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# Sales Taxation of Online Education

**Benjamin A. Davidson**

The University of North Carolina at Chapel Hill

**Author Contact Information:**

Benjamin A. Davidson

UNC-Chapel Hill

104 Airport Dr., Suite 3100, CB: 1145

Chapel Hill, NC 27599

[bdavidson@unc.edu](mailto:bdavidson@unc.edu)

919.962.6365

## Sales Taxation of Online Education

Benjamin A. Davidson<sup>1</sup>

The sales taxation of online education occurred almost by accident. As physical goods have transitioned to digital form, states have protected their tax base by taxing the sale of digital goods. Maryland has been the focus of significant attention for expanding its base to include digital services, but in the United States the application of a consumption tax to digital services remains the exception, not the rule. Distinguishing between a good and a service is not always easy though. With the overnight transition from in-person to online classrooms, educational services suddenly occupied the same digital space as the digital goods that had been targeted for taxation. As the United States emerges from the COVID-19 pandemic, most educational services will return to the in-person classroom, but higher education is forever changed. This article examines how four states have navigated these challenges and identifies opportunities for future legislation and regulation.

### I. Digital audiovisual works and a problem of overinclusion

Before turning to the solution, we must first understand the problem. U.S. jurisdictions have traditionally applied sales tax to tangible personal property. Over time, books have transitioned from paper to e-readers; music has moved from tapes and discs to digital audio files; movies have followed a similar path. That digital goods are frequently licensed instead of sold in fee simple is not a problem; sales tax laws frequently address leases and licenses of property.<sup>2</sup> The problem is the medium. The digitalization and electronic transfer of goods previously in tangible form has forced sales tax laws to evolve, lest the base erode. The Streamlined Sales Tax Governing Board, now with 23 full member states and one associate member, amended the Streamlined Sales and Use Tax Agreement (SSUTA) in 2007 to define digital products.<sup>3</sup>

SSUTA defines specified digital products as electronically transferred digital audiovisual works, digital audio works, and digital books.<sup>4</sup> It defines a digital audiovisual work as “a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.”<sup>5</sup> This definition easily describes Hollywood blockbusters, corporate training videos, educational television series, and workout videos. However, it also describes pre-recorded continuing education presentations such as CLE and CPE, as well as pre-recorded college instruction. Taken one step further, if a pre-recorded lecture is a digital audiovisual work, a live online lecture may meet this definition as well. Both appear on the screen as “a series of related images which, when shown in succession, impart an impression of

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<sup>2</sup> See, e.g., N.C. Gen. Stat. §§ 105-164.3(227) and (235).

<sup>3</sup> SSUTA section 332 (Sept. 20, 2007). The definition was effective January 1, 2008.

<sup>4</sup> SSUTA Appendix C, Part II at p. 111 (May 20, 2021).

<sup>5</sup> *Id.*

motion, together with accompanying sounds, if any.” Viewers may be unaware of whether the lecture they are watching is live or pre-recorded, and may be surprised to learn that even “live” programs are often broadcast online with a 30-second delay.

As a result of this definitional difficulty, statutes imposing sales tax on the sale or license of digital audiovisual works can be read as applying to some, if not all, online education. Most recently, the Maryland Comptroller applied the 21st-Century Economy Fairness Act<sup>6</sup> to all online education – live and pre-recorded – until the Maryland General Assembly enacted Digital Advertising Gross Revenues, Income, Sales and Use, and Tobacco Taxes—Alterations and Implementation,<sup>7</sup> exempting certain online instruction.<sup>8</sup> States have responded to this dilemma by introducing a variety of exemptions and exclusions to align their state statutes with their policy objectives.

## II. Federal limitations

One common thread that informs states’ responses is an effort to comply with the federal Internet Tax Freedom Act (ITFA). First enacted in 1998, the ITFA prohibits states from imposing discriminatory taxes on electronic commerce.<sup>9</sup> A discriminatory tax includes any tax imposed on electronic commerce that “is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means.”<sup>10</sup>

In drafting statutes that comply with the ITFA, states must decide what forms of online education involve “similar” property, goods, or services to in-person instruction. Some states have determined that the ITFA protects all live online education from taxation unless its live in-person counterpart would also be subject to tax. Other states have determined that live-streaming is necessary for ITFA protection, but not sufficient.

## III. State legislation

This article reviews the approach that four states have taken to excluding or exempting the sale of online education.<sup>11</sup> Three of the states – Washington, Wisconsin, North Carolina – have adopted SSUTA, whereas the fourth – Maryland – has not. Even among SSUTA states there are notable differences, as discussed below. The states are presented in the approximate order of their legislative enactments or, in the case of Wisconsin, its litigation.

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<sup>6</sup> 2021 Md. Laws Ch. 38.

<sup>7</sup> 2021 Md. Laws Ch. 669.

<sup>8</sup> Business Tax Tip #29 Sales of Digital Products and Digital Code, at 7-8 (Mar. 9, 2021).

<sup>9</sup> 47 U.S.C. § 151 note § 1101(a). The ITFA was first enacted in 1998 by Title XI of P.L. 105-277 (1998). It was made permanent by section 922 of the Trade Facilitation and Trade Enforcement Act of 2015, P.L. 114-125 (2016).

<sup>10</sup> *Id.* § 1105(2)(i).

<sup>11</sup> Some states exclude certain online education from the definition of digital audiovisual work or digital good, whereas others include online education in the definition of digital audiovisual work but exempt its sale from taxation.

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