



June 19, 2012

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Federal “Digital Goods and Services Tax Fairness Act” Would Reduce State and Local Revenue for Critical Services and Promote Tax Avoidance

The proposed Federal Digital Goods and Services Tax Fairness Act of 2011 (“DGSTFA,” H.R. 1860/S.971) would limit state and local governments’ ability to levy taxes on downloaded music and movies, and online services like photo storage and payroll processing. This would reduce the ability of Texas and its local governments to provide necessary public services. The revenue losses would grow as more types of entertainment, information, and business-to-business services use online technologies.

Texas, which relies on the sales tax for more than half of all state tax revenue, would be affected more than most other states. Cities, counties, and transit authorities, which also count on sales taxes to support local services, would also be affected. This legislation would only worsen the current financial woes of state and local governments.

- DGSTFA would create new opportunities and incentives for corporate tax avoidance and manipulation, while discriminating against local retailers. This legislation would enable many corporations to avoid paying sales taxes entirely on their purchases of online services, such as payroll processing and website hosting, even if those services are taxable both where the seller is located and where the purchaser is located. In addition, this bill would encourage ongoing sales tax evasion by millions of online retailers who sell through online marketplaces like Amazon, because states would be permanently barred from requiring those marketplace operators to collect taxes when they bill customers for taxable goods and services. Lastly, this legislation would repeal immediately Texas’ existing sales taxes on downloaded computer software, even though store-based retailers must charge taxes on the same software. This last provision would force Texas to reenact its law or risk even greater long-term loss of state revenues.
- DGSTFA’s preferential treatment for certain online industries would place more Main Street businesses at a competitive disadvantage. There is no reason why certain online industries should be uniquely entitled to this treatment.



- DGSTFA is unnecessary to prevent double taxation. The chief substantive argument made by DGSTFA's proponents is that the bill is needed to prevent "double taxation" of digital products. However, "multiple and discriminatory" state and local taxes on all online goods and services are already barred by the Internet Tax Freedom Act enacted by Congress in 1997, and there is no evidence that such double taxation is occurring. Rather than preventing double taxation, this legislation would open up opportunities for online sellers of physical goods to change their legal structures to avoid charging sales taxes even once, and it would spur substantial litigation because of its vaguely-defined and unspecified terms.

For More Information

For more information or to request an interview, please contact Brian Stephens at stephens@cphp.org or 512.320.0222, ext. 112.

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