



## Digital Goods Tax Legislation Rebooted on Capitol Hill

By Michael Belarmino

The Digital Goods and Services Tax Fairness Act of 2019 is one of those bills that keeps state and local government advocates in a constant state of vigilance.

Any legislation introduced in the U.S. Congress generally has the potential to experience an endless cycle of reintroduction every two years, unless they are among the lucky few that become law during a congressional session. In the case of several bills relating to GFOA's priorities, constant reintroduction is preferred, in the hope that through vigorous advocacy they too will become law. However, the potential reintroduction of certain other bills is not always welcome, keeping state and local government advocates in a constant state of vigilance. The Digital Goods and Services Tax Fairness Act of 2019 is one such bill where the latter applies.

### HISTORY OF THE LEGISLATION

H.R. 1725 and its Senate companion, S. 765, are the current versions of a tax bill that GFOA and others in the state and local community have long opposed as a solution in search of a problem. Prior versions of the bill date back as far as 2009. Proponents of the measure claim the legislation is necessary because there is no national framework to govern the taxation of digital transactions. The primary purpose of the framework would be to prevent multiple states and local governments from claiming that they have the authority to tax the same digital transaction, which purportedly would result in a myriad of taxes on the consumer.

One of the main hypothetical situations proponents of the bill use to demonstrate that it is needed is a consumer

who decides to purchase and download a song while on vacation. In this situation, bill proponents claim that the state the consumer is visiting, the state where the server providing the song is located, and the consumer's home state could all decide to tax the purchase. There are two initial problems with this scenario, however. The first is that despite digital downloads being around for over a decade, bill proponents have not provided any data to show that this in fact is happening — not to mention that the nature of “downloading” music is changing, since there are many more streaming services today than there were ten years ago. Second, it appears that it would take a significant amount of effort and a high level of sophistication for a state (or a local government) to track and audit the scenario described above to ensure that the correct taxes were collected.

This legislation tracks similar previously introduced bills that have one common underlying theme: technology — or more specifically, the explosive advances in technology that have dramatically altered consumer behavior. Most recently, we witnessed developments (and a significant victory for state and locals) in the area of remote sales taxation stemming from the 2018 U.S. Supreme Court decision, *South Dakota v. Wayfair, Inc.* The issue of taxing remote sales is one that state and local governments have wrestled with since 1964. After many decades, the issue finally became ripe for consideration because of the Internet's role in substantially

increasing the reach of retailers to go far beyond state borders. Many states have either recently implemented or are still exploring how to implement remote seller laws as a result of the court's decision.

The key point for remote sales tax is that the issue, for the most part, was resolved through the court system rather than in Congress. For years, legislation that would grant state and local governments the ability to require remote sellers to collect sales tax languished in Congress despite having strong bipartisan support. Thus, states took it upon themselves to find a resolution that did not involve the federal legislative process. It is difficult to imagine a scenario today where the issue of taxing digital transactions could weave its way through the courts, much less a scenario where state and local governments would want to take a case dealing with the issue all the way to the U.S. Supreme Court — which makes it all the more concerning when legislation like the Digital Goods bill resurfaces, making state and locals play defense to prevent the bill from advancing.

## PROBLEMS WITH THE LEGISLATION

There is probably little disagreement with the idea that consumers should not have to pay multiple taxes from various jurisdictions on the same digital transaction. If the bill were solely about sourcing the digital transaction (i.e., establishing the framework to define the point of sale in order to determine the appropriate taxing authority), that would not be especially problematic. We've already seen efforts like the Streamlined Sales and Use Tax Agreement where government and business have come together to work out the issue of sourcing rules. But given the lack of data to indicate that

multiple jurisdictions are in fact trying to tax the same digital transaction, could might conclude that the Digital Goods bill isn't necessary.

Unfortunately, proponents continue to push the initiative, and the language of the bill seems to go beyond simply establishing a framework for the sourcing of a digital transaction. One of the concerns that GFOA has raised, going back to previous versions of the bill, is that the broad definition of digital service could result in the loss of revenues generated from on-demand and pay-per-view services from local cable franchise fees. This is an important revenue stream for many local communities that is allocated for a variety of purposes, including supporting public safety and education.

Furthermore, the bill calls for digital goods and services to be taxed at the same rate as other tangible goods under a state's general sales tax — which prevents state and local governments from setting their own tax policy. GFOA opposes legislation that fails to preserve the right of state and local governments to enact and administer their own tax laws without intervention from or preemption by federal authorities.

One of the other major problems relates to studies and estimates of previous versions of the bill and its fiscal impact on state and local governments. Most notably, in 2015, the Congressional Budget Office issued a cost estimate for the then-version of the Digital Goods bill and determined that it would impose an intergovernmental mandate, as defined in the Unfunded Mandates Reform Act.<sup>1</sup> In its cost report, the Congressional Budget Office estimated that the bill's prohibition on state and local governments from taxing some sales of digital goods

and services would cost them approximately \$1 billion in forgone revenues in at least one of the first five years after the law's enactment and at least that amount in each subsequent year. That amount far exceeded the threshold established in the Unfunded Mandates Reform Act for intergovernmental mandates — a threshold of \$77 million (adjusted annually for inflation) in 2015. Whether the Congressional Budget Office will be asked for a cost estimate of the current bill is unclear.

## CONCLUSIONS

The likelihood that Digital Goods could advance out of committee and to the floor in each chamber currently remains uncertain. Nonetheless, since the bill is a preemption of state and local tax authority and it would cause substantial future losses of vital revenue, GFOA will work to ensure federal lawmakers are aware of these concerns. Stay tuned and keep an eye out for alerts or updates as developments occur. The voice of GFOA members is absolutely necessary and invaluable when opposing federal preemptions like the Digital Goods bill. ■

### Note

1. The Unfunded Mandates Reform Act was enacted in 1995, in part to ensure that Congress, during the legislative process, adequately considered the potential effects of mandates in proposed legislation. Thus, under the law, the Congressional Budget Office is required, at certain stages of the legislative process, to assess the cost of mandates that would apply to state, local, and tribal governments or to the private sector. Ultimately, the objective of Unfunded Mandates Reform Act was to reduce the number of mandates passed down to state and local government through federal laws.

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