

# Taxation of Digital Goods and Services

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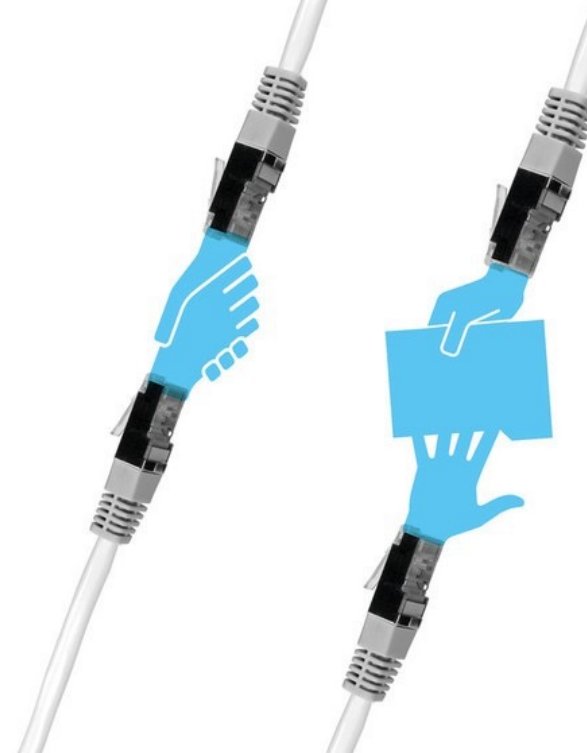
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# Agenda

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- Digital Ad and Personal Data Taxes
- Marketplace Collection Laws
- IaaS/PaaS/Remote Access/  
Streaming/ Digital Goods
- NFTs and Cryptocurrencies



# Learning Objectives

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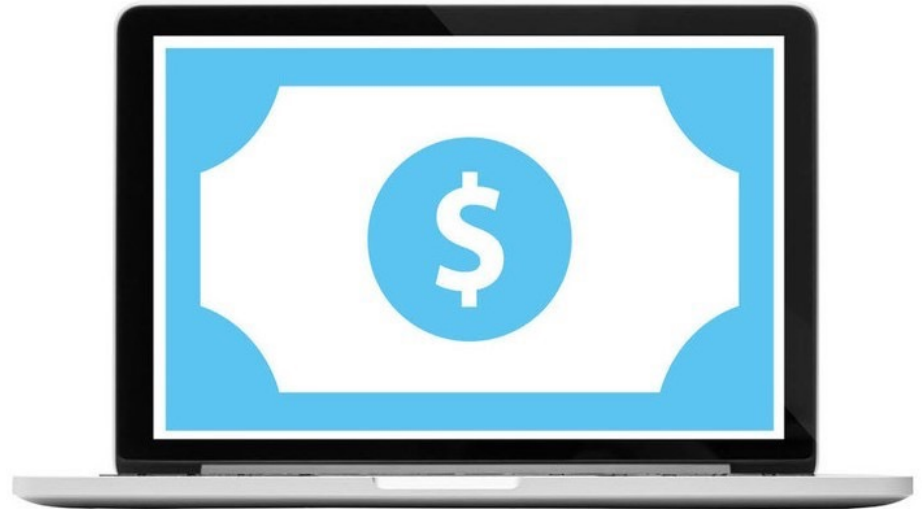
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- Provide an overview of digital advertising and marketplace facilitator legislation.
- Address anticipated legislative developments related to digital advertising and marketplace facilitators.
- Review developments regarding sales tax treatment of software as a service and digital goods.



# Digital Advertising & Personal Data Taxes



# Digital Services/Data Tax Proposals

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## Overview

- Legislation proposing new taxes targeting “big tech” has been introduced in over a **dozen** states in the last two years.
- Four categories of tax proposals:
  - Gross revenue/receipts taxes on digital advertising services;
  - Gross revenue/receipts taxes on social media advertising revenue;
  - Expansion of sales tax base to reach “digital advertising services”; and
  - Severance-style taxes on companies selling personal information and data.

# Why Are These Taxes Being Introduced?

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- “Big tech” is perceived by some legislators as not paying enough state taxes.
- Maryland Senate Budget and Taxation Committee Vice Chair Jim Rosapepe (D) has said that the purpose of Maryland’s digital advertising services tax is to “make sure the big tech guys pay their fair share.”



# Why Are These Taxes Being Introduced?

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- Others have identified broader political concerns about the power of “big tech.”
  - In a May 2019 New York Times editorial, Paul Romer (former Chief Economist of the World Bank) expressed concerns that digital platform companies have “created a haven for dangerous misinformation and hate speech that has undermined trust in democratic institutions.”
  - In Indiana, legislation specifically targeting advertising revenue of social media providers was introduced by a Republican senator mere days after social media companies banned President Trump from their platforms.



# Maryland Digital Advertising Gross Revenues Tax

## Background

- HB 732 (enacted Feb. 12)
  - Creates a new digital advertising gross revenues tax separate from, and in addition to, the existing Maryland sales tax.
    - The current Maryland sales tax is narrow, though attempts have been made to “modernize” the base.
    - Tax imposed on a person’s annual gross revenues derived from digital advertising services in Maryland.
- SB 787 delayed the start of the digital advertising tax by one year, to Jan. 1, 2022.



# Maryland Digital Advertising Gross Revenues Tax

## Imposition & Rate

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- Imposed on “annual gross revenues...derived from digital advertising services in the State.”
  - “Annual gross revenues” means “income or revenue from all sources, before any expenses or taxes, computed according to generally accepted accounting principles.”
  - Digital advertising services “includes advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services.”
  - “Digital interface” broadly defined as “any type of software, including a website, part of a website, or an application, that a user is able to access.”

# Maryland Digital Advertising Gross Revenues Tax

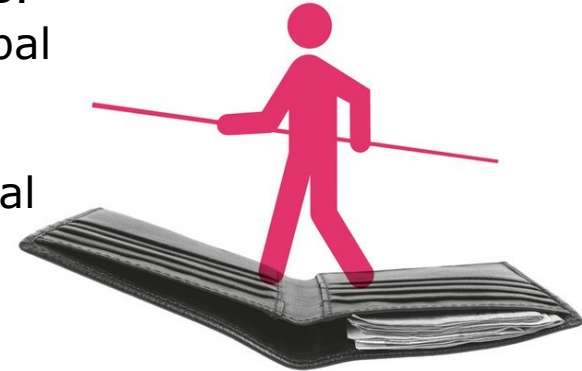
## Imposition & Rate

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- Determined based on each entity's global "annual gross revenues."
  - 2.5% of the assessable base for a person with global annual gross revenues of \$100M through \$1B.
  - 5% of the assessable base for a person with global annual gross revenues more than \$1B through \$5B.
  - 7.5% of the assessable base for a person with global annual gross revenues more than \$5B through \$15B.
  - 10% of the assessable base for a person with global annual gross revenues exceeding \$15B.



# Maryland Digital Advertising Gross Revenues Tax

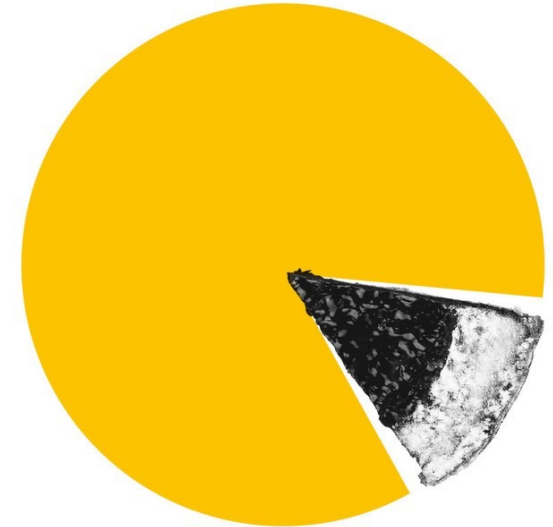
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## Apportionment

- Maryland legislation delegated apportionment determination to State Comptroller.
- Proposed regulations released by the Comptroller on August 31, 2021 proposes to calculate the numerator of the apportionment fraction (i.e., gross revenues from digital advertising in Maryland) by looking to whether the device showing the advertising is in Maryland.



# Maryland Digital Advertising Gross Revenues Tax

## Apportionment

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- Same proposed regulations describe the “development” of the statutory apportionment fraction using a 4-step computation:
  - First, “[a]n apportionment factor shall be developed as a fraction, where the numerator is the number of devices that have accessed the digital advertising services from a location in the State, and the denominator is the number of devices that have accessed the digital advertising services from any location.”
  - Second, that factor would next be applied to “the digital advertising gross revenue received by the taxpayer to compute the digital advertising gross revenue attributable to the State.”
  - Third, the Comptroller adopts a throwout rule for devices that have an “indeterminate” location.
    - A DAT taxpayer will be required to exclude from the numerator and the denominator (described above) those devices that a taxpayer cannot identify – on a worldwide basis – “the actual, physical location of a digital interface when a digital advertising service is accessed by a user.”
  - Finally, the factor is “applied to the digital advertising gross revenue pursuant to [the second step, above, in COMAR 03.12.01.02.02B(2)], without any adjustment to the amount of revenue to be apportioned.”

# Maryland Digital Advertising Gross Revenues Tax

## Apportionment, Applied

### Statute

Md. Code Ann., Tax-Gen. § 7.5-102(b)(1)

Annual Gross Revenues  
Derived from MD Digital  
Advertising Services

X

Annual Gross Revenues  
Derived from U.S. Digital  
Advertising Services

Annual Gross Revenues  
Derived from U.S. Digital  
Advertising Services  
**(ASSUMED)**

=

Annual Gross Revenues  
Derived from MD Digital  
Advertising Services  
(Assessable Base)

Md. Code Ann., Tax-Gen. § 7.5-102(b)(2) – “The Comptroller shall adopt regulations that determine the state from which revenues from digital advertising services are derived.”

# Maryland Digital Advertising Gross Revenues Tax

Apportionment, Applied

## Regulation

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# of Devices That Have  
Accessed Digital  
Advertising Services  
from MD

---

X

Taxpayer's Digital  
Advertising  
Gross Revenue

=

Annual Gross Revenues  
Derived from MD Digital  
Advertising Services  
(Assessable Base)

# of Devices That Have  
Accessed Digital  
Advertising Services From  
Any Location

# Maryland Digital Advertising Gross Revenues Tax

## Apportionment, Applied

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### Statute and Regulation

$$\begin{array}{l} \left[ \begin{array}{l} \# \text{ of Devices That Have} \\ \text{Accessed Digital} \\ \text{Advertising Services} \\ \text{from MD} \end{array} \times \begin{array}{l} \text{Taxpayer's Digital} \\ \text{Advertising} \\ \text{Gross Revenue} \end{array} \right. \\ \left. \begin{array}{l} \# \text{ of Devices That Have Accessed Digital} \\ \text{Advertising Services From } \underline{\text{Any Location}} \end{array} \right] \times \begin{array}{l} \text{Annual Gross Revenues} \\ \text{Derived from U.S. Digital} \\ \text{Advertising Services} \\ \underline{\text{(ASSUMED)}} \end{array} = \begin{array}{l} \text{Annual Gross Revenues} \\ \text{Derived from MD Digital} \\ \text{Advertising Services} \\ \text{(Assessable Base)} \end{array}$$

Annual Gross Revenues  
Derived from U.S. Digital  
Advertising Services

# Maryland SB 787 Amendments & Clarifications to Maryland Tax Regime

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- Pass-through prohibition: "A person who derives gross revenues from digital advertising services in the State may not directly pass on the cost of the tax imposed under this section to a customer who purchases the digital advertising services by means of a separate fee, surcharge, or line-item."





# Maryland SB 787 Amendments & Clarifications to Maryland Tax Regime

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- Exclusion from tax for digital advertising services on digital interfaces owned or operated by or on behalf of a “broadcast entity” or “news media entity.”
- A “broadcast entity” is “an entity that is primarily engaged in the business of operating a broadcast television or radio station.”
- A “news media entity” is “an entity engaged primarily in the business of newsgathering, reporting, or publishing articles or commentary about news, current events, culture or other matters of public interest.”
- However, a “news media entity” does not include an entity that is primarily an aggregator or republisher of third-party content.”

# Maryland Litigation Over New Digital Ad Tax

1. State court case: *Comcast et al. v. Comptroller* (Md. Cir. Ct., filed Apr. 15, 2021). Seeking a declaratory judgment that the ad tax:
  - a. Violates the Internet Tax Freedom Act
  - b. Violates the Due Process Clause
  - c. Violates the Commerce Clause's fair apportionment requirement and discriminates against interstate commerce
  - d. Improperly delegates taxing authority to Comptroller
2. Federal court case: *US Chamber of Commerce v. Comptroller* (D. Md., filed Feb. 18, 2021). Also seeking injunctive & declaratory relief, for many similar reasons.

# New York—Severance Tax Model

SB 4959 (filed Feb 19)

- Would impose a monthly excise tax on the collection of the consumer data of individual New York consumers by commercial data collectors.
- The tax rate varies based on the number of New York consumers the commercial data collector collects data on within the month, ranging from \$0 per month (less than or equal to one million New York consumers) to \$2,250,000 per month plus 50 cents per month on the number of New York consumers over ten million (over ten million New York consumers).





## Indiana

HB 1312 (filed Jan. 14)

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- Would have imposed a surcharge tax on social media providers.
- This proposed bill shares similarities with proposed digital advertising taxes in Maryland and New York, except that Indiana's proposed surcharge tax is targeted at social media providers deriving revenue from advertising services on their platforms of at least \$1 million dollars and does not contain a tiered rate structure.

# Future Trends for Digital Advertising Taxes

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- So far, only Maryland's tax has passed.
- Maryland's tax is already being challenged in federal, state court, on the basis that, among other things:
  - The tax violates the Internet Tax Freedom Act because it is a discriminatory tax on electronic commerce—the tax does not apply to traditional non-electronic advertising, such as billboard or classified ads.
  - The tax violates the Commerce Clause of the US Constitution by discriminating against interstate commerce because the tax's rate structure (based on global annual revenues from all sources) targets companies headquartered outside of Maryland.
  - The tax violates the First Amendment because it targets a specific platform of expression.

# Future Trends for Digital Advertising Taxes

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- Will other states push forward with legislation next year, or wait and see the outcome of Maryland litigation?



# State Marketplace Collection Laws & Litigation



# Background – Marketplace Laws

- All states with a sales and use tax have now enacted a marketplace collection law. The last three states passed their laws this year:
  - Florida SB 50 (signed by Gov. DeSantis 4/19)
    - Marketplace providers must collect and remit beginning July 1, 2021 after reaching a \$100,000 sales threshold.
    - Marketplace providers would be required to collect and remit the E 911 fee, waste tire fee, and lead-acid battery fee beginning April 1, 2022.
  - Kansas SB 50 (veto overridden 5/3)
    - Marketplace providers must collect and remit beginning July 1, 2021 after reaching a \$100,000 sales threshold.
  - Missouri SB 153 (passed 5/14)
    - Requires marketplace facilitators that meet a \$100,000 threshold to collect and remit tax beginning January 1, 2023.



# Some Issues Raised by Marketplace Laws

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Do they apply  
to taxes other  
sales/use  
taxes?

Who will  
determine  
taxability of  
product, the  
facilitator or  
seller?

Does a  
marketplace  
facilitator have  
to provide any  
type of notice  
that it will be  
collecting tax  
on marketplace  
sales?

Is the  
marketplace  
facilitator or  
seller required  
to accept  
exemption  
certificates?

# Marketplace Collections Go Local

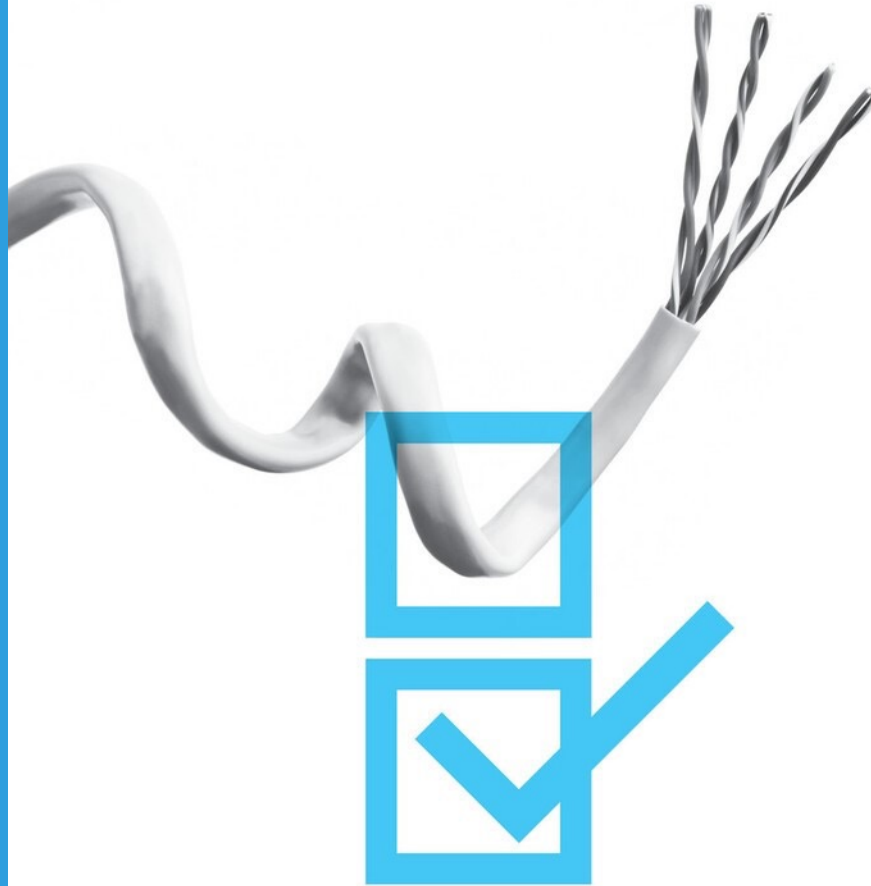
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- Local administration of sales taxes and fees poses unique compliance challenges for marketplace facilitators.
  - For example, Texas has a regulation that is intended to be effective October 1, which sources online sales to the destination of the sale for local sales tax purposes (contrary to the “origin sourcing” rule generally applicable for local sales tax purposes).
  - A Texas locality has filed a suit seeking to enjoin the regulation.
- Trend toward state-run online sales tax reporting portals.
  - Alaska, Alabama, Colorado, Louisiana
- Expect laws and ordinances to address collection of other taxes and fees.
  - Hotel and restaurant taxes, resort area fees, plastic bag taxes, soda taxes, and more!

# Remote Access, Digital Goods and Services



# Update on Taxation of IaaS/PaaS

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- Wisconsin – Issued proposed guidance re: sales and use tax treatment of computer hardware, software, and services (Feb. 20, 2020).
- SaaS – Charges for accessing prewritten computer software located on the vendor's server is not taxable (as long as the customer does not operate the vendor's service, control its operation, and does not have physical access to the vendor's server).
- IaaS – Charges for storage on someone else's server that the customer doesn't have control over or physical access to are not taxable.
- PaaS – contains elements of SaaS and IaaS and taxability depends on the factors above for SaaS and IaaS.



# Streamlined Sales Tax Issues with Taxing Digital Products and Services (e.g., SaaS)

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- **Wisconsin** DOR and other state DORs using various provisions to impose tax
  - CRIC interpretation on “telecommunications services” pending before the SSUTA Governing Board
- **West Virginia** using general services sales tax on services to tax “streaming” services
- **Kansas** imposes tax on subscription radio and tv services
  - Potential SSUTA compliance issue under Section 332 of the SSUTA with WV and KS taxing products “transferred electronically”
- Sourcing digital products – is a full address required by the SSUTA? (default is origin sourcing)
- Is uniformity needed? No business consensus to date

# Massachusetts – Remotely Accessed Software Products

*Citrix Sys. Inc. v. Comm’r of Revenue*, 139 N.E.3d 293 (Mass. 2020)

- The Massachusetts Supreme Judicial Court held that receipts from subscriptions to remote access software were subject to sales tax as taxable transfers of prewritten software rather than a non-taxable service.
- Following a change in the law to tax sales of prewritten software regardless of delivery medium, the Massachusetts Department of Revenue promulgated a regulation stating that taxable sales include “transfers of rights to use software installed on a remote server.”
- The court deferred to the Department’s interpretation of law, as reflected in its regulation.

# Colorado – Digital Goods

HB 21-1312 (enacted June 23, 2021, effective July 1, 2021)

- Adds “digital goods” to the statutory definition of “tangible personal property” subject to sales and use tax.
  - Intended to codify Colorado Department of Revenue’s “long-standing treatment of digital goods,” as reflected in its regulations.
- Under the new law, the definition of “tangible personal property” will include digital goods, regardless of the method of delivery.
- The new definition specifies that “digital goods” includes, but is not limited to, electronic download and internet streaming of video, music, or electronic books.

## Business Tax Tip #29 (June 3, 2021)

- Clarifies the Comptroller's interpretation of its sales and use tax on "digital products," including software
- The revised version of this tax tip incorporates SB 787's amendments and also provides numerous explanatory examples on topics such as:
  - Gift cards
  - Electronic services
  - Advertising agencies
  - Education and entertainment
  - Data, documents, and electronic communications
  - Software



*Oracle USA Inc., et al. v. Commissioner of Revenue*,  
No. SJC-13013 (Mass. 2021)

- Holding that the vendors can apportion sales tax on software purchased by a Massachusetts company to other states where the software was accessed and seek a tax refund
- The Court rejected the Commissioner's argument that vendors could not seek apportionment through the abatement process for their refund claims
- The Court also held that the legislature could not delegate the fundamental policy question of whether to allow apportionment of sales and use tax on software sold in Massachusetts but transferred out-of-state

# Some Other (Recently Failed) Digital Sales Tax Proposals

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## Georgia HB 594 (filed Feb. 22)

- This bill would expand the sales and use tax to encompass certain transactions of digital goods and services. "Digital goods or services" is defined include prewritten software, digital codes, SaaS, and related licenses

## Kansas HB 2230 (filed Feb. 3)

- This bill would extend sales tax to all sales of digital property and subscription services, regardless of whether: (1) The purchaser has the right to permanently use the property; (2) the purchaser's right to access or retain the property is not permanent; or (3) the purchaser's right to use is conditioned upon continued payment

## Utah SB 95 (filed Jan. 13)

- This bill would provide a sales and use tax exemption for tangible personal property consumed in the production or development of taxable computer software

## Vermont HB 261

- This bill would eliminate the sales and use tax exemption for prewritten computer software accessed remotely
- This bill would also impose sales and use taxes on vendor-hosted prewritten computer software

## Wyoming HB 176 (filed March 1)

- This bill would expand the sales tax to every retail sale of specified digital products within the state, including "the sale price for access to specified digital products through a streaming or subscription service that does not provide the purchaser with permanent use of the specified digital products."
- Under current law, Wyoming only subject specified digital products to tax if the purchaser has a permanent use of the specified digital product

# Taxation of Streaming Video—Chicago

*Labell v. City of Chicago*, 2019 IL App (1st) 181379 (Ill. App. Ct. Sept. 30, 2019)

- **Holding:** Illinois Appellate Court upheld the City of Chicago's imposition of its amusement tax on streaming video, streaming audio and online gaming services, finding that the tax did not:
  1. Exceed Chicago's home rule authority by taxing services occurring outside of Chicago;
  2. Violate the Uniformity Clause of the Illinois Constitution; or
  3. Violate the federal Internet Tax Freedom Act.
- Apple is currently bringing its own challenge to the tax on an "as applied" basis.
  - City is currently seeking dismissal on basis that Apple's complaint does not allege facts specific to Apple or different in any material way from the facts presented in *Labell*.

# Multistate Tax Commission

## Potential Expansion, Uniformity of States Taxing Digital Products?

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- MTC Uniformity Committee has approved a recommendation that MTC staff draft “a white paper on sales taxation of digital products, identifying potential best practices and areas for increased uniformity.”
  - MTC believes this is necessary because majority of states with sales taxes “impose tax on at least some types of digital products.”
- The recommendation intends for “digital products” to include the “entire category of products made possible by digital or electronic technologies that are not, primarily, tangible or physical property or traditional services.”
  - And the term “digital products” may include digital services.
- The outline of the white paper will be presented at the MTC’s November meeting.

# NFTs and Cryptocurrencies



# NFTs and crypto currencies

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## ➤ What are they?

- Digital representations of specific, one-of-a-kind tangible assets
  - art, music, videos, sports cards, etc.
- Confirmed via token and ownership is certified through blockchain
- Being used to create and sell a wide variety of intellectual property

## ➤ Sales tax characterization

- Intangibles
- Currencies/investment instruments
- Digital goods - many states already tax digital products/goods (i.e., downloaded books, movies, audio files, video games, etc.)
  - Scope of digital goods definition
  - Can the ownership be considered “permanent”?

# NFTs and crypto currencies

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- Where are they?
  - NFT is typically just the token that verifies the existence and ownership of the underlying content, not the content itself
  - “Data persistence”
  - Information available to the seller/purchaser
- How to source for sales tax
  - location of the purchaser or seller
  - the billing address of the purchaser
  - where the agreement is executed



# NFTs and crypto currencies

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- Other considerations
  - What is the right tax base?
    - Valuation of the assets
    - Anticipating change in value over time
  - Which transaction to tax?
    - Nature of trading creates multiple transactions
    - Resale exception and casual sale exemptions
  - Who is responsible?
    - Often sold over online marketplaces
    - Impact of the marketplace facilitator rules, consignment/auction considerations







# Thank you!

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