

Written Testimony
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Hearing on H.R. 1860, the “Digital Goods and Services Tax Fairness Act of 2011”

House Committee on the Judiciary
Subcommittee on Courts, Commercial and Administrative Law

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Chairman Coble, Ranking Member Cohen, and members of the Subcommittee, thank you for this opportunity to be here today to testify in support of H.R. 1860, the “Digital Goods and Services Tax Fairness Act of 2011.” My name is Jim Eads and I am a Director of Public Affairs for Ryan LLC, a leading tax services firm headquartered in Dallas with offices throughout the United States in Canada and in Europe. I applaud Chairman Smith and Rep. Cohen for their leadership on this issue.

This bill would establish a national framework for state and local taxes imposed on digital commerce, precluding multiple and discriminatory taxation of digital goods and services. Some might question whether this is a “solution in search of a problem,” indeed in a prior position, I might have even suggested that myself, but today digital commerce is a rapidly growing segment of our economy and the inherent complexities that surface in how digital commerce is transacted and taxed, this measure is both timely necessary. It will provide certainty to the millions of consumers and businesses that purchase digital goods and services, the thousands of providers required to collect state and local taxes on digital commerce, and the state and local jurisdictions seeking to tax digital goods and services.

Prior to my employment at Ryan, I was the Executive Director of the Federation of Tax Administrators. That role brought me before this committee many times as it was considering various legislative proposals impacting state and local taxes. While I am here today to testify in support of H.R. 1860, my consideration of the issues and possible solutions to the problems is the same regarding the appropriate role of Congress when you are considering legislation

impacting state and local taxes. Congress should respect state sovereignty and the need for state and local governments to administer their own fiscal issues and proceed cautiously in moving forward with any legislative measure impacting state and local tax authority. I suggest that your appropriate role as you consider this kind of legislation is to be thoughtful first as to the nation's interest then cautious, deliberate and mindful to the respective roles of federal and state governments.

While this was and is my opinion as to how these kind of issues should be considered, I have come to believe that this measure strikes the right balance and demonstrates when Congressional action is clearly needed to resolve some of the complexities that surface in today's Internet based economy where digital transactions take place over global broadband networks transcending numerous state boundaries. In fact, to provide the certainty needed for state and local jurisdictions seeking to tax digital commerce, Congressional action is needed to grant a jurisdiction the right to tax digital goods and services even when the activity may not have actually taken place within that jurisdiction's borders. Without Congressional action, there is uncertainty as to whether the state and local governments have the legal right to tax these transactions. This measure will provide consumers, sellers and state governments and tax administrators with the certainty and stability as to the revenue streams that they are seeking.

A little over a year ago, Governor Douglas of Vermont testified on behalf of the National Governor's Association at a hearing entitled "State Taxation: The Impact of Congressional Legislation on State and Local Government Revenues." At that hearing he outlined four principles to evaluate when it was appropriate for Congress to enact legislation addressing state and local tax issues. His testimony suggested that any federal legislation in this arena should do no harm, preserve flexibility, be clear and find the win-win. The specifics behind those principles are outlined below.

"Do no harm" – any legislation should "not disproportionately reduce existing state revenues."

"Preserve flexibility" – in discussing how states are addressing their budget gaps, the role of government is being analyzed, which will lead to "changes at the state level that could have

long-term, positive effects on the delivery of services, modernizing revenue systems and holding government accountable.” As such, “States should not be hindered in their pursuit of these reforms by federal legislation that restricts a state’s authority to act.”

“Be clear” – “Federal legislation, especially in the context of state taxation, should be clear to limit ambiguity or the need for expensive and time-consuming litigation.”

“Find the win-win” – “The goal of all legislation should be to find a balance that improves the standing of all stakeholders.”

I believe that the provisions of H.R. 1860, the “Digital Goods and Services Tax Fairness Act of 2011” are consistent with the principles outlined above:

“Do no harm” – this legislation does “not disproportionately reduce existing state revenues.” In fact, this legislation sets forth the framework needed to ensure that state & local jurisdictions wishing to tax digital commerce can do so with certainty by clearly identifying which jurisdiction is entitled to tax such transactions and precluding any other jurisdictions from claiming the right to tax the same transaction. This measure will provide revenue stability for state and local governments as they continue to seek to modernize their sales tax structure to include the 21st century digital economy.

“Preserve flexibility” – this legislation does not restrict the state’s ability to “modernize their revenue systems.” This legislation will actually help facilitate a state’s ability to update their existing tax structure by clearly setting forth how states can include digital transactions in their general transaction tax base. This legislation does not set forth whether digital goods and services should be taxed or not, that is a decision left to the state policymakers. This measure only sets forth the framework needed for the states that do decide to tax digital commerce, to ensure that it is done in a fair and rational manner.

“Be clear” – this legislation is “clear” and would “limit ambiguity or the need for expensive and time-consuming litigation.” Without this legislation clearly identifying which

jurisdiction has the right to tax digital transactions, costly litigation would be inevitable as multiple states try to claim the right to tax the same digital transaction. The concepts contained in this legislation are very similar to the provisions contained in the “Mobile Telecommunications Sourcing Act,” which has not seen any litigation over its provisions in the last nine years that the provisions have been in effect.

“Find the win-win” – this legislation “finds the balance that improves the standing of all stakeholders” as it provides certainty to the consumers of digital goods and services, the providers required to collect state and local taxes on digital transactions and the state and local taxing jurisdictions seeking to tax such goods and services. It also respects state sovereignty as the decision to impose taxes or not is left to the elected officials in each state.

The other main provision in this legislation is to preclude expansion of discriminatory “utility” type taxes from being imposed upon digital commerce solely because these goods and services are transacted over global broadband networks. One only has to look at all of the utility impositions currently levied on communication services today to understand that this risk is real. In fact, using wireless services as the case study, it is evident that jurisdictions continuing to face significant budget deficits see this growing segment of the economy as an easy target for additional revenue by trying to wedge them into an outdated definition of telecommunications services and assert utility type taxes should apply. Given the wide range of providers of digital goods and services, and the inherent inequities imposing utility type taxes on digital commerce would create, it is very important to stop this trend before it becomes a problem like the one we have seen emerge for wireless services.

In summary, the existing state and local tax structure was based largely on the manufacturing/industrial/retail economy of the 20th Century and is ill equipped to address the complexities that surface in taxing the 21st Century digital based economy. States must update their existing tax systems to reflect the new global economy in order to ensure they will have simple, transparent, equitable, economically neutral and reliable tax systems to generate sustainable revenue for efficient delivery of core government services by state and local governments. However, the states cannot address all of these issues on their own. Federal

legislation is needed in certain areas of state and local taxation to address interstate jurisdictional issues with respect to which state and locality is authorized to tax certain transactions that take place in today's information based "borderless" economy. Addressing these issues through federal legislation is critical and absolutely necessary to preserve interstate and global commerce.

Chairman Coble, Ranking Member Cohen and members of the Subcommittee, thank you again for holding this hearing and allowing me to testify in support of this bill. I hope that both the Subcommittee and the full Committee will mark-up this legislation soon, so that the certainty needed for how state and local taxes can be imposed on digital commerce in a fair and rational manner can be enacted as soon as possible to the ultimate benefit of all of the interests involved.