

SIMPLIFYING THE TAXATION OF DIGITAL GOODS

MAY 3, 2019



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Congress recently introduced federal legislation to simplify the taxation of digital goods by states in companion bills H.R. 1725 and S. 765, introduced concurrently on March 13, 2019. The “Digital Goods and Services Tax Fairness Act of 2019” (the Act) aims to standardize tax sourcing as it relates to the sale of digital goods and services. Tax “sourcing” refers to the process of determining which taxing authority has jurisdiction to impose tax on a transaction. Currently, in the absence of federal legislation, individual states may determine how and where the sale of a digital good or service is sourced. This can result in multiple taxing authorities claiming jurisdiction over the same sale. The Act would eliminate the sourcing inconsistencies that currently exist among states that tax digital goods and services and establish uniform rules for determining which state has authority to tax the sale of a digital good or service.

While the ‘free-for-all’ tax sourcing scheme is nothing new among the states, sourcing for digital goods and services is particularly complicated due to the numerous ways these items can be provided, stored, delivered, accessed, and used.

Often times three or more states could be involved in a single transaction, which causes disagreement between states regarding which state has authority to tax the transaction. While many states source the sale of a digital good using destination-based sourcing (where the service is received), some states tax digital goods and services based on where the service is provided (which could be argued is the location of the server on which the digital good is stored). Other states have different sourcing rules entirely.

A “digital good” covered by the Act would include all software, and other goods, transferred to the purchaser electronically. NOTE: This definition may not match the definition of digital good used by those states that tax digital goods. A “digital service” would include remote access to digital goods, audio or video programming service, and VoIP service. Below are some examples of commonly-purchased digital goods and services covered by the Act:

- Electronically delivered software, audio, or video
- Television programming services
- Cloud-based services (SaaS, PaaS, IaaS)
- Music subscription services
- Video streaming services

The issue of where to situs sales of digital goods and services has become more important in the last few years due to the growing number of digital goods that are delivered electronically and/or may be purchased in a mobile environment. Often times it may be entirely unclear where the purchase of a digital good should be sourced. For example, it may be impossible to determine where to situs a digital good purchased during airline travel.

The Act would require all states to adhere to uniform, destination-based sourcing rules for sales of digital goods and services (generally the customer’s tax address as long as it is a business location of the customer). If a digital service is available for use by the customer in multiple locations, the service can be sourced to the locations of use provided by the customer, as long as the method used by the customer is reasonable and consistent. The Act also allows for the customer to provide the addresses at the time of sale or at a later time, which may be a different time period allowed by some states. In the event the seller does not have sufficient information to determine the customer’s tax address, the seller has the option to source the sale based on the location of its own business operations. Notably, the Act specifically excludes servers, machines, and devices used for simply routing or storage of digital products and services from the definition of location.

The Act contains a provision regarding tax types that are excluded from the bill and, therefore, it seems to be targeted primarily at sales and use taxes. Excluded tax types include taxes on or measured by apportioned income, apportioned revenue, apportioned gross receipts, apportioned taxable margin, and a business and occupation tax. It is unclear, however, whether the Ohio Commercial Activity Tax (CAT) would be excluded from the sourcing rules in the bill, as the CAT is measured by gross receipts situated to Ohio, rather than an apportioned amount of gross receipts.

With the impact of *Wayfair*, bills such as the Digital Goods and Services Tax Fairness Act of 2019, which are aimed at simplifying broad tax issues, could draw more attention than they have in the past. We will be monitoring the status of this bill as it works its way through the legislative process and provide meaningful updates as they become available.

ZHF Observation

Since Ohio is one of the few states that taxes certain services (electronic information (EIS), electronic publishing (EPS) and automatic data processing (ADP)) that could arguably fall under the definition of digital goods/services, this situsing change could definitely impact Ohio. Further, Ohio will need to analyze the types of services that currently are being interpreted as EIS, EPS or ADP that will be prohibited from being taxed effective July 1, 2020. Based on the definition of “internet access” found in 47 USC 151, some services currently being taxed as EIS, EPS or ADP may not be taxable after June 30, 2020.

If you would like to talk about this or any other state and local tax issues, please contact [Jason Walker](#), [John Trippier](#), or any other ZHF professional.

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