

Taxing the Digital Economy



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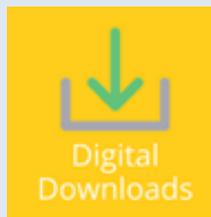
What Is the Digital Economy?

The “digital economy” refers to the new ways of doing business that occur every second around the world over the internet. Digital technology is widely available and spawning new businesses and new business models for making and delivering products and services. Digital technology enables more people and businesses around the world to transact business and create new products and services. This trend, though, poses challenges for tax and regulatory schemes intended for a bricks and mortar economy.

Computer and Data Processing Services

Connecticut taxes digital goods and services under the broad category of “computer and data processing services.” By law, these services include providing computer time, storing and filing information, retrieving or providing access to information (i.e., digital content), and providing consulting services.

These services are taxable in Connecticut if the benefit of the services is received here (i.e., if the customer is located in Connecticut). They are subject to a reduced sales and use tax rate of 1%, which has been in effect since July 1, 2001 ([CGS § 12-407\(a\)\(37\)\(A\)](#) and [Conn. Agencies Regs. § 12-426-27\(b\)\(1\)](#)).



Digital Downloads and Streaming Services

What are they? Digital downloads are goods (i.e., files) that people purchase online and download to their computer, smartphone, or other device (e.g., ebooks, iTunes songs, software). Streaming services charge a recurring fee for the ability to stream digital content over the internet (e.g., Netflix).

How are they taxed? Digital downloads and streaming services are generally considered computer and data processing services.



Cloud Computing

What is it? In short, cloud computing is a means of distributing a variety of business applications over the internet. The “cloud” is not a singular place — it describes a shared infrastructure that functions much like a utility. The cloud contains thousands of servers located at data centers in many locations around the world that can run thousands of applications and be accessed on-demand by users.

How is it taxed? Cloud services are generally considered computer and data processing services.

Physical Presence Rule for Taxing eCommerce Sales

A 1992 Supreme Court ruling limits states' ability to collect sales taxes on e-commerce sales made to state residents by out-of-state (remote) retailers. *Quill Corp v. North Dakota*, 504 U.S. 298, requires that retailers have a substantial nexus (i.e., physical presence) in a state in order for that state to require them to collect and remit sales taxes. This limitation means that as e-commerce sales grow, states are losing an ever-increasing amount of sales tax revenue from remote retailers.

In the absence of federal action on this issue, states have attempted other approaches to challenging *Quill's* physical presence rule. This includes click-through or affiliate nexus laws that extend sales tax nexus to remote retailers that pay commissions to independent affiliates who refer customers to the retailers through internet links. About a third of states, including Connecticut, have adopted these laws, but e-commerce retailers have largely refused to comply.



Sharing Economy

What is it? In the “sharing economy,” sometimes called the “peer-to-peer” model, individuals offer and buy goods and services directly to and from each other, usually through a web platform that a business provides. Well-known examples of this model include Uber and Lyft, which connect drivers to people looking for rides, and Airbnb, which allows people to list their property for rent.

How is it taxed?: It depends. Sales tax laws do not specifically account for the sharing economy, but some of the goods and services offered by individuals over a web platform may be subject to sales tax. However, it is unclear whether the web platform has to collect and remit sales taxes on its users' behalf, although DRS has reached agreement with some to do so (e.g., Airbnb).



e-Commerce

What is it? e-Commerce refers to the buying and selling of goods and services online.

How is it taxed?: If a good or service is taxable when purchased in-person, it's likely subject to sales or use tax when purchased online. Retailers with a physical presence in Connecticut (e.g., a retail chain with a location in the state) must collect and remit sales tax to the state. If an out-of-state retailer is not required to collect taxes on a sale to a Connecticut resident, then the resident likely owes use tax on the purchase, but use tax is difficult to track and collect.

Digital Economy's Policy Challenges

The digital economy's new business models present some tough challenges for policy makers, especially as the revenues generated from traditional transactions decline.

- Do tax collectors have the means to audit the growing number of home-based businesses and their online transactions?
- Should digital goods like e-books and downloaded movies be taxed at the same rate as their physical counterparts?
- Are there other legislative approaches to resolving the remote sales tax issue?

Learn
More

“Room Occupancy Tax on Airbnb,” OLR Report [2016-R-0308](#)

“Issue Brief: Transportation Network Companies,” OLR Issue Brief 2016-R-0293

“OLR Backgrounder: The ‘Sharing Economy’ and Public Policy,” OLR Report [2013-R-0298](#)

Annette Nellen, “[Taxation and Today's Digital Economy](#),” *Journal of Tax Practice and Procedure* (2015)

