



## NCSL Executive Committee Task Force on State and Local Taxation

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# Digital Goods Update

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# Agenda

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- NCSL Principles
- Taxability Maps
- 2017 Legislative Developments
- Digital Tax Litigation Update
- Federal Legislation



# NCSL Executive Task Force on State and Local Taxation Principles and Resolutions

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- Cloud Based Services (*August 2012*)
  - To ensure that taxation is equitable, states should: Establish consistent sourcing regimes that recognize the special challenges to avoid multiple taxation; and not impose discriminatory taxes on Cloud Based Services.
  - States should base their decisions on the nature of the service and not on the nature of the provider.
  - Avoid imposing tax through administrative action.
- NCSL Supports Passage of the Federal Digital Goods & Services Tax Fairness Act (*August 2016*)
  - The National Conference of State Legislatures urges Congress to pass the Digital Goods and Services Tax Fairness Act, in conjunction with or after consideration of the Remote Transaction Parity Act, to establish a national frame work providing certainty and uniformity for state and local governments in the taxation of digital goods and services, while protecting consumers from multiple and discriminatory taxation and supporting the continued growth of the digital economy.

# NCSL Policy Directives & Resolutions

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- Standing Committee on Communications, Financial Services & Interstate Commerce
  - Government should not choose winners and losers of the digital age.
  - Government tax systems should regulate and tax communications and digital commerce in a competitively neutral and non-discriminatory manner.
  - Video policies should assure that like services are treated alike, investment is encouraged and services are taxed in a non-discriminatory manner.
  - Franchise fees should be tied to actual costs to use the rights of way and collected by one central agency per state.



# Digital Taxation - Overview

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- States continue to enact legislation expanding their sales taxes to digital goods and services and cloud-based goods and services.
  - There continues to be significant differences from state to state in how such goods and services are taxed.
  - Some states have alternative tax regimes where application of their taxes to such goods and services is unclear.
- States also continue to evaluate their current authority to tax e-commerce services (e.g., cloud computing services, etc.).
  - States attempt to tax such goods and services through either legislative changes or by applying existing tax laws related to the taxation of software or other tangible goods.
- A few states have specifically exempted digital goods/services or cloud computing services from taxation.

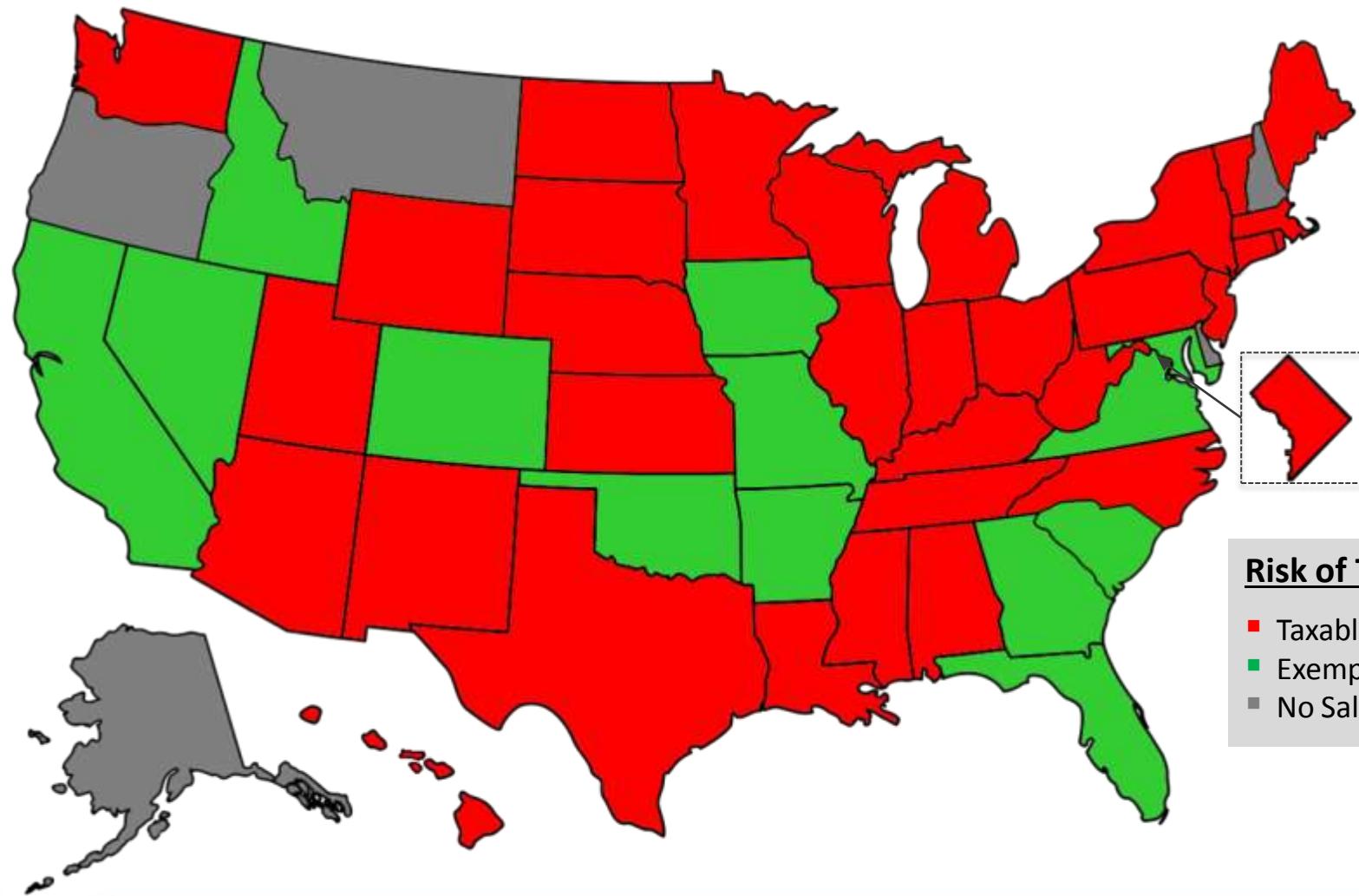
# Digital Taxation – Maps

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- The following maps show the taxability of various categories of digital content and services, updated through Feb. 2017.
- Categories include:
  - Prewritten (canned) computer software delivered electronically
  - Software as a Service (SaaS)
  - Digital Products/Goods (*i.e.*, movies, music and books)
  - Video Streaming
  - Audio Streaming



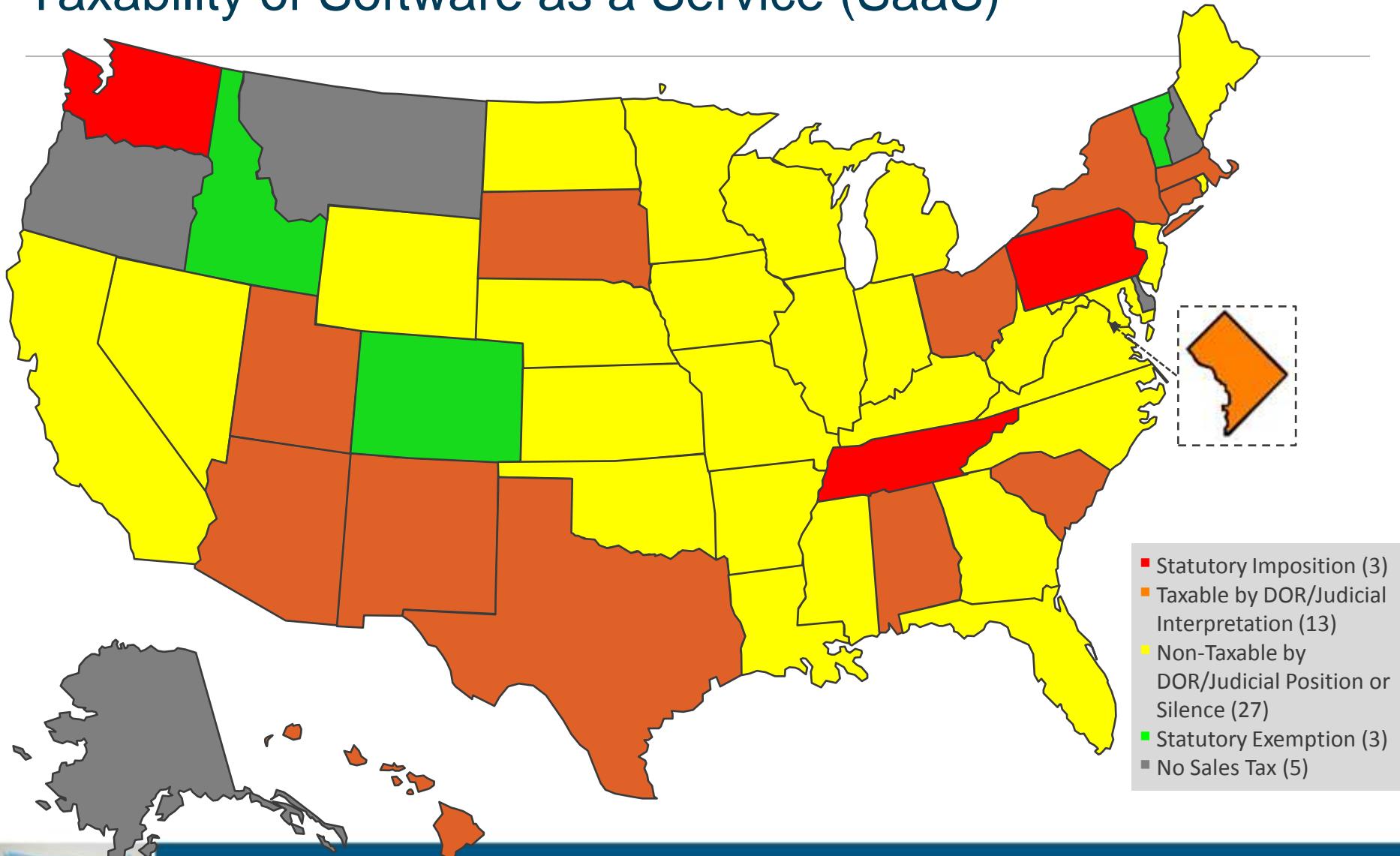
# Taxability of Prewritten Software Delivered Electronically



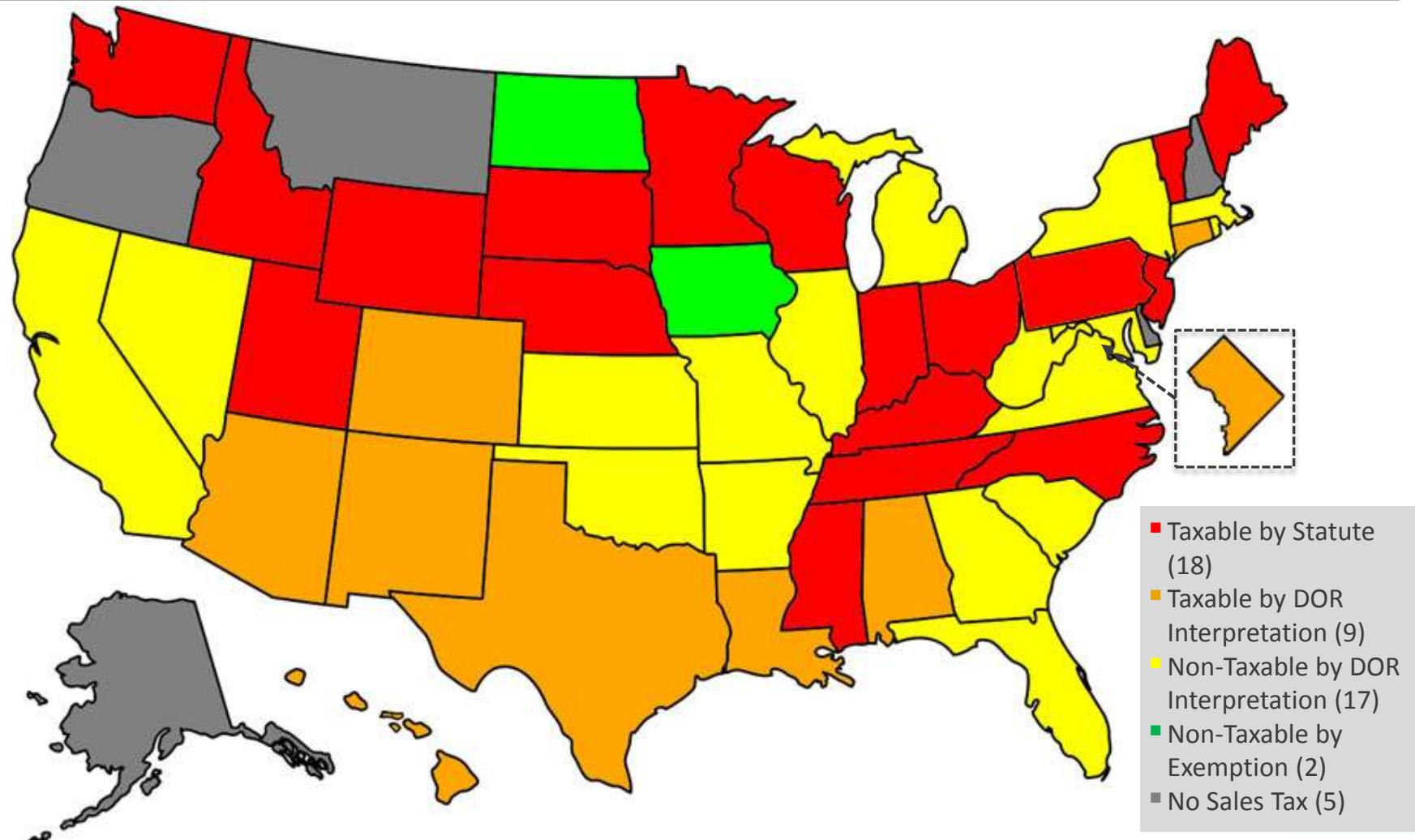
## Risk of Taxation

- Taxable (33)
- Exempt (13)
- No Sales Tax (5)

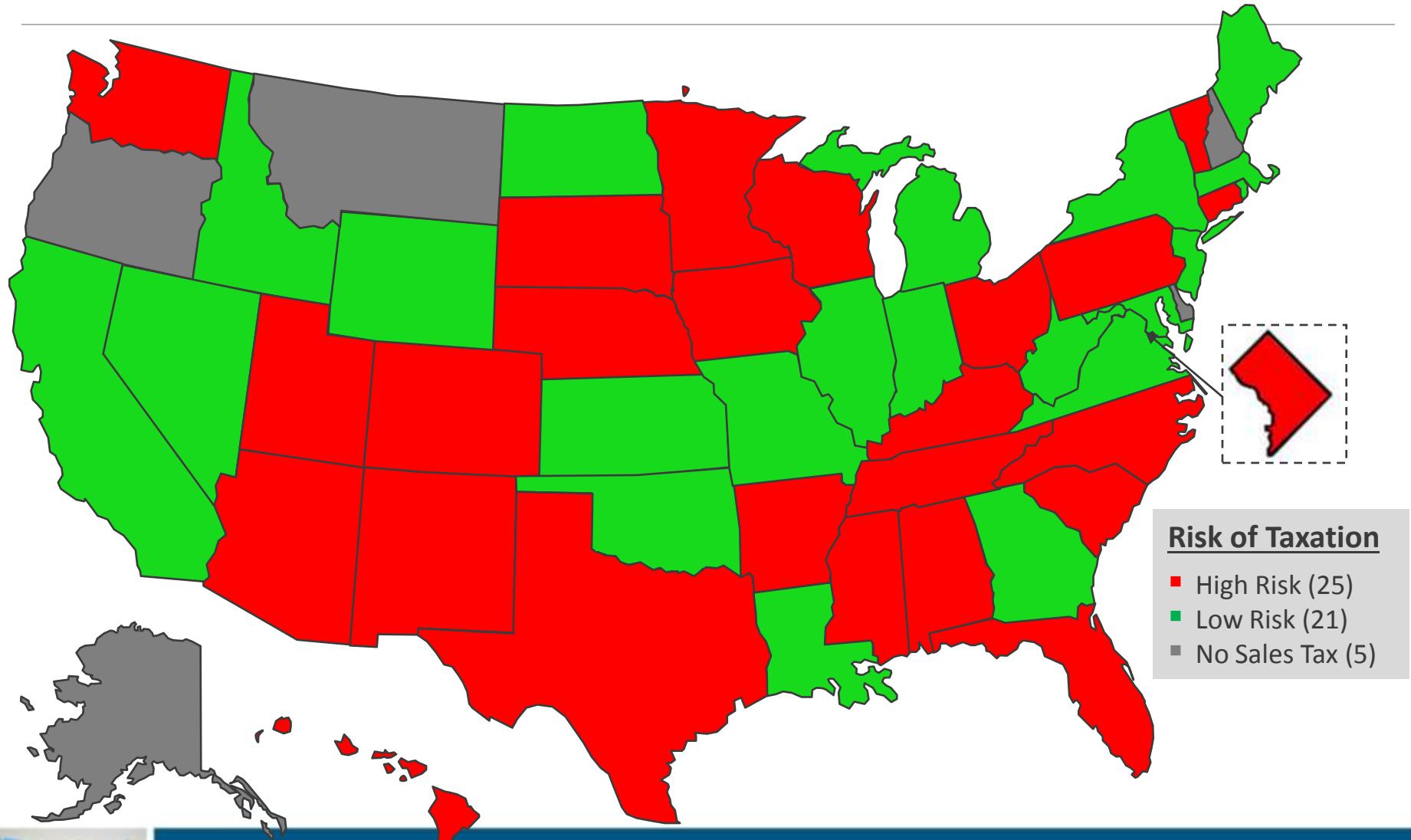
# Taxability of Software as a Service (SaaS)



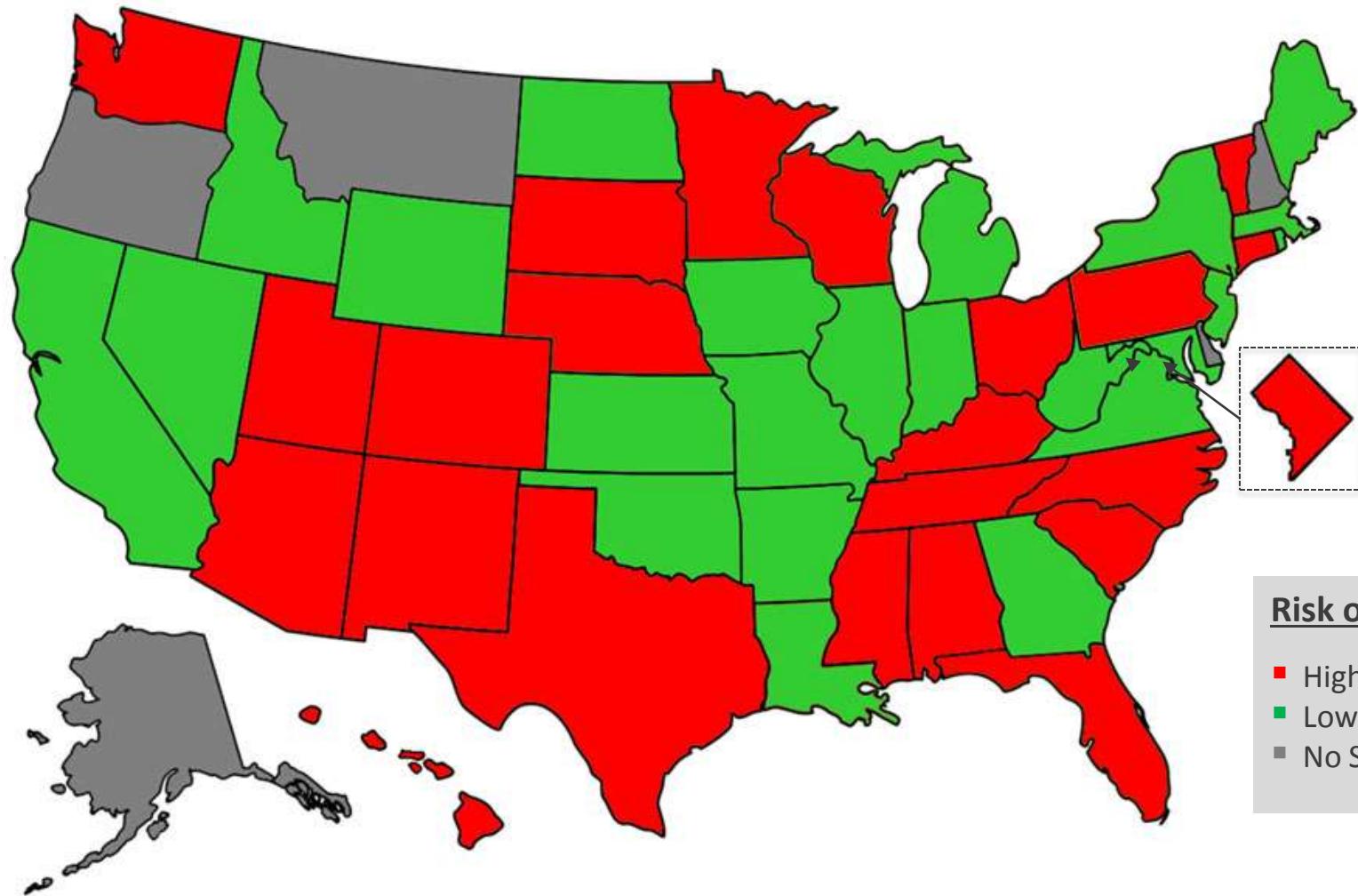
# Taxability of Digital Products



# Taxability of Streamed Video Content



# Taxability of Streamed Audio Content



# Digital Taxation – 2017 Legislative Developments

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## ▪ Arkansas

- Legislation (HB 1162) enacted earlier this year will impose tax on specified digital products and digital code starting next year.
  - Broad imposition language applies to streaming and subscriptions.
  - Effective Jan. 1, 2018.
- The digital imposition was added last-minute to counteract the revenue impact of a tax cut for veterans.

## ▪ Arizona

- Strike-all amendment to bill (HB 2355) would have exempted over-the-top linear (live) audio and video programming services provided to a customer over the internet from municipal taxation [did not advance].
- Digital tax interim study committee expected this year



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# Digital Taxation – 2017 Legislative Developments

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## ■ Alabama

- After a legislative working group met last fall, the DOR was tasked with drafting legislation that was widely anticipated to be introduced in 2017
  - High-level outline of DOR proposal released in Jan. 2017
    - Legislative leaders and stakeholders reached an impasse and digital tax legislation never came to light in the 2017 session
- In an unexpected turn of events, the DOR re-proposed amendments to the rental tax regulation (Rule 810-6-5-.09) nearly identical to those that were proposed in 2015 and opposed by the Legislative Council
  - Would interpret “digital transmissions” to be subject to the rental tax as TPP
  - Applicable to taxable transactions occurring on or after July 1, 2017
  - Public hearing scheduled for April 11 was cancelled at the request of Gov. Kay Ivey and the rule will die a natural death unless certified by early July



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# Digital Taxation – 2017 Legislative Developments

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## ▪ California

- *Lucent* hearing
  - On January 30, the Assembly Revenue and Taxation Committee held an legislative hearing on California’s Technology Transfer Agreement (TTA) laws in light of the *Lucent* decision.
    - The hearing provided a general overview of the *Lucent* decision, a status update on the BOE’s efforts to interpret and implement the decision, and the potential budgetary implications of the decision.
    - 900+ refund claims pending before BOE
  - Legislature has expressed interest in “clarifying” the *Lucent* case, but to-date no legislation has been introduced this year
    - In June 2013, BOE officials and Gov. Jerry Brown made an eleventh-hour attempt to insert language into a budget trailer bill that would have retroactively overturned the effects of a similar decision (*Nortel*) and curtailed the ability of other taxpayers to claim refunds of taxes on software qualifying for exclusion under the TTA laws.

# Digital Taxation – 2017 Legislative Developments

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- **California (cont.)**
  - Local video streaming prohibition (AB 252)
    - *Background* – in 2016 a coalition of cities sought to administratively interpret their utility tax to apply to over-the-top streaming providers
      - Current policy would distinguish tax treatment of over-the top services based on the nature of the provider.
    - Assembly Revenue and Taxation Committee Chair introduced legislation that would temporarily prohibit (through Jan. 1, 2023) local tax imposition on video streaming services, including, but not limited to, any tax on the sale or use of or any utility user tax on video streaming services regardless of the provider.
    - Held in Assembly Revenue and Taxation Committee after April hearing
      - Interim study committee forthcoming on this issue
      - Expected to be advanced in 2018

# Digital Taxation – 2017 Legislative Developments

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## ▪ Florida

- HB 1377 and SB 1636
  - Would have exempted “internet video service” from the definition of “communications services” subject to the communications services tax.
    - Defined “internet video service” to mean “a subscription video programming service received by the end user customer by means of a wired or wireless Internet connection.”
  - Would have prohibited all public bodies from levying on or collecting from sellers or purchasers of Internet video service any tax, charge, fee, or other imposition on or with respect to the provision or purchase of Internet video service.
  - Both bills died in committee in May

# Digital Taxation – 2017 Legislative Developments

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## ■ Illinois

- Senate Democrat’s “grand bargain” revenue bill (SB 9) was amended to tax “video and audio streaming services” as a taxable service.
- A subsequent iteration of the bill would have:
  - Imposed a new tax “upon the act or privilege of providing direct-to-home satellite service, direct broadcast satellite service, or digital audio-visual works to a subscriber in this State by any provider at the rate of 5% of the provider’s gross revenues derived from or attributable to that subscriber.”
  - Imposed a new entertainment tax “upon the subscribers of entertainment in this State at the rate of 1% of the charges paid for the privilege to witness, view, or otherwise enjoy the entertainment.”
- Failed to meet May 31 budget bill deadline – now requires a 3/5 vote in both chambers.

# Digital Taxation – 2017 Legislative Developments

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## ▪ Louisiana

- Bills backed by Gov. John Bel Edwards (HB 562) and House Democrats (HB 655) would expand the list of taxable “sales of services” to include the furnishing of:
  - Data processing services;
  - Audio and video services, including the streaming or downloading of digital goods;
  - Information services; and
  - Cable TV and satellite services, including the distribution of video programming to subscribing or paying customers, with or without the use of wires.
- The bills would expand the definition of “tangible personal property” using language similar to 2016 PA digital tax expansion.
- Neither bill has advanced out of House Ways and Means.



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# Digital Taxation – 2017 Legislative Developments

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- **Maine**

- Governor LePage's FY 18-19 Budget would extend the 6% service provider tax to:
  - “The sale of access to streaming video or audio content, whether single use or by subscription, to an end user that does not have the right of permanent use granted by the seller, and in the case of a subscription, the right of access is contingent on continued payments by the purchaser.”
- Because the imposition would be on the provider (at a different rate than sales tax), this proposal raises ITFA concerns.
- Currently being reviewed at committee level.



# Digital Taxation – 2017 Legislative Developments

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## ■ West Virginia

- Legislature considering tax reform bills (HB 107 and SB 1007).
- One revenue source being considered is a broad new tax on “digital products” and “digital code” electronically transferred to the purchaser.
  - Would apply regardless of whether the digital content is provided for permanent use or less than permanent use and regardless of whether continued payment is required.
    - Streamed, rented and subscription-based content would be subject to the tax.
  - “Digital automated services” are included within the scope of “digital products” and is defined as “any service transferred electronically that uses one or more software applications.”
  - Would apply to sales/use of digital products/code starting July 1, 2017.
- Negotiations between legislative leaders and Gov. Justice on-going.

# Digital Taxation – 2017 Legislative Developments

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## ▪ Others

### – Minnesota

- HF 349 – digital products tax repeal
- Executive tax bills (HF 893 and SF 726) – would have expanded “other digital products” to have a catch-all (*i.e.*, all items subject to tax in tangible form).
  - While Minnesota already taxes most digital content, this legislation would have imposed a new tax on digital periodicals (*i.e.*, magazines).
- Neither bill was included in the omnibus tax bill

### – Oklahoma

- FY 18 Executive Budget Proposal sought to broadly tax digital goods, software, data processing and information services.

### – Pennsylvania

- Executive Budget Proposal would tax “computer services”



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# Digital Taxation – Litigation Update

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## ▪ City of Chicago

- On June 5, the Entertainment Software Association (ESA) filed a complaint in Cook County Circuit Court challenging the City of Chicago's Amusement Tax Ruling # 5 (2015), which administratively expands the city's 9 percent Amusement Tax to online amusements, including streaming gaming, movies, television and music.
- Basis for lawsuit is violation of federal Internet Tax Freedom Act (ITFA), which prohibits state and local governments from imposing multiple or discriminatory taxes on electronic commerce.
- ESA is requesting declaratory judgment and permanent injunction enjoining the city from enforcing Ruling # 5.
- Liberty Justice Center has a similar lawsuit pending on the same issue.

# Digital Taxation – Litigation Update

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## ▪ Kentucky

- In 2015, the Board of Tax Appeals (BTA) held that Netflix's video streaming service is not comparable to taxable "multichannel video programming services" (defined to include cable, satellite and IP TV).
  - See *Netflix, Inc. v. Finance and Administration Cabinet Dep't of Revenue*, Order No. K-24900 (Bd. Tax App. Sept. 23, 2015)
- In August 2016, a Kentucky Circuit Court affirmed the BTA order.
  - See No. 15-CI-01117 (Franklin Cty. Cir. Ct., Aug. 23, 2016).
- DOR filed notice of appeal on Sept. 20, 2016.
  - Attempted to transfer the case to Kentucky Supreme Court, but ultimately withdrew the motion and the case was dismissed earlier this year.
- The Circuit Court decision holding that Netflix's services are not within the scope of the cable/satellite imposition is now final.

# Digital Taxation – Federal Legislation 114<sup>th</sup> Congress

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- H.R. 1643/ S.851 (114<sup>th</sup> Congress) The Digital Goods and Services Tax Fairness Act:
  - Provides a framework for the taxation of digital goods and services.
    - Restricts taxation of a digital good or service to taxation by a state or local jurisdiction whose territorial limits encompass a customer tax address, as defined by this Act.
    - Provides a “bundling rule” for the taxation of digital goods and services transactions that are aggregated and not separately stated from other goods and services.
  - Prohibits multiple and discriminatory taxation of digital goods and services.
  - Excludes from the definition of "digital service" a service that is predominantly attributable to the direct, contemporaneous expenditure of live human effort, skill, or expertise, a telecommunications service, an ancillary service, an Internet access service, an audio or video programming service, or a hotel intermediary service.
  - Includes pay-per-view video services and video on-demand in the definition of a digital service.



# Digital Taxation – Federal Legislation 115<sup>th</sup> Congress

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- The Digital Goods and Services Tax Fairness Act is not yet introduced yet in the 115<sup>th</sup> Congress.
  - The Sponsors are working with the communications industry to address concerns the industry has with the prior version.
- Communications Industry Concerns
  - Because of changes in technology, the growth of over-the-top video services, and the current efforts of some state and local governments to tax digital goods and services because of the nature of the provider, the communications industry believes that the bill needs to be updated. Specific areas include:
    - Updating and clarifying definitions of digital goods and services to account for the growth of over-the-top video services.
    - Ensuring that all over-the-top video services are treated in a competitively neutral manner regardless of the provider.



# Digital Taxation – Federal Legislation

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- What can Policymakers do:

- Work with Congress to address nexus over remote sellers including remote sellers of digital products and services.
- Work with Congress to develop a modern framework for sourcing digital goods and services, similar to what was effective for wireless services in 2002.
- Ensure that tax systems do not pick winners and losers, and treat digital goods and services in a competitively neutral and non-discriminatory manner.



# Comments? Questions?

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