MULTISTATE TAX COMMISSION
Maximizing the synergies of multistate tax cooperation

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April 8, 2015

The Honorable Bob Goodlatte
Chairman
Judiciary Committee
United States House of Representatives

The Honorable John Conyers, Jr.
Ranking Member
Judiciary Committee
United States House of Representatives

The Honorable Orrin G. Hatch
Chairman
Committee on Finance
United States Senate

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate

Re: H.R. 1643/S. 851, the Digital Goods and Services Tax Fairness Act of 2015

Dear Chairman Goodlatte, Chairman Hatch, Ranking Member Conyers and Ranking Member Wyden:

On behalf of the Multistate Tax Commission, I am writing to express concerns about H.R. 1643/S. 851, the Digital Goods and Services Tax Fairness Act of 2015 (Digital Goods Act). While we recognize the need to have uniform rules for sourcing sales of digital goods and services to states for tax purposes, this bill does not protect states against sales-shifting to avoid tax altogether and its other provisions are flawed, potentially creating significant problems for states and their tax administrators.

The Digital Goods Act indicates that its purpose is "to promote neutrality, simplicity, and fairness in the taxation of digital goods and services," but its ambiguous terms will cause the opposite result. The Act imposes a mandatory sourcing regime for "digital goods" and "digital services" for state tax purposes, and provides "most-favored" tax status to those goods and services. The Act is complicated and contains critical terms that are ambiguous. Most importantly, while it prohibits all but one state (the state to which the seller sources that sale) from taxing any sale of digital goods and services, it fails to grant jurisdiction to that state to impose tax if the seller is a remote seller.

Remote sellers will be able to structure sales to avoid collecting tax

One of the major challenges facing the state sales tax system (the only broadly applicable consumption tax system in the United States) is the fact that, under a 1992 Supreme Court Case (*Quill*), states may not require out-of-state sellers without physical presence in the state to collect the tax from consumers. As a result, the states lose out on collecting billions of dollars in sales taxes due and owing each year. This also gives these so-called "remote" sellers a competitive advantage over local sellers.

The Digital Goods Act would allow remote sellers of digital goods to take advantage of this state of affairs by granting them flexibility in keeping records or information, which in turn will provide an opportunity for the sales to be sourced to a state where the seller has no physical presence. It also allows the use of intermediaries to facilitate sales in a way that would shield remote sellers from collection duties in particular states. Moreover, by foreclosing the state of origin (where the remote seller arguably will always have physical presence) from choosing to tax the sales, the Act effectively allows the non-collection of sales tax on digital goods and services to continue, beyond the control of the states.

Digital goods and services are given most-favored tax status

The Digital Goods Act also grants "most-favored" tax status to digital goods and services. (See Sec. 2 and the definitions of "discriminatory" and "multiple" taxes.) Proponents of the Act have promoted these provisions claiming that they will prevent states from subjecting sales of digital goods and services to unfair or excessive taxes.

While it is true that states have taxed digital goods and services differently from traditional goods and services, the difference is that they have overwhelmingly taxed digital goods and services less. States already provide protections against multiple taxes and, since the Act mandates that only a single state may tax the transaction, there can be no need for special protections from multiple taxes.

The provisions are not just unnecessary; they are complicated and they raise a number of potential problems and unintended consequences for tax administrators. In part, this is because critical terms (e.g. "imposed", "similar", etc.) are undefined.

Finally, the states are already prohibited from imposing higher taxes on transactions conducted via the Internet under the Internet Tax Freedom Act (ITFA). There is a critical difference, however, between ITFA and this Act. Under ITFA's provision, the protection applies to "electronic commerce" vis-à-vis traditional commerce—and so it protects the same item from being taxed more because it is sold over the Internet. (Which is ironic since states often cannot require Internet sellers to collect tax at all.) The Digital Goods Act protection applies to a "digital good" and "digital service" vis-à-vis "similar" (not the same) goods and services. (See Sec. 7 (7).) States must, therefore, exempt or provide tax benefits to a digital good or service if a "similar" (undefined) traditional good or service is exempted or receives tax benefits (credits, etc.), even if the difference is clearly supported by legitimate tax policy reasons. This will certainly engender substantial and ongoing controversy and litigation.

The Act creates unnecessary problems for state tax administrators

The Act also imposes other unnecessary rules that overlap with rules already on the books at the state level and that will continue to apply to taxes imposed on sales of traditional goods and services. (For example, the Act contains a bundling rule which dictates how sales of "mixed" taxable and nontaxable transactions must be treated if the transaction contains a digital good or service. See Sec. 5.) There will, therefore, effectively be two systems for administering the taxes—

one that applies to sellers of digital goods and services and one that applies to sellers of traditional goods and services. This needless displacement of existing rules will undoubtedly cause conflicts and problems, complicating state tax administration.

I also note that there are critical administrative questions that the Act should address, which it fails to address. For example, the multiple location rule of Sec. 4(e) provides for sourcing of digital goods or services available for use in multiple locations simultaneously, but the rule does not provide for apportionment where the charge for the digital good or service is not broken out separately. The rule also does not specify that the "multiple locations" must be locations in some way directly connected to the customer.

For these and other reasons, the tax administrators representing the states belonging to the Multistate Tax Commission believe the bill would create more problems than it solves.

Thank you for the opportunity to present these views.

Sincerely,

pp: Julie P. Magee
Alabama Commissioner of Revenue
Chair, Multistate Tax Commission