

October 12, 2009

TO: DiMA Members

FROM: Jonathan Potter
Greg Barnes

RE: DiMA Support for Federal Legislation to Ensure that Taxes on Digital Goods Are Not Discriminatory or Duplicative

Memo Highlights at a Glance

- States are seeking creative ways to raise revenues, including by imposing new taxes on digital products such as downloadable music, songs and books. In some states these taxes could apply to services also, e.g., subscription services, because many of the states already tax cable television service and want to cover all media services.
- For more than a year a coalition of digital media companies (including Amazon.com, Apple and Microsoft) and trade associations has opposed digital goods/services taxes by engaging in state legislatures and Departments of Taxation/Revenue, but a parallel federal legislative effort will soon become public when legislation is introduced in Congress.
- DiMA proposes to support federal legislation's introduction and to actively promote hearings in 2009 and enactment in 2010.

General Background

As the economy worsens, tax revenues shrink and demands on state services grow. As a result state legislatures and governors are looking for new revenue. One source of revenue that many states have turned to involves the taxation of digital products such as music, videos, books and games.

- In 2007 one state passed a digital taxation law.
- In 2008 five states enacted digital taxation laws; but eleven state legislatures introduced bills and started down the digital taxation path.
- In 2009 several more states passed digital taxation laws.

Federal Digital Goods Legislation

Because so many states have been introducing (and several enacting) digital tax legislation that is duplicative and discriminatory, Verizon and several DiMA companies have been developing draft legislation to require digital taxation standards and consistency. The draft bill is attached.

Several considerations have gone into the drafting and introduction of this bill:

- Initially, it would seem more beneficial to aggressively ask Congress to prohibit or impose a moratorium (e.g., for five years) on state and local digital goods taxes, which has been a successful strategy to inhibit local Internet access taxes. However, the current view is that pursuing a prohibition or moratorium when states are facing serious economic challenges would likely harm proponents' political credibility, so the "non-discrimination" strategy seems more prudent.

- Though passage is nearly impossible in 2009 and will be a challenge in the future, introduction and hearings this year are important. The hope is that state legislatures are on notice when they reconvene in 2010, and that states give serious consideration of possible future federal standards when they consider legislating next year.

Simultaneous with drafting the proposed bill, Verizon has been engaged in exploratory meetings with Congressional staff to gauge interest in the issue and introduction, and has apparently found that several Members are likely to be supportive and eager to introduce.

DiMA Opportunity

DiMA has been invited to join the coalition in support of federal legislation. For several reasons, DiMA staff is strongly supportive of our active engagement in this effort.

- Every DiMA member is at risk as a result of digital goods/ services taxation, and when states and localities impose non-standardized taxes the transaction costs could be independently extraordinary – in addition to the tax costs.
- Most associations with affected members (e.g., NCTA, USTA, RIAA, MPAA, ESA) have much more important primary issues, so they will not be able to allocate substantial resources to this effort. By engaging actively and publicly, DiMA has the opportunity to generate new member companies.
- Because of a quirk in legislative jurisdiction, this bill will be considered by the House Judiciary Committee, where DiMA already has good relationships but where our existing relationships will be aided by expanding our activity beyond contentious copyright issues.

Associations are not expected to fund the effort, as company participants will fund directly.

Next Steps

Our next anticipated step is formal notice to the coalition that DiMA will join, and then participating in Coalition and Congressional meetings in support of introduction and hearings. Participation will provide us with insight and input into the legislative process, which we will communicate as this effort gets underway.

Please let us know if you have any questions or suggestions regarding the substance or politics of the attached digital tax legislation, the approach outlined above, or DiMA's engagement in this issue.

Thank you.