, which will lead to "changes at the state level that could have

long-term, positive effects on the delivery of services, modernizing revenue systems and holding government accountable.” As such, “States should not be hindered in their pursuit of these reforms by federal legislation that restricts a state’s authority to act.”

“Be clear” – “Federal legislation, especially in the context of state taxation, should be clear to limit ambiguity or the need for expensive and time-consuming litigation.”

“Find the win-win” – “The goal of all legislation should be to find a balance that improves the standing of all stakeholders.”

I believe that the provisions of H.R. 1860, the “Digital Goods and Services Tax Fairness Act of 2011” are consistent with the principles outlined above:

“Do no harm” – this legislation does “not disproportionately reduce existing state revenues.” In fact, this legislation sets forth the framework needed to ensure that state & local jurisdictions wishing to tax digital commerce can do so with certainty by clearly identifying which jurisdiction is entitled to tax such transactions and precluding any other jurisdictions from claiming the right to tax the same transaction. This measure will provide revenue stability for state and local governments as they continue to seek to modernize their sales tax structure to include the 21st century digital economy.

“Preserve flexibility” – this legislation does not restrict the state’s ability to “modernize their revenue systems.” This legislation will actually help facilitate a state’s ability to update their existing tax structure by clearly setting forth how states can include digital transactions in their general transaction tax base. This legislation does not set forth whether digital goods and services should be taxed or not, that is a decision left to the state policymakers. This measure only sets forth the framework needed for the states that do decide to tax digital commerce, to ensure that it is done in a fair and rational manner.

“Be clear” – this legislation is “clear” and would “limit ambiguity or the need for expensive and time-consuming litigation.” Without this legislation clearly identifying which

jurisdiction has the right to tax digital transactions, costly litigation would be inevitable as multiple states try to claim the right to tax the same digital transaction. The concepts contained in this legislation are very similar to the provisions contained in the “Mobile Telecommunications Sourcing Act,” which has not seen any litigation over its provisions in the last nine years that the provisions have been in effect.

“Find the win-win” – this legislation “finds the balance that improves the standing of all stakeholders” as it provides certainty to the consumers of digital goods and services, the providers required to collect state and local taxes on digital transactions and the state and local taxing jurisdictions seeking to tax such goods and services. It also respects state sovereignty as the decision to impose taxes or not is left to the elected officials in each state.

The other main provision in this legislation is to preclude expansion of discriminatory “utility” type taxes from being imposed upon digital commerce solely because these goods and services are transacted over global broadband networks. One only has to look at all of the utility impositions currently levied on communication services today to understand that this risk is real. In fact, using wireless services as the case study, it is evident that jurisdictions continuing to face significant budget deficits see this growing segment of the economy as an easy target for additional revenue by trying to wedge them into an outdated definition of telecommunications services and assert utility type taxes should apply. Given the wide range of providers of digital goods and services, and the inherent inequities imposing utility type taxes on digital commerce would create, it is very important to stop this trend before it becomes a problem like the one we have seen emerge for wireless services.

In summary, the existing state and local tax structure was based largely on the manufacturing/industrial/retail economy of the 20th Century and is ill equipped to address the complexities that surface in taxing the 21st Century digital based economy. States must update their existing tax systems to reflect the new global economy in order to ensure they will have simple, transparent, equitable, economically neutral and reliable tax systems to generate sustainable revenue for efficient delivery of core government services by state and local governments. However, the states cannot address all of these issues on their own. Federal

legislation is needed in certain areas of state and local taxation to address interstate jurisdictional issues with respect to which state and locality is authorized to tax certain transactions that take place in today's information based "borderless" economy. Addressing these issues through federal legislation is critical and absolutely necessary to preserve interstate and global commerce.

Chairman Coble, Ranking Member Cohen and members of the Subcommittee, thank you again for holding this hearing and allowing me to testify in support of this bill. I hope that both the Subcommittee and the full Committee will mark-up this legislation soon, so that the certainty needed for how state and local taxes can be imposed on digital commerce in a fair and rational manner can be enacted as soon as possible to the ultimate benefit of all of the interests involved.

Mr. ROSS. Thank you, Mr. Eads.

I will now begin the questioning by recognizing myself for 5 minutes.

Mr. Atkinson, this bill has a diverse group of supporters, including the disabled community, the high-tech sector, and various African American, Asian, and Hispanic groups. Why do you think there has been such a broad base of support for this bill?

Mr. ATKINSON. Well, I think for two reasons. One is it is a commonsense bill. It doesn't preclude the States from taxing this. It just says you can't tax it twice and you can't take it at a higher rate. I think the average person would just say that is just common sense and that is going to be good.

Mr. ROSS. It is consumer-friendly.

Mr. ATKINSON. And consumer-friendly. Exactly. It is not unfair to consumers. It treats them the way they would be treated in kind of the existing realm.

Secondly, I think people are very aware that this is going to be a very fast-growing area of our economy, and increasingly people are going to be consuming more and more digital goods online. And, as that happens, people want to know that they are going to be treated fairly by tax authorities.

That would be my guess as to why it has seen such broad support.

Mr. ROSS. Some recent news reports have stated this bill would affect State taxes on all online purchases, including purchases of tangible goods made online. In your opinion, is that an accurate statement of what this bill would do?

Mr. ATKINSON. No. My view of this bill is it would deal with a small subset of goods that are sold online, which are the digital goods, not analog or physical goods that are purchased online but shipped on non-telecommunications means. To me, I read the bill as a narrow slice of that overall digital economy, just the goods that are delivered digitally—and services.

Mr. ROSS. They say that the power to tax is the power to destroy. I guess, as Mr. Eads pointed out, in this particular case H.R. 1860 gives us a balance between the over-exercise of that taxing power and yet not abridging the sovereignty of the States' rights. Would you agree?

Mr. ATKINSON. Well, I do agree with that, although I have to say I have a slightly different view of States authority here and sovereignty. Having worked for a Governor, I am quite aware of State issues, and I respect the challenges they face. But the digital economy is fundamentally different than the old physical analog economy, where much of what people purchased was within their State, and it made sense for State regulatory and tax systems to be at the State level. But when we are talking about a digital economy, we are talking about something that is inherently national, if not international. I think that just fundamentally changes the way we have to think about it.

Mr. ROSS. Thank you.

Mr. BRUBAKER, when I purchase a digital good or service today, the seller is ultimately the tax collector for that transaction. Digital goods providers have to figure out which States impose a tax and then apply the tax to the transaction. Without a national framework, won't digital goods providers be exposed unnecessarily to litigation over where a sale takes place and how much the tax can be imposed by a certain State?

Mr. BRUBAKER. Right now, there are very few States imposing taxes on digital goods, so I don't think it is much of a challenge at this point. And the States are being extremely cautious.

I think developing a framework in fact is an excellent idea. I just don't think the framework in this bill works yet. I think we would certainly like an opportunity to work with the business community on some of the issues that we find in the bill, like the definitions, which are vague and unclear in some cases or nonexistent in others. Those are the kinds of things that lead to litigation. And the Federal court provision will make it difficult to get resolution to those issues so that States can provide authoritative guidance to taxpayers.

I worry about the small taxpayers in our State that want to know now what do I need to do on this. So I think we need a framework. I just don't think this bill is there yet.

Mr. ROSS. Thank you.

Mr. Eads, you are the former executive director of the Federation of Tax Administrators, as you mentioned, a group that is represented here today by Mr. Brubaker and is opposed to this bill. Responding to Mr. Brubaker's testimony, can you explain to us how this bill would bring clarity and simplification to each State's policy for taxing digital goods, in 1 minute or less?

Mr. EADS. Chairman Ross, the States are in a quandary here, as are businesses, as are consumers. Most certainly in the retail sales tax area most of these laws were written right after the Depression and have been updated on an ad hoc basis since then. The economy simply is more robust, more vibrant, more changing than it has been. And tax policy tends to lag in that area. So I believe that you are trying to do the right thing here by setting forth some framework in which all the parties have a clear understanding of the rules.

Mr. ROSS. Thank you.

With 12 seconds left, I will conclude my questioning and then recognize the distinguished Member from Tennessee and the Ranking Member, Mr. Cohen, for 5 minutes.

Mr. COHEN. Thank you, Mr. Ross.

Mr. Brubaker, you are from Washington State, is that correct? And you say you are looking out for the small taxpayers, is that right?

Mr. BRUBAKER. We try very hard to do so, yes.

Mr. COHEN. Your State, like my State in Tennessee, is one of the few States that doesn't have a State income tax, is that correct?

Mr. BRUBAKER. That is correct.

Mr. COHEN. Doesn't that make your State like my State, one of the most regressive States in the country for taxation and hurt the small taxpayer?

Mr. BRUBAKER. Well, it is certainly regressive in its taxation of low-income families. I think our business taxes are not quite as regressive as our taxes that affect individuals.

Mr. COHEN. I am thinking in terms of the small,

low-income families. I guess that is different from small taxpayers because they don't have lobbyists. That is the people I am concerned about.

Mr. Brubaker. The business and occupation tax has a very low rate. It is really broad, and so the rates are generally low. I don't think it poses a large burden on most small taxpayers. We do have

an exemption for them—or a threshold—so they only pay once they are above a certain income.

Mr. COHEN. How about those low-income folks when you don't have that income tax? It is regressive. It hurts them, doesn't it?

Mr. BRUBAKER. Yes.

Mr. COHEN. What is Washington State doing to try to make your tax system more progressive and concern about the low-income people that are in favor of this bill?

Mr. BRUBAKER. We have quite a few limitations on what we can do to change our tax system right now that have been enacted by initiatives. So you won't be seeing any changes in our tax without a two-thirds vote of our legislature. It is very hard to achieve.

Mr. COHEN. So you can't have an income tax without two-thirds.

Mr. BRUBAKER. That is correct.

Mr. COHEN. As a result of that, does that mean you have to look for other forms of taxation to supply the services that Washington State needs to supply to those low-income people that are suffering?

Mr. BRUBAKER. Right now, it means that we can't get anything else without a two-thirds vote either. So we are doing all of our budgeting by cuts.

Mr. COHEN. The bottom line is you need more access to taxes like this that can make up for the fact that you don't have a flexible tax system that has now been handicapped by these initiative processes in your constitution and you don't have the opportunity of a more progressive tax system through an income tax. So you have got to resort to these type of taxes to care of the needs of your people.

Mr. BRUBAKER. We are using the taxes we already have and applying some of them to some digital goods and services as much as we do others. We have a thriving digital goods and services economy in our State, so we are being very careful in how we do this. We do not want to harm that sector of our economy.

Mr. COHEN. Are you familiar with the Amazon Tennessee issue that just came through our legislature?

Mr. BRUBAKER. I am not quite sure how to answer that.

Mr. COHEN. Yes or no would be the appropriate answer. These aren't real tough ones.

Mr. BRUBAKER. I haven't read what came through your legislature. I know there have been different things pending, but I haven't read what actually passed. So I can't give you a yes or no to something I don't know.

Mr. COHEN. Mr. Eads, Mr. Camp predicted the end of the world was going to happen Saturday.

Mr. EADS. I am sorry, Mr. Chairman?

Mr. COHEN. We are here. Mr. Camp predicted the world was going to end on Saturday.

Mr. EADS. To the best of my knowledge, it did not.

Mr. COHEN. That is right.

Mr. Brubaker suggested it will occur when we pass this bill. Tell us why he is wrong, too.

Mr. EADS. Thank you ever so much, Mr. Cohen. I would never compare my friend Russ Brubaker to Mr. Camp.

I think in the debate about these taxes, depending on which side you are on, fear is a powerful ally; and I think that what you are called on to do in the exercise of your responsibilities in the national Congress is to try to sort that out and determine what is best for the United States.

Don't get me wrong. I have appeared before you when I represented FTA and argued quite zealously for the right of the States to determine their own fiscal destiny. I still do believe that. But I also believe that, in exercise of your responsibility to protect this vibrant market, some rules that enhance understanding are almost always worthwhile.

Mr. COHEN. Thank you.

Mr. Atkinson, please provide some examples of the States taxing on digital goods and services. Mr. Brubaker said there are no discriminatory taxes. I think you can maybe cite some examples of discriminatory taxes that are imposed.

Mr. ATKINSON. At least certainly in some areas, it is not exactly digital goods, but we see that in the wireless areas where there are States such as New York State and California and other States that have very, very high taxes on wireless services, including data services for your iPhone or your BlackBerry, for example, that are much higher than any other kinds of sales taxes in the State. So that would be a very good example of that.

Mr. COHEN. Thank you.

My time has expired. Therefore, I yield back the remainder of my time.

Mr. ROSS. Thank you, Mr. Cohen.

The Chair now recognizes the distinguished gentleman from Georgia, Mr. Johnson, for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman.

I was thinking I woke up on Sunday morning and I thought I was in heaven. But you all have now burst my bubble. So back to reality, right?

Mr. Atkinson, you believe that unless Congress creates a national framework to ensure consistency and fairness in the Tax Code, there is a risk that digital goods and services purchased and downloaded in one State will be taxed at higher rates than related fiscal goods. Is that correct? And, Mr. Brubaker, do you agree that that is a legitimate problem?

Mr. ATKINSON. I would say I think it is certainly a risk.

Mr. JOHNSON. Excuse me, Mr. Brubaker, do you see that as a legitimate issue?

Mr. BRUBAKER. Well, I think there is some risk if we leave it unattended too long. But we need to work for a framework that takes into account the need for definitions and for allowing things to be taxed somewhere. And so I think it is possible to construct a framework, and I think it needs to be done in a timely fashion, and I think it can be. I just think that this framework is not there yet. I do think we need a framework for this area of taxation.

Mr. JOHNSON. So you are concerned about definitions lodged in this proposed legislation. What definitions do you have problems with?

Mr. BRUBAKER. Well, there are quite a few.

One is a term that is not even used in the bill, but it actually is a foundation for how it works, which is that you should have to have a tangible equivalent before you tax something in the digital world. I have concerns about that. Because, one, if the term is not in the bill but yet it is the basis of the bill in some respects and you end up in a situation where, with all the kinds of digital products there are, it is very hard often to describe an exact tangible equivalent. People will disagree about what is a tangible equivalent and what is not.

Just think about all the way music is now provided through digital services. When is it a tangible equivalent and when is it not? So without some work on a precise definition on that, then we are going to have difficulties.

There are quite a few definitions that are not in the bill at all, and then again there are—I can actually—I will supply the Committee shortly with a complete list in writing of the terms we think are deficient or nonexistent.

Mr. JOHNSON. Please do.

And so you are willing to work with folks like Mr. Atkinson and Mr. Eads to actually perfect this legislation—or can it be perfected? Must we start out again, totally new legislation?

Mr. BRUBAKER. It is a tough question to answer in the sense that I am not sure how quickly this particular framework could be brought into line with something that the States could support. I hope it could be.

I think it is important that the certain principles have to be followed. They include simplicity and fairness, conformity with the Streamlined Sales and Use Tax Agreement, neutrality regarding industry and the means of delivery, some consideration to revenue impacts and pyramiding. And, on the business side, consideration given to the amount of pyramiding on them. I think that is an important issue in digital goods.

I think it takes time to sort through those, so I don't want to say that I think it can be done in a couple of weeks. I think it could be done in the course of a reasonable amount of time.

Mr. JOHNSON. Mr. Atkinson, do you agree that it would make sense to sit down and work through some of the problems that some of the bill's opponents might have? Wouldn't that be reasonable to do?

Mr. ATKINSON. I am not a tax administrator. So when I hear an issue like the tangible equivalent, that seems reasonable to me. But I am not a tax administrator.

Mr. JOHNSON. I am not either, but it seems like a reasonable observation. Does it seem that way to you as well? Could be reasonable.

Mr. ATKINSON. It could be. But I also know that the United States has a long history of opposing any Federal intervention on taxes, and I am not clear what this is from.

Mr. JOHNSON. Do you think that there is some reason to go forward with this legislation quickly, as opposed to just simply having a bipartisan, if you will, reasonable discourse about it to try to perfect it? Do you think that would be the best thing to do?

Mr. ATKINSON. I think it would be useful to pass this bill in this Congress, because these are issues that are going to get worse. And

even as Mr. Brubaker said, I think he said, "There is some risk if we leave it unattended too long."

Mr. JOHNSON. Well, I tell you, anytime somebody tells me that, okay, you have got to buy this timeshare today or else you won't be able to buy it tomorrow, the price will go up or it is going to be gone, you must act quickly, do it now, impulse buying is great, then I get the opposite reaction. It causes me to just want to hold up and think that there is some ulterior purpose for moving forward, like perhaps there is a privileged category in the legislation for certain types of goods and services or there is some kind of trick in there that is going to protect somebody's ability to make an unfair profit off of something. So something doesn't smell right, in other words, when that happens.

Mr. ROSS. The gentleman's time has expired.

That being the last of our questions, I would like to thank our witnesses for being here today.

Without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for the witnesses.

Mr. JOHNSON. Mr. Chairman, excuse me for interrupting, respectfully, but I find that we have a pattern here with these hearings on legislation, here in this Committee particularly. We just have one round of questions. We stick to the 5-minute rule. We are not really getting into the guts of the matters that come before us. And I just want to make that known for the record.

I certainly would not be opposed to a second round or even a third round of questions on this particular issue. I would ask the Ranking Member what his thoughts were as far as another round of discussion about this. This bill is coming up for markup, I understand, in about 2 weeks or so, and I just think we have got about an hour and 40 minutes before votes are called, and I myself would really like to talk with Mr. Eads, get his thoughts on it.

Mr. ROSS. I do have a conflict starting at 5 o'clock so that would put a little hamper on that.

Mr. Cohen?

Mr. COHEN. I am at the discretion of the Chair. I do have a teleconference on peace in the Middle East. And I am afraid if I am not there, God knows what will happen.

Mr. JOHNSON. I see I am outvoted on this.

Mr. ROSS. Point well taken, Mr. Johnson.

Mr. COHEN. People in the Middle East may be concerned about that.

Mr. ROSS. Please do note, however, if there are additional questions that need to be asked or would like to be asked by the Members, please have the written questions for the witnesses, which we will forward and ask the witnesses to respond to as quickly and promptly as possible so that their answers can be made part of the record.

Without objection, all Members will have 5 legislative days to submit any additional materials for inclusion in this record.

With that, again, I thank the witnesses, and this hearing is adjourned. Thank you.

[Whereupon, at 4:50 p.m., the Subcommittee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

Statement of Chairman *pro tem* Dennis Ross
Subcommittee on Courts, Commercial and Administrative Law
Hearing on “H.R. 1860, the Digital Goods and Services
Tax Fairness Act of 2011”
Monday, May 23, 2011, at 4:00 p.m.

Digital goods and services are increasingly important in our modern American economy. The digital platform not only makes consumption of entertainment media more convenient for consumers, but it also improves the efficiency of society as a whole. Data no longer need to be printed out and mailed to another location for processing—it can be delivered through cloud computing or email. And more students have access to a college education by logging in to remote classrooms hosted on web-based applications.

Advances in digital technology have also resulted in advances in the mobile telecommunication industry. Rather than carry around a wad of plastic supermarket value cards in your wallet, you can download an inexpensive application to your smart-phone that will store all of your cards and make them available for scanning upon the touch of a button. A December 2010 study revealed that consumers prefer to receive breaking news via smart-phone more than on any other platform, including the Internet and television.

State governments are generally free to set their own tax policy, but they may not do so in a manner that burdens interstate commerce. Transactions involving digital goods and services are unique. Imagine you are sitting at Dulles Airport in Virginia waiting for a flight. You download a music file from Apple, which is headquartered in California. The music is sent to you via a server in Oklahoma. Which of these states should be permitted to tax this transaction?

There is already some confusion among states concerning where the sale of a digital good takes place. Every state has an incentive to claim that the sale took place in its borders, and therefore to subject the transaction to its sales tax. As a result, some transactions risk being taxed several times over. Confusing tax policy not only gets passed on to consumers, but it also slows innovation.

A federal framework for taxation of digital goods will relieve the potential burden on interstate commerce that patchwork state laws may impose. I am pleased to be a cosponsor of the Digital Goods and Services Tax Fairness Act.

I look forward to hearing testimony from the witnesses today concerning this important legislation.

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Expanding the Wireless Frontier

Steve Largent
President/CEO

May 23, 2011

The Hon. Lamar Smith, Chairman
Committee on Judiciary
2138 Rayburn House Office Building
Washington, D.C. 20515

The Hon. Steve Cohen, Ranking Member
House Judiciary Subcommittee on
Courts, Commercial and Administrative Law
1005 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Smith and Congressman Cohen:

On behalf of CTIA – The Wireless Association® and its member companies, I want to offer my sincere thanks and deep appreciation for your continued leadership on providing the much needed certainty for how state and local taxes can be imposed upon digital commerce with the introduction of H.R. 1860, *the Digital Goods and Tax Fairness Act of 2011*. The concepts contained within this bill are very similar to the provisions enacted in the Mobile Telecommunications Sourcing Act (P.L. 106-252) that was enacted in 2000. That measure was one of the first to address the inherent complexities that mobility and the continued expansion of broadband networks create in the area of state and local taxation. As you know, states and localities are increasingly imposing disproportionately high tax rates on wireless services and we know they have digital goods and services well within their sights. Your steadfast support of H.R. 1002, *the Wireless Tax Fairness Act of 2011*, and the soon to be introduced VoIP sourcing legislation has proven invaluable in driving towards a telecommunications tax regime that provides both uniformity and certainty for all consumers.

State laws governing sales and use and other transactions taxes are ill suited for today's international digital ecosystem that operates over global communications networks. The attempt to apply these tax laws has resulted in a lack of certainty and transparency to consumers and the potential for multiple and discriminatory taxation of digital commerce that impedes broadband investment, innovation, and adoption. As the nation continues to transform to a highly service based economy, more and more states will be looking to include the digital goods and services in their state and local tax base and without the national framework set forth in H.R. 1860, consumers will be at risk for overly burdensome and unfair taxes imposed upon digital transactions.

H.R. 1860 strikes the proper balance between states rights and Congress's Constitutional authority to regulate interstate commerce. States that wish to impose a sales tax on digital goods can do so under the legislation as long as they enact legislation that complies with the federal framework, which would prevent multiple, excessive and regressive taxation.

Again, thank you for your continued leadership on providing the much certainty in the state and local taxation on the 21st Century digital economy. CTIA and its member companies look forward to working with you and your very capable staff to enact H.R. 1860 as soon as possible.

Sincerely,

Thanks for your help!

Steve
Steve Largent



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FEDERATION OF TAX ADMINISTRATORS

The Association of Tax Agencies of the 50 United States, District of Columbia and New York City

May 31, 2011

Chairman Howard Coble
Courts, Commercial, and Administrative Law Subcommittee
Committee on the Judiciary
United States House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515-4323

Thank you for the opportunity to testify before the Committee on H.R. 1860. During the May 23rd hearing we pointed out that vague and undefined terms in the legislation would create expensive and extended litigation in Federal courts. We were asked to provide a list of the undefined and poorly defined terms in this bill. Below is a list of such terms. We look forward to working with the Subcommittee on this legislation.

The undefined or poorly defined terms in H.R. 1860 include:

- In Section 2 the term “excessive” taxes and the term “providers” are used but never defined (although, apparently, “providers” is meant to take the place of “seller,” but the term is also used to refer to telecommunications providers).
- In section 4(c)(2) “tax address or addresses” does not provide enough information for handling multiple locations. “Tax address” is defined, but the definition does not provide any guidance or definition for multiple locations or “tax addresses.”
- In Section 4(d) it is unclear whether an electronically delivered good with a nonpermanent right to use is a digital good. Would a nonpermanent digital good become a digital service? Does the reference in Section 4(d) to “judicial interpretation” include a quasi-judicial decision made through a state’s administrative process? In other words, would an administrative appeal decision be considered a “judicial interpretation”?
- In section 4(e)(1) can a seller “reasonably identify” the charges for the bundled digital good before, after, or during the appeals process or the purchase process? What standards make identification reasonable?
- Section 4(e)(2) uses the term “transport” in reference to the delivery of digital goods and services. Not only is “transport” not defined, it implies that “digital goods” may be a broader category of goods.

- In Section 5(1) the definition of “customer” does not address sales of licenses to digital goods and services, including software licenses.
- Section 5(2) uses the term “receive” in the definition of the “customer’s tax address” but there is no definition of this term in the bill. In the context of digital goods and services, the term must be defined. For example, if the customer orders the good from one location and the good is accessible at any time after the order is placed, is the good received where it is ordered or only where it is first accessed?
- In Section 5(2) “tax address or addresses” does not provide enough information for handling sales delivered to multiple locations. Apparently this is left up to the seller in Section 4(c)(2). This will affect a large number of sales.
- Section 5(2)(E) uses the term “address of the seller” but this address is not defined or specified in the bill. (Just as customers can have more than one “address,” we assume sellers can have more than one address.)
- Section 5(2)(F) uses the term “advertising services,” which is not defined. There is currently contentious litigation over whether providing links and receiving commissions for referring customers through online web sites is merely advertising or sales activity.
- In Section 5(3) the interaction between “transferred electronically,” “delivered electronically,” and “provided electronically” is unclear and poorly defined. Generally, “delivered” could be downloaded; “transferred” could be download or accessed/streamed, and “provided” appears to be limited to access (like remote access software), but really it could be download or access. Does this mean that digital goods can only be downloaded? Does this mean that digital services can only be accessed or streamed? If a movie is downloaded, then it is “delivered or transferred electronically,” but if the same movie is streamed to the customer, then it is a digital service. Is this correct? It is still the same movie file, just accessed differently. Furthermore, the Streamlined Sales and Use Tax Agreement (SSUTA), for example, draws a distinction between delivered and transferred. Software is delivered and digital products are transferred.
- In Section 5(6) “digital service” means any service provided electronically and Section 5(3) defines “provided” electronically as “provided remotely via electronic means.” What is not specifically defined, however, is the term “service.” This creates a number of potential problems. For example, an engineering service would not normally be thought of as a digital service. But what if the engineering firm provides its final engineering report to its client via email? The service would arguably be provided via remote electronic means. Does this make the engineering service a “digital service?” In that case, virtually any service that results in some report or other summary of the results that can be provided remotely via electronic means (architectural plans, research reports,

financial investment advice, audit reports, legal documents, etc.) would be a “digital” service.

- In Section 5(7)(A) “discriminatory taxes” are defined but not in a way that will prevent substantial litigation. What is the comparison class? The definition refers to “similar” services, but does not use the term with respect to goods. So potentially all goods are in the comparison class, not just similar goods. The definition also refers to taxes “generally imposed.” That term, however, is defined to exclude taxes imposed on “specific services.” Most state sales and use taxes are only imposed on specific services. Does this mean the bill does not cover those taxes? It may be that the bill intends to incorporate a kind of “tangible equivalent” concept, but this concept is not in the bill. What if there is no “tangible equivalent?” Also, the definition uses the phrase “under other terms that are disadvantageous.” This term is vague and could potentially mean any of a number of different things and would presumably apply even if the terms imposed are necessary for the collection of tax on digital goods and services.
- Section 5(10)’s definition of “purchase for resale” is, in part, circular. The definition is a purchase of a digital good or service “if such good or service is purchased for the purpose of reselling it, *or . . .*” Because of this circular definition, the term is basically undefined. This is a problem because it can be especially difficult to determine when a service purchased by a business is resold or consumed. For this reason, states that tax services often apply bright line tests that seek to exclude sales for resale in a way that may not be perfect, but can at least be administered. Without the ability to use bright line tests, the term “resale” raises a number of questions. For example, if a business uses software (assuming it is a digital good) but also makes the software available to customers for their incidental use, is the software resold or not? Also, the definition of “resale” specifically includes any “broadcast, rebroadcast, streaming, restreaming, transmission, retransmission, licensing, relicensing, reproduction, copying, distribution, redistribution, or exhibition” regardless of whether the buyer actually sells (or charges its customer) for that retransmission. Assume a corporate group buys software (as a digital good) and the parent company transmits the software to its subsidiaries for their internal use without any intention of reselling it to a third party. Is this a “resale?” What if the parent company charges the subsidiaries for the cost of the software?
- Under the bill, taxes can only be imposed on “sellers” or “customers.” In Section 5(12) “seller” does not include “a person that provides, on behalf of another, order taking, order fulfillment, billing, or electronic delivery or transfer service with respect to the sale of a digital good or a digital service.” These providers are not sellers and therefore not subject to tax. It is critical to understand this term, therefore. It is not clear, however, whether a seller that performs these functions as well as some other functions would be a “seller” or not. Because there can be virtually unlimited arrangements between third-party sellers and Internet sales providers, this raises a virtually unlimited number of questions. For example, if an

Internet sales company that provides order taking, order fulfillment, and billing also provides a customer loyalty program of the customers of the third-party seller, would such a company qualify for the exclusion from tax or not? What if the Internet company provides customer credit for the customers of the third party? Advertising or marketing services? Other accounting related services? Banking services?

- In Section 5(14) "tax" includes "any charge imposed by a State or local jurisdiction for the purpose of generating revenues, etc. . . ." The problem with this definition is not necessarily that it is unclear, but that it is overly broad and will undoubtedly make the application of other definitions and rules under the bill much more complicated, and likely will create unintended consequences.
- In Section 7 the term "accrued and enforced" is not defined in determining which past state tax laws are subject to this bill. The retroactive aspects of this bill will have a negative impact on past, present, and future state tax collections. But the lack of definition for "accrued and enforced" leaves unanswered the question of which taxes are protected. Do taxes have to be collected pursuant to an audit, administrative, or judicial collection action to be "accrued and enforced?" Or does mere acceptance of payment by a tax agency qualify? This will likely be an issue that will be resolved ultimately by litigation.
- In Section 9 "multiple tax" is vague and does not address situations in which the customer has "tax addresses" instead of a single "tax address."

Again, thank you for the opportunity to testify on this important topic and to provide more information to the Subcommittee.

Sincerely,



Martin S. Morris

Chief Director, Legislative Affairs

cc Patrick T. Carter
cc Russ Brubacker
cc Verenda Smith