

Digital Services Tax

SANDBERG
PHOENIX

ST. LOUIS, MO

CLAYTON, MO

KANSAS CITY, MO

CARBONDALE, IL

EDWARDSVILLE, IL

O'FALLON, IL

www.sandbergphoenix.com

Digital Services Tax:

“Why the world is watching” from Bloomberg Tax: January 6, 2021, “The digital economy is growing two and a half times faster than the global GDP, and governments are trying to tax the resulting revenue – mostly jurisdictions that are not home to the largest companies in the digital economy.

Growth of the Digital Economy

The Digital Economy is equivalent to 15.5% of global GDP and is growing two and half times faster than the global GDP over the past 15 years according to the world bank. This rapid expansion has sparked global debates in many legal and regulatory realms. In the field of international taxation, the debate focuses on whether the current rules are appropriate in the modern global economy especially regarding the allocation of income and profits among countries for tax purposes or purposes of being potentially subject to tax.

Article Written by Amie Ahanchian, Donald Hok, Philippe Stephanny and Elizabeth S. Shingler

U.S. Trade Representative initiates investigation and in December 2019, issues a notice that the DST is unreasonable or discriminatory and burdens or restricts US commerce

In response (to the European Commission attempt to impose a digital services tax), the U.S. has threatened to impose retaliatory tariffs, arguing that DSTs unfairly target U.S. multinational corporations. As a result, while only a portion of businesses will immediately be subject to DSTs, many more will feel the impact and tariffs going into effect.

Article Written by Amie Ahanchian, Donald Hok, Philippe Stephanny and Elizabeth S. Shingler

While the US is rebuking the European taxes on DST's, internally the states are disjointed in their individual approach to sales and income taxation.

It appears at first blush, that the result of the DST seems reminiscent of the domino effect in the United States of South Dakota v. Wayfair, Inc. wherein the United States Supreme Court held by a 5 to 4 majority that states may charge tax on purchases made from out of state sellers, even if the seller does not have a physical presence in the taxing state.

Since Wayfair, states have not only embarked upon aggressively collecting sales tax essentially from internet sales throughout the United States, but have begun to embark upon a new definition of Nexus to subject companies to **income tax** within their state jurisdictions.

The Multistate Tax Commission

The multistate tax compact was formed in 1966 by a group of state officials including tax administrators, attorneys general, state legislators, and a special committee of the counsel of state governments. The purpose of the compact was to promote uniformity in tax administration procedures among the states. The compact deals primarily with taxes which affect businesses that operate in more than one state. The model act had been drafted in 1957 by the Uniform Law Commission. Of course, this commission is an advisory commission, and each state is free to pass its own definition of products and services subject to sales and income taxes.

P.L. 86-272 has been the law for 6 decades.

In 1959 the Federal Government enacted P.L. 86-272 to limit a state's ability to impose a net income tax on transactions occurring in interstate commerce. Under this federal law a state cannot tax the income from sales of tangible personal property if the taxpayer's only business activities in the state are the solicitation of orders that are approved and shipped from outside the taxing state. . . the U.S. economy has dramatically changed since P.L. 86-272 was enacted more than 60 years ago, but the law has never been amended to reflect changes in the typical business model.

MTC Reviewing Fed Laws Covering State Income Tax January 4, 2021, written by Jamie Yesnowitz, Chuck Jones, Lori Stolly and Patrick Skeehan

MTC advice

As a result of the Wayfair decision the MTC introduced proposed language "as a general rule, when businesses interacts with a customer via the businesses' website or app, the business engages in an activity within the customer's state" alternatively, "if the website merely presents static, text or photos, there is no engagement or facilitation within the customer's state."

The Digital Goods and Services Tax Fairness Act (2011)

In 2011, the US Congress enacted The Digital Goods and Services Tax Fairness Act to promote neutrality, simplicity and fairness in the taxation of digital goods and services but didn't go far enough in providing guidance and direction for the individual states. (www.quadermo, 8/13/2020).

Obviously, Wayfair and the digital tax discussion has caused a *free for all* for states to attempt to raise revenue by crafting each state's own definition.

The obvious challenge is how does a state define a digital sales tax. One blog as early as 2018 as a tax on "digital products such as movies, books and e-Books, music, ringtones, photographs, magazine and newspaper subscriptions" . . . many states treat software differently than digital products like e-Books.

Sales Tax By State: Should You Charge Sales Tax on Digital Products by Jennifer Dunn February 13, 2018

Just as we have witnessed the domino effect of Wayfair which has caused each state to define its own definition of Nexus, it is likely that each state will cause it to define its own definition of digital goods or services. There is no Uniform Sales Tax in the U.S. It is up to each individual state whether or not it wants to charge sales tax, and how much and on which products. This means for each **sale of goods** and in some states, **services**, which your business makes in the U.S., you need to look at the sales tax regulations at a state level for definition and a local level for tax rate for each sale of products or services.

The sales tax laws have been updated to include digital goods and services in different ways across the different U.S. states, an application of these laws have become troublesome for most state and local governments. Quick stats: There are 28 states that tax digital products. There are 23 states that do not tax digital products. Four states do not have a retail sales tax at all: Delaware, Montana, New Hampshire and Oregon. Four of the states that tax digital products the tax rates vary from 1% to 7%.

What are generally considered digital goods?

From a tax perspective there are 6 types of digital goods:

1. Online Data Processing Services
2. Downloaded Software
3. Downloaded Books, such as e-Books and Kindle
4. Downloaded Music, Digital Audio Files Such as I-Tunes and Podcasts
5. Downloaded Movies or Digital Videos such as Netflix and Amazon Prime
6. Other Downloaded Electronic Goods

Maryland is 1st to pass and advertising tax as the other states watch for the outcome.


In an article in the National Law Review "Maryland Breaks Ground with Digital Advertising Tax" Wednesday, March 17, 2021 "Overriding the governor's veto of House Bill 732, the Maryland Senate on February 12, 2021 passed the nation's first state tax on the digital advertising revenues pulled in by large companies.

The author Stephen Hollman correctly assessed the landscape by saying "The Maryland tax . . . reflects the collision of two economic forces magnified by the pandemic"

Large firms will be taxed from Maryland digital advertising services. The tax applies to annual gross revenue from digital advertising services in Maryland from entities with \$100,000,000.00 in global annual gross revenue or more. The tax rate increases based on global annual gross revenues of the entity 5% for entities with over \$100,000,000.00 in global annual gross revenues

Maryland Senate Bill 787

1. Creates a reprieve from tax for certain revenues
2. Prohibits taxpayers from directly passing on the cost of the tax to customers by means of a separate fee or surcharge, but does not prohibit taxpayers from simply increasing the cost of goods or services
3. Suspends the effect of data to new tax until 2022



**Stay tuned... this is just
the beginning of a
compliance nightmare.**

ST. LOUIS, MO

CLAYTON, MO

KANSAS CITY, MO

CARBONDALE, IL

EDWARDSVILLE, IL

O'FALLON, IL

www.sandbergphoenix.com