



DOAA

Georgia Department
of Audits & Accounts

Greg S. Griffin
State Auditor

February 24, 2023

Honorable Shaw Blackmon
Chairman, House Ways and Means
133 State Capitol
Atlanta, GA 30334

SUBJECT: Fiscal Note
House Bill 170 (LC 43 2531)

Dear Chairman Blackmon:

The bill would apply the Georgia state and local sales and use tax to digital goods and services, as defined, while also allowing exemptions from the tax for subscription-based services and for digital goods, including prewritten software, sold for commercial purposes. The new law would apply to transactions occurring on or after January 1, 2024.

Impact on State Revenue

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would increase state revenue as shown in Table 1. Because the bill goes into effect in January 2024, FY 2025 would be the first full year of a revenue increase. The appendix provides details of the analysis.

Table 1. Estimated State Revenue Effects of HB 170 LC 43 2531

(\$ millions)	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
State	\$64.7	\$137.5	\$144.7	\$151.5	\$158.6
Local	\$55.0	\$116.9	\$123.0	\$128.8	\$134.8

Impact on State Expenditures

The Department of Revenue (DOR) would be able to implement the provisions of the bill with existing resources.

Respectfully,

Greg S. Griffin
State Auditor

Kelly Farr, Director
Office of Planning and Budget

GSG/KF/mt

Analysis by the Fiscal Research Center

LC 43 2531 applies the state sales and use tax to digital goods and services transferred electronically, by adding and revising definitions in O.C.G.A. §48-8-2 related to digital goods and services, and by amending O.C.G.A. §48-8-30 so as to impose sales and use tax on digital products on the same basis as tangible personal property.

Digital products, as defined, include the following goods and services when delivered electronically, regardless of the permanence of end users' rights to use of or access to the products or whether the product is sold on a subscription basis:

- Specified digital products, including digital audio-visual works, digital audio works, and digital books;
- Other digital goods, including artwork, photographs, periodicals, newspapers, magazines, video or audio greeting cards, video games or electronic entertainment, and digital applications; and
- Digital services, including those offering the right to access or use prewritten computer software, specified digital products, or other digital products.

Under current law, prewritten computer software is exempted, under O.C.G.A. §48-8-2(91), from sales tax in the state when delivered electronically. The bill replaces this provision, along with the currently reserved paragraph (90) of the same code section, to create two new exemptions, as follows:

- Paragraph (90) would exempt digital services sold on a subscription or membership basis provided the right to access or use the service extends at least 30 days and not more than one year.
- Paragraph (91) would exempt prewritten computer software and digital products sold to a commercial enterprise and used primarily for its commercial purposes.

Section 4 of the bill provides for an exemption for digital products purchased for resale, as is provided in current law for other taxable goods and services purchased for resale, and does not affect the analysis in this note. Section 5 specifies the treatment of, and record-keeping requirements for, bundled transactions including digital products along with telecommunications or other services that may be taxed at a lower rate or not at all. This section serves to ensure that the full amount of tax owed under this legislation is collected and thus does not affect the analysis herein.

Analysis

Sales data specifically for digital artwork, photographs, or greeting cards are not readily available, but such items are likely included in other categories (e.g., in app sales or digital books and periodicals) and thus captured in the estimates. For the other categories of digital products and for electronically delivered prewritten software, the analysis relies on data from IBISWorld, Statista, the U.S. Census Bureau, the Bureau of Economic Analysis (BEA), and other sources.

Data on digital goods purchased specifically in Georgia were not available, so national data were scaled to Georgia based on population share in 2022, approximately 3.27 percent, and further adjusted for the lower level of real after-tax income in Georgia relative to the national average, approximately 91 percent of the national average based on 2021 BEA estimates. After adjustment, Georgia's share of final sales of these digital goods is assumed to be approximately 2.98 percent.

Digital video-game content (downloaded computer games, gaming network subscriptions, mobile games, and online games) generated an estimated \$77.9 billion of sales in the U.S. in 2022, based on data from Statista, up about 14.1 percent over 2021. The Statista estimates show total digital video game sales growing by approximately 8.2 percent annually from 2022 to 2027, bringing 2027 digital sales to an estimated \$115.6 billion nationally. For purposes of this note, sales are assumed to grow in 2028 at the same rate as in 2027, about 5.6 percent, bringing U.S. digital game sales to approximately \$122

billion in 2028. Subscription-based video games sales, which would be exempt and are thus excluded from the taxable sales estimates herein, account for a relatively small portion of total digital game sales compared to other digital products, only about 4% in 2021, based on reporting from industry news source Video Games Chronicle. Growth of the subscription segment is assumed to be 10.4 percent per year, based on a Grandview Research forecast.

The **digital video** category, including subscription streaming (SVOD), electronic sell-thru (EST; individual video downloads/rentals), and video on demand (VOD) from cable providers, is a \$34.5 billion market in the U.S. for 2022, according to the Digital Entertainment Group's Year-End 2022 Digital Media Entertainment Report. SVOD is the largest segment, accounting for about 88 percent of revenues in the category, and the fastest growing at 17 percent in 2022 compared to 14 percent overall. EST and VOD account for 7 percent and 5 percent in 2022, respectively; the former grew by 2 percent in 2022 while VOD saw a decline of 14 percent. All three segments experienced a sharp rise in sales in 2020, though both of the smaller segments pulled back in 2021. We assume each segment returns to its pre-pandemic (2017-19) trend growth of about 15.9 percent for SVOD, 6.3 percent for EST, and -0.1 percent for VOD for the forecast periods. Given the exemption for subscription-based digital services, SVOD is excluded from estimates of the taxable sales based.

Music downloads and streaming services, according to the Recording Industry Association of America (RIAA), accounted for approximately \$13 billion of U.S. industry revenues in 2021. Paid subscription services accounted for approximately 72.8 percent of total digital music revenues while advertising accounted for 15.1 percent and payments to performers and copyright holders (for services under statutory licenses) accounted for 7.6 percent, leaving 4.5 percent or approximately \$587 million of digital download sales that would be taxable under the bill. RIAA reports that industry revenues from digital downloads declined, on average, by 17.3 percent per year from 2018 to 2021, though in the latest year, the decline slowed to 11.7 percent. In comparison, subscription and ad-supported streaming revenues grew at an annual rate of 19.1 percent from 2018 to 2021 and 23.8 percent in the latest year.

For the two largest download subcategories, singles and albums, we use their more recent, slower rates of decline to project sales, resulting in an annual rate of decline for downloads overall averaging 10.3 percent per year.

Digital sales of magazines and newspapers are assumed to be all subscription sales, which would be exempt under the proposed law. Periodicals in general earn revenue from advertising, subscriptions, and newsstand sales of physical copies, none of which would be made taxable by this bill.

The **digital books** category, including e-books and digital audiobooks, is estimated at about \$3.7 billion of sales nationally in 2021, based on data from trade sources Publishers Weekly, Publishing Perspectives, and the Audio Publishers Association (APA). E-books accounted for about 58 percent of the total, but e-book sales have reportedly flattened in recent years; digital audiobooks have experienced faster growth as their share of the overall book market has grown from below 4 percent until 2015 to 11.3 percent in 2022, according to Publishing Perspectives. Estimates from the APA and Grand View Research suggest that the digital downloads share of the audiobook market is about 54 percent, with 3 percent sold in physical form and the balance of about 43 percent sold by subscription in 2021. We assume that the subscription share will grow to 50 percent by 2028 while the physical audiobook share remains flat. Data on subscription-based sales of e-books could not be found, but industry reporting suggests that the subscription share is significant and growing, led by Amazon's Kindle Unlimited subscription service launched in 2014 and followed more recently by large publishers, including offerings of textbook subscription services. Lacking a specific estimate for e-books, we assume a subscription share like that of audiobooks.

The **mobile apps** category represents software applications downloaded for smart phones and other devices that is not included in the estimates for computer software but is assumed to fall under the definition of other digital goods, which includes "digital applications," a term not separately defined.

Estimated total sales for the category in 2021 is approximately \$95 billion nationally, according to data from Statista. Mobile apps earn revenues from three sources, including advertising, in-app purchases, and a small amount for purchases of apps; only the latter two would be taxable under the proposed law. For the category as a whole, advertising accounts for approximately 48 percent of total sales as of 2021, while in-app purchases and paid apps account for 51 percent and less than 1 percent, respectively.

Within the mobile apps category, some sales subcategories – i.e., gaming, music, video, news and magazines, and books – are accounted for separately in this analysis, while the business apps subcategory – about 1 percent of total category sales – is assumed to be for commercial purposes and thus exempt under the bill. Excluding these subcategories, the balance of category revenues is approximately \$25.9 billion as of 2021. Of this amount, approximately \$16.6 billion was advertising sales, leaving approximately \$9.2 billion of in-app purchases and paid apps. App revenue growth through 2027 is based on forecasts compiled by Statista for the relevant subcategories' non-advertising revenues, extended to 2028 based on 2025-27 forecast trends. Forecasted growth of the relevant revenue streams averages approximately 6.8 percent annually from 2021 to 2028.

For the digitally delivered **prewritten software** category, we rely primarily on IBISWorld data and forecasts for the software publishing industry, NAICS code 5112, with adjustments to industry sales data to account for the following factors:

- According to IBISWorld, 26 percent of industry sales are of system software, which is likely to be sold preinstalled on hardware and thus would be subject to tax as part of that sale, unless otherwise exempted under current law. Sales of system software by digital download rather than on CD or DVD (such physical sales are taxed currently) are assumed to be negligible. Other industry sales are not software (e.g., consulting services and training) or are custom software, which would not be taxable under current law or the proposed bill. The balance is application software, which accounts for approximately 48.2 percent of industry sales.
- A portion of industry sales are currently tax exempt based on the purchaser's status and will remain so, such as sales to tax exempt entities including schools and governments. Government sales account for about 10 percent of industry sales, according to IBISWorld estimates. Net exports of software technology, according to BEA data, amounted to about \$25 billion in 2021 or about 6 percent of the IBISWorld estimate of industry sales.
- According to IBISWorld, commercial sales, which would be exempt under the bill, account is about 64 percent of industry sales.
- According to International Data Corporation, subscription-based sales is estimated at 53 percent of total sales.

Adjusting for all of these factors, the share of industry revenues that would be taxable under the proposed law is estimated to be approximately 6.9 percent in 2022, or about \$30.6 billion nationally. This amount is grown through 2028 using forecasted real growth rates for the industry from IBISWorld and adjusting for inflation using CBO's February 2023 forecast of the GDP price index. The resulting growth rate of projected sales average 5.6 percent per year from 2022 through 2028.

Estimated proforma-taxable sales in all categories are shared down to Georgia as discussed above and presented in Table 2 below, with FY 2024 adjusted to reflect the midyear effective of the proposed bill. State and local sales tax revenues from digital products, assuming local tax at 3.40 percent, the population-weighted average local rate as of January 2023, are presented in Table 1.

Note that the state revenue estimates assume that substantially all sales are by online sellers that either have physical nexus in the state or meet the thresholds to be considered to have economic nexus in the state and required to collect and remit Georgia sales taxes. To the extent of sales by smaller remote sellers, state revenue gains would be smaller.

Table 2. Georgia Annual Digital Product Sales

(\$ millions)	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Video Games	\$839.4	\$1,797.3	\$1,895.1	\$1,983.8	\$2,073.9
Videos	\$65.9	\$136.8	\$142.2	\$147.9	\$154.0
Music	\$6.4	\$11.4	\$10.3	\$9.3	\$8.5
E-Books/Audiobooks	\$33.6	\$68.0	\$68.4	\$68.9	\$69.3
Mobile Apps	\$171.3	\$369.0	\$391.0	\$409.2	\$426.9
Software Publishing	\$500.9	\$1,054.3	\$1,109.4	\$1,168.7	\$1,232.9
Total	\$1,617.4	\$3,436.9	\$3,616.4	\$3,787.9	\$3,965.6