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Digital goods and services legislation considered in U.S. House

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On May 12, 2011, U.S. House Judiciary Committee Chairman Lamar Smith introduced legislation (H.R. 1860, the "Digital Goods and Services Tax Fairness Act of 2011") that would "ensure that States and political subdivisions thereof do not discriminate against providers and consumers of digital goods and digital services by imposing multiple, excessive and discriminatory taxes and other burdens on such providers and consumers." The bill was the subject of a hearing on May 23, 2011, in the House Judiciary Subcommittee on Courts, Commercial and Administrative Law, and is cosponsored by the Subcommittee's Chairman (Rep. Howard Coble) and its Ranking Member (Rep. Steve Cohen).

Multiple and discriminatory taxes prohibited

Under the legislation, states and localities would be prohibited from imposing "multiple and discriminatory taxes" on or with respect to the sale or use of digital goods or digital services. A discriminatory tax generally is defined in comparison with sales or sellers of tangible personal property or of similar services that are not provided electronically, and include differences in the tax rate imposed and tax base. A multiple tax is any tax imposed on a digital good or service for which the state or local jurisdiction fails to give credit for tax previously paid to another state or locality. The term "tax" is broadly defined to include any charge by a state or locality to generate revenue for governmental purposes, except for a tax on or measured by net income or an ad valorem tax.



Key provisions include sourcing hierarchy, retail limitation, software treatment, bundling rule

The legislation contains a general section regarding "Retail, Sourcing, and Other Limitations and Rules" that would govern how states treat digital goods and digital services.

Sourcing Hierarchy. Included in this section is a general limitation on the taxation of sales of digital goods or digital services to the state and locality "whose territorial limits encompass the customer's tax address." The customer's "tax address" is the customer's place of primary use as defined under federal law, for purposes of digital goods or services sold (and charges for such goods or services billed by) a provider of mobile telecommunications service. For other sellers, the customer's tax address is generally the location where the digital good or digital services is received by the customer, *if known by the seller*. Otherwise, the tax address is deemed to be the customer's physical address, including the address obtained from the customer's payment instrument if no other address is available. The default sourcing rule is the address of the seller from which the digital good or digital service was sold, if no other address is known or obtained by the seller. These rules generally follow the destination-based sourcing hierarchy provided under the Streamlined Sales and Use Tax Agreement. If the seller relies in good faith on information regarding the tax address (or tax addresses, for sales to multiple customer locations) provided by the customer, the seller is held harmless for any additional tax based on a different determination by the state and local taxing authorities.

Retail Limitation. Also under the legislation, tax may only be levied on digital goods or digital services to the extent there is a sale to a "customer," meaning a person that purchases a digital good or service for a purpose other than resale. A purchase for resale includes purchases for use as a component part of or for integration into another digital good or digital service that is to be sold to another person. This includes the purchase of a digital good or digital service for further commercial broadcast, rebroadcast, streaming, restreaming, transmission, retransmission, licensing, relicensing, reproduction, copying, distribution, redistribution, or exhibition of the digital good or service, in whole or in part, to another person. This restriction is similar to that found in the Streamlined Sales and Use Tax Agreement with respect to products transferred electronically, except that the Agreement's restriction is only a default that states may bypass if they specifically impose and separately enumerate tax on a sale to a purchaser who is not an end user. The legislation also contains a "taxpayer limitation," such that taxes on or with respect to the sale of digital goods or services may only be imposed on, and collected only from, a customer or a seller.

Software Treatment, "Limitation on Expansive Interpretation." The legislation defines "digital good" as any good or product that is delivered or transferred electronically, including software. Further, the legislation defines "digital services" as any service that is provided electronically, including the provision of remote access to and use of a digital good (*i.e.*, including various forms of "cloud computing"), but excluding telecommunications service, Internet access, or audio or video programming service (programming provided by, or generally considered comparable to programming provided by, a radio or television broadcast station).

Thus, all of the restrictions in the legislation regarding digital goods and digital services apply to electronically delivered or transferred software and remote access or use software, respectively. The Streamlined Sales and Use Tax Agreement, in contrast, includes prewritten computer software, regardless of delivery method, within its definition of tangible personal property.

The legislation contains a subsection providing a "Limitation on Expansive Interpretation" of existing state tax imposition laws, so that "[n]o tax on or with respect to the sale or use of tangible personal property, telecommunications service, Internet access service, or audio or video programming service may be construed by any regulation, administrative ruling, or otherwise, to be imposed on or with respect to the sale or use of a digital good or a digital service." Further, the legislation provides that a transaction involving a digital good will be characterized only as a transaction involving the provision of a digital service unless the transaction results in the transfer or delivery of a complete copy, with the right to permanent use or use for a specific period, of the digital good that is the subject of the transaction. Taxes on digital goods may not be construed by any regulation, administrative ruling, or otherwise as being imposed on or with respect to the sale or use of a digital service. The legislation provides that these limitations will "not apply to any construction of a statute that was approved by a judicial interpretation of that statute on or before the date of enactment" of the legislation.

Bundling Rule. The legislation provides that if charges for digital goods or digital services are aggregated with, and not separately stated from, charges for other goods or services, the charges for digital goods or services may be taxed at the same rate or on the same basis as charges for the other goods or services unless the seller can reasonably identify the charges for digital goods or services from its books and records kept in the regular course of business. This bundling rule is similar to the "accounting rule" found in the Internet Tax Freedom Act for charges for Internet access aggregated with and not separately stated from telecommunication or other charges.

The legislation further provides that if a charge for a digital good or service is aggregated with, and not separately stated from, charges for electronically delivering or transporting the digital good or providing the digital service to the customer, then the seller may either use the above bundling rule (*i.e.*, books and records) or treat the service of electronic delivery or transport as a non-severable and incidental component of the digital good or digital service.

Effective date

Except as otherwise provided, the legislation would be effective on enactment, and would not affect liability for taxes accrued and enforced before the enactment date or affect ongoing litigation relating to such taxes.

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