



DEPARTMENT OF AUDITS AND ACCOUNTS

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January 17, 2017

Honorable Jay Powell
Chairman, House Ways and Means
133 State Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill (LC 34 4964)

Dear Chairman Powell:

The bill would apply the Georgia state sales tax to digital products delivered electronically, including apps, music, e-books, online subscription services, and other digital products sold to end users and prewritten computer software transferred electronically. The new law would be effective on July 1, 2017 but would apply to transactions occurring on or after January 1, 2018.

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would increase state revenues beginning in fiscal year 2018. In fiscal year 2019, the first year of the bill's full impact, state revenue would increase between \$53.9 million and \$96.3 million (Table 1). The revenue increase would grow to a range of \$64.8 million to \$115.7 million in fiscal year 2022.

Table 1. Estimated State Revenue Effects of LC 34 4964

(\$ millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Upper Bound	\$46.7	\$96.3	\$102.2	\$108.6	\$115.7
Most Likely Case	\$26.1	\$53.9	\$57.2	\$60.8	\$64.8

Local sales taxes would also be assessed on digital goods, resulting in an increase in local government sales tax revenue. As shown in Table 2, the increase would range from \$40.4 million to \$72.2 million in fiscal year 2019 and grow in subsequent years. The amounts are based on a 3.0% local sales tax rate.

Table 2. Estimated Local Revenue Effects of LC 34 4964

(\$ millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Upper Bound	\$35.0	\$72.2	\$76.6	\$81.4	\$86.8
Most Likely Case	\$19.6	\$40.4	\$42.9	\$45.6	\$48.6

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The Department of Revenue will need to update tax forms and develop internal and external training. One-time costs for contract and part-time personnel for these tasks is estimated to be \$12,125.

Sincerely,



Greg S. Griffin
State Auditor



Teresa A. MacCartney, Director
Office of Planning and Budget

GSG/TAM/mt

Analysis by the Fiscal Research Center

To estimate the revenue generated by this provision, data from IBISWorld, the U.S. Census Bureau, the Bureau of Economic Analysis (BEA), and other sources were relied upon. Data on digital goods purchased in Georgia were not readily available, so national data were used and scaled to Georgia as described below.

Table 3 presents the estimated sales in Georgia of various digital goods, projected by fiscal year. The national sales data for all categories were allocated to Georgia based on population share in 2016, approximately 3.19 percent, and further adjusted for the lower level of real after tax income in Georgia relative to the national average, approximately 92.1 percent of the national average based on BEA estimates. After adjustment, Georgia's share of final sales of these digital goods is assumed to be approximately 2.94 percent.

For the software publishing industry, NAICS code 5112, several additional adjustments were made to industry sales data to account for the following factors:

- 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 9.2 percent of industry sales, according to IBISWorld estimates.
- Net exports of software technology, according to BEA data, amounted to about \$30 billion in 2015 or about 15 percent of the IBISWorld estimate of industry sales.
- Also according to IBISWorld, 32.8 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. Sales of system software by itself and not 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, the latter of which would not be taxable under the proposed bill. Approximately 37.9 percent of sales are of application software that may be affected by the bill.
- Assuming government (or other exempt purchasers) and net export shares total about 25 percent of application software sales, the portion either currently taxed or that would be taxed under the proposed bill would be about 28.4 percent of industry sales.
- Some portion of this amount is currently delivered in tangible form (e.g. on a CD or DVD) and thus is already taxed. Industry press reports suggest this is a shrinking portion of the market as virtually all packaged software products are now available for purchase by download. In fact, many computers sold today come without CD/DVD drives at all. Many other software applications are not delivered for installation to the user's computer, but instead are licensed for remote use (e.g. the "software-as-a-service" or "SaaS" delivery model). According to a 2014 presentation from Amazon Web Services, SaaS delivery is expected to account for 20% of application software spending by 2017. Other sources cite market research firm IDC as estimating that 70 percent of software sales in 2015 were delivered online. This 70 percent online share estimate is taken as a proxy for the untaxed share of application software sales in 2015 and is assumed to grow one percentage point

per year.

- It is thus assumed for purposes of this estimate that 19.9 percent of industry sales (70 percent of 28.4 percent) are of application software delivered electronically as of 2015, growing by 0.3 percentage points per year thereafter.

Table 3. Georgia Annual Digital Product Sales

(\$ millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Apps/programs	\$49.9	\$57.4	\$66.0	\$76.0	\$87.3
Music	\$181.4	\$195.9	\$211.6	\$228.5	\$246.8
Video Games	\$383.2	\$429.1	\$480.6	\$538.3	\$602.9
E-Books	\$248.6	\$265.6	\$286.9	\$309.8	\$334.6
Magazines	\$89.2	\$90.0	\$90.7	\$91.2	\$91.7
Movies & Videos	\$28.9	\$29.5	\$29.2	\$28.9	\$28.6
Software Publishing	\$1,287.7	\$1,339.4	\$1,389.3	\$1,441.9	\$1,501.3
Total	\$2,268.9	\$2,406.9	\$2,554.2	\$2,714.6	\$2,893.2

These product sales are then multiplied by the state 4 percent and average local 3 percent tax rates to calculate the upper bound revenue estimates.

Finally, the estimates are adjusted to reflect issues around nexus and, absent nexus, the ability of the state to collect use taxes due on these sales. Similar to online sales of tangible goods, many sellers of these digital products and services may not have nexus in the state, in which case the state cannot, under current law, obligate sellers to charge or collect sales tax. However, large sellers of these products likely overlap to a large degree with online retailers of tangible goods, including non-store retailers like Amazon.com and the online sales operations of large retail chains with nexus in Georgia. There may be less overlap in software, particularly in SaaS, but no data are available from which to estimate the share of sellers with nexus in the state. Thus it is assumed that the share of digital product sales that would remain untaxed is similar to that in online sales of tangible goods.

Based on Census data on e-commerce sales by traditional and non-store retailers, and DOR data on sales tax collections from non-store retailers, it is estimated that about 44 percent of total e-commerce sales to Georgia purchasers went untaxed in FY 2016. Thus the most likely case estimate assumes a similar share of digital goods and services will remain untaxed.

Note: Based on discussion with DOR and review of the bill language and related code sections, a few potential drafting issues are noted here for convenience, though it has been assumed for purposes of this fiscal note that these issues would be resolved prior to passage.

- First, the bill references on line 43 “specified digital products”, but the bill does not actually specify the products, other than prewritten software. For purposes of this fiscal note, the specified digital products are assumed to be the same as identified in previous digital downloads legislation.
- The bill does not repeal the exemption under O.C.G.A. §48-8-3(91) for prewritten computer software delivered electronically. Repeal has been assumed herein.

According to DOR, there may be other issues concerning sourcing rules under O.C.G.A. §48-8-77, the definitions of “retail sale” and “sale” in §48-8-2(31) and (33), and the multistate Streamlined Sales Tax Agreement. However, addressing any of these issues is beyond the scope of this fiscal note.