



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

December 16, 2015

### **H.R. 1643** **Digital Goods and Services Tax Fairness Act of 2015**

*As ordered reported by the House Committee on Judiciary on June 17, 2015*

#### **SUMMARY**

H.R. 1643 would prohibit state and local governments from imposing taxes on the sale of some digital goods and services that are taxable under current law.

CBO estimates that enacting H.R. 1643 would have no direct impact on the federal budget. Enacting H.R. 1643 would not affect direct spending or revenues; therefore pay-as-you-go procedures do not apply. Enacting the bill also would not increase net direct spending or on-budget deficits in any of the four 10-year periods beginning in 2026.

The prohibition on the ability of state and local governments to tax the sale of some digital goods and services would be an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the cost of complying with that mandate would far exceed the threshold established in UMRA for intergovernmental mandates (\$77 million in 2015, adjusted annually for inflation). H.R. 1643 also would impose a private-sector mandate, as defined in UMRA, on sellers of digital goods and services by requiring them to maintain tax information on their customers. CBO estimates that the incremental cost to comply with the mandate would fall below the annual threshold for private-sector mandates established in UMRA (\$154 million in 2015, adjusted annually for inflation).

**ESTIMATED COST TO THE FEDERAL GOVERNMENT:** None.

#### **ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS**

H.R. 1643 would impose an intergovernmental mandate as defined in UMRA by prohibiting state and local governments from taxing some sales of digital goods and services. CBO estimates that the cost—in the form of forgone revenues—to state and local governments would total about \$1 billion in at least one of the first five years after the mandate becomes effective and at least that amount in each subsequent year. The costs

would far exceed the threshold established in UMRA for intergovernmental mandates (\$77 million in 2015, adjusted annually for inflation).

Specifically, the bill would prohibit state and local governments from imposing taxes on the sales of digital goods and services under any of the following conditions:

- The customer's tax address is not within the state or locality;
- The taxing jurisdiction does not reduce the tax owed by the amount of taxes paid to other jurisdictions or include an exemption for resale and component parts; and
- The tax rate applied to the digital good or service is higher than the rate that would apply to a similar good or service that is not delivered electronically.

The bill also would prevent state and local governments from imposing taxes on revenues generated by businesses that provide billing services for or deliver digital goods and services on behalf of sellers of digital products or services.

## **BASIS OF ESTIMATE FOR THE INTERGOVERNMENTAL MANDATE**

UMRA includes in its definition of mandate costs any revenues that state and local governments would be prohibited from raising as a result of complying with the mandate. The mandate costs of H.R. 1643 would include any taxes that state and local governments would be precluded from collecting under the bill. (UMRA's definition of mandate costs excludes increases in revenues that state and local governments might collect in reaction to enactment of a mandate.)

CBO estimates that most states and some local governments would see an immediate revenue loss upon enactment of H.R. 1643 because they are currently collecting taxes on sales that, under the bill, would be exempt from taxation. Subsequently, businesses likely would rearrange their activities to take advantage of beneficial tax treatments that would result from the interaction of the new federal law and certain state taxing regimes. Those changes in business activities would probably result in additional revenue losses to the states. However, CBO has no basis for estimating the extent to which such reorganizations would occur and has not included an estimate of such losses in the mandate costs noted above.

CBO used information from a variety of sources to estimate the state and local revenue losses that would result from enacting this legislation. Using data from the states, industry, academia, and the U.S. Bureau of the Census, CBO estimated potential losses based on information about current tax collections, the structure of state and local taxing systems, and national sales of digital goods and services.

In the absence of clear definitions, CBO made several assumptions about the meaning of key terms in the bill. Those assumptions include:

- Services that are provided to the consumer electronically, such as data processing and storage, database, online marketplace, and website services, are digital services;
- Items that are downloaded by consumers, such as software and software updates, books, games, apps, and pay-per-view movies, are digital goods;
- Items that are purchased over the Internet and mailed to the consumer are not digital goods; and,
- Items that are purchased over the Internet and received in person, such as tickets to a concert or movie, are not digital goods.

Those and other assumptions were necessary to identify the scope of goods and services that would be affected by the bill's limits on taxation.

States use a variety of rules to determine whether sales and revenues are taxable under current law. Differences in the taxing systems of individual states affect how much revenue each state or local government would likely forgo under the bill. CBO examined both the characteristics of the sales tax structure of each state and data about sales in each state to estimate potential revenue losses.

To estimate the costs of enacting H.R. 1643 to state and local governments, CBO first used census data and market studies to estimate the total sales of digital goods and services to customers in each state. Since many states exempt purchases by entities such as governments, nonprofits, educational institutions, and religious organizations from sales taxes, CBO used additional information from the states and academic studies to calculate the portion of sales taxes that could be affected if H.R. 1643 were enacted. CBO estimates such taxes would total about \$7 billion in 2016, absent the bill. In general, CBO expects that states would lose about 15 percent of sales taxes on digital goods and services—or about \$1 billion—annually, nationwide. To calculate annual losses, CBO estimated the likely percentage each state would lose based on its current tax system and applied that percentage to the sales taxes potentially affected.

In total, lost revenues from enacting H.R. 1643 would total less than 1 percent of state and local sales taxes on all goods and services annually, CBO estimates.

The percent of revenues lost by each state would vary significantly and would depend on the characteristics of each state's tax system. For example, a state that imposes taxes on the sale of digital goods and services to buyers that intend to repackage them into a different

digital good or service that they resell would lose a higher percentage of their sales taxes than a state that exempts such sales from taxation.

State and local governments often alter their tax codes to address changing circumstances. However, such changes are difficult to predict; thus, for the purposes of estimating the direct costs of the mandate in H.R. 1643, CBO has considered only the revenues from taxes that are currently in place and actually being collected, or estimates for changes that are already in statute and that will be implemented over the next five years.

## **ESTIMATED IMPACT ON THE PRIVATE SECTOR**

H.R. 1643 would impose a private-sector mandate, as defined in UMRA, on sellers of digital goods and services by requiring them to determine and maintain customer tax addresses related to the sales of such products. Those sellers also would be responsible for collecting and remitting taxes to the state and local jurisdictions that contain the customer tax address if the state has the authority to require the seller to do so. The customer's tax address would be determined by rules outlined in the bill. According to industry sources, in states that impose taxes on digital goods and services, sellers in their jurisdiction are generally required to maintain the customer tax address, and to collect and remit the correct amount of tax. Because most businesses already comply with requirements similar to those in the bill, CBO estimates that the incremental cost to comply with the mandate would fall below the annual threshold for private-sector mandates established in UMRA (\$154 million in 2015, adjusted annually for inflation).

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