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Netflix and Quill: Using Access and Consumption to Create a Plan for Taxing the Cloud

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NOTES

NETFLIX AND *QUILL*: USING ACCESS AND CONSUMPTION TO CREATE A PLAN FOR TAXING THE CLOUD

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INTRODUCTION

On June 9, 2015, the Chicago Department of Finance created an uproar when its Comptroller, Dan Widawsky, issued two rulings extending the reach of Chicago's amusement tax to include online streaming media, calling into question whether and how a tax can apply to film, television, and music in an age of streaming entertainment.[1] But, the idea of an amusement tax is nothing new, dating back to at least the 1800s.[2] Although taxing Internet streaming services may seem unprecedented, the amusement tax as a potential

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1. *See* Dan Widawsky, Comptroller, Dep't of Fin., City of Chi., Amusement Tax Ruling #5 (June 9, 2015) [hereinafter Widawsky, Amusement Tax Ruling], https://www.cityofchicago.org/content/dam/city/depts/rev/supp_info/TaxRulingsandRegulations/AmusementTaxRuling_5_06_09_2015.pdf [https://perma.cc/ZJ4R-SRKW]; Dan Widawsky, Comptroller, Dep't of Fin., City of Chi., Personal Property Lease Transaction Tax Ruling #12 (June 9, 2015) [hereinafter Widawsky, Personal Property Lease Transaction Tax Ruling], https://www.cityofchicago.org/content/dam/city/depts/rev/supp_info/TaxRulingsandRegulations/LeaseTaxRuling12-06092015.pdf [https://perma.cc/3PPQ-BV3U]. For an overview of the tax rulings and some of the problems they pose, see Tax Practice Group McDermott Will & Emery, *Taxing the Means or the Ends? Chicago Cloud Computing Rulings' Confused Approaches Can Support Taxpayer Challenges*, NAT'L L. REV. (Aug. 17, 2015), http://www.natlawreview.com/article/taxing-means-or-ends-chicago-cloud-computing-rulings-confused-approaches-can-support [https://perma.cc/5A33-C9UF]; *see also* Melissa Harris, *The Mess Chicago's 'Cloud Tax' Only Makes Messier*, CHI. TRIB. (July 26, 2015), http://www.chicagotribune.com/business/columnists/ct-harris-cloud-tax-proposal-0726-biz-20150724-column.html [https://perma.cc/Z4PD-ZXMT] (arguing that tax policy should be created at the state level). It should be noted that since the writing of this Note, Chicago is not the only taxing jurisdiction expanding its reach to streaming media, and some are doing so at the state level. Pennsylvania's Act 84 of 2016 introduced a 6 percent sales and use tax on electronically transferred digital products. Act of Jul. 13, 2016, P.L. 526, No. 84, http://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2016&sessInd=0&act=84 [https://perma.cc/A6VP-PE53]; *see also Digital Products*, PA. DEP'T REVENUE, http://www.revenue.pa.gov/GeneralTaxInformation/Tax%20Types%20and%20Information/Pages/Sales%20Use%20and%20Hotel%20Occupancy%20Tax/Digital-Products.aspx# [https://perma.cc/AQF8-YMYJ]. At the local level, in California, Pasadena city officials are considering a tax on Internet media through a utility tax intended for utilities like water, electricity, and traditional cable television. *See* James F. Peltz, *Pasadena and Other California Cities Weigh a 'Netflix Tax' for Video Subscribers*, L.A. TIMES (Oct. 3, 2016, 3:00 AM), http://www.latimes.com/business/la-fi-agenda-netflix-tax-20161003-snap-story.html [https://perma.cc/3J2G-75TZ].

2. *See, e.g.*, George Curtis, COMM. ON THE D.C. LICENSE TAX ON MERRY-GO-ROUNDS, ETC., H.R. REP. NO. 55-1291, at 1 (1898). Nor is the amusement tax debate new to Chicago: before the "Cloud Tax" was the "Yuppie Tax," which attempted to extend Chicago's amusement tax to health club membership fees. Paul Reidinger, *The Price of Amusement: "Yuppie Tax" Upheld*, A.B.A. J., Aug. 1, 1987, at 120, 120 (1987) (setting the stage in Chicago for a court's take on the amusement tax).

vehicle to do so is not.[3] Immediate and widespread opposition, however, suggests that the world is not ready. From a suit challenging the ruling to remarks made by the Federal Communications Commission, to proposed federal legislation, and even to delays in implementing the tax due to complaints from local businesses, Chicago's tax ruling is already subject to bad blood.[4]

Even though it is understandable that both businesses and consumers—those ultimately responsible for bearing the cost of the tax—would be hesitant to accept a tax on streaming entertainment, such a tax may be inevitable.[5] With the changing media landscape

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3. An amusement tax is defined as "[a] tax on a ticket to a concert, sporting event, or the like," which is often "expressed as a percentage of the ticket price." *Amusement Tax*, BLACK'S LAW DICTIONARY (10th ed. 2014). The amusement tax may offer a means to skirt the confines of a sales and use tax, as well as a precedent limiting the enforcement of a sales and use tax. For example, some argue that the physical presence requirement set forth in *Quill Corp. v. North Dakota*, 504 U.S. 298, 317-18 (1992), discussed in greater detail *infra* Part II.A, may only apply to a sales and use tax, and not to other taxes such as income or franchise tax. *See* John A. Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 45 WM. & MARY L. REV. 319, 323 (2003) ("Indeed, dictum in *Quill* suggests that the nexus standard for taxes other than sales and use taxes may not be physical presence."). See *infra* Part I and Part III.B for a discussion on various state attempts to implement sales and use taxes on e-commerce.

4. *See* Digital Goods and Services Tax Fairness Act of 2015, S. 851, 114th Cong. (2015); Complaint for Declaratory and Injunctive Relief at 1, Labell v. City of Chicago, No. 2015-CH-13399 (Ill. Cir. Ct. filed June 9, 2015) [hereinafter Labell Complaint]; Ajit Pai, Comm'r, Fed. Commc'ns Comm'n, Remarks of FCC Commissioner Ajit Pai Before the Churchill Club Palo Alto, CA (July 17, 2015) ("[I]n California, by contrast, digital streaming services are not taxed.... [T]hat's the right approach. Government should welcome the growth of online video, not discourage it.... [I]t is a basic principle of economics that the more you tax something, the less of it you get."); *Personal Property Lease Transaction Tax Ruling 12, Note*, CITY OF CHI. (June 30, 2015), http://www.cityofchicago.org/city/en/depts/fin/provdrs/tax_division/news/2015/june/PersonalPropertyLeaseTransactionTax12Effective7-1-2015.html [https://perma.cc/4LC6-FGGM] (extending the effective date of the ruling from September 2015 to January 2016 to allow businesses additional time to make necessary changes to implement the tax).

5. *See* Rebecca Millar, *The "Netflix Tax"—Coming to a Country Near You*, CONVERSATION (Apr. 21, 2015, 4:11 PM), https://theconversation.com/the-netflix-tax-coming-to-a-country-near-you-40475 [https://perma.cc/X8XQ-STAH] (discussing a streaming consumption tax in Australia and elsewhere: "A Netflix tax—as the media has dubbed it—is not a radical new idea but an inevitable and necessary development. It is qualitatively different from the base-broadening involved in removing GST exemptions for food, education, health, and other social goods and is more appropriately described as base-restoration."); Pras Subramanian, *Why You'll be Paying a 'Netflix Tax' Soon*, YAHOO! FIN. (Aug. 21, 2015), http://finance.yahoo.com/news/why-you-ll-be-paying-a--netflix-tax--soon-161951515.html [https://perma.cc/6V79-VM6R] (discussing Chicago and other state efforts to implement taxes on cloud computing and internet streaming services, arguing taxes are not improper and, rather, should be expected); The Canadian Press, *'Netflix Tax' Inevitable, Say Experts*, HUFFINFGTON POST BUS.: CAN.

and transition to Internet consumption, state and local jurisdictions, without a means to tax many remote vendors, lose out on millions of dollars.[6] Implementing a tax on online media allows taxing jurisdictions to recoup some of the losses the cord-cutting trend of transitioning from cable to online entertainment imposes on them;[7] Chicago alone expects revenues of up to $12 million.[8] Despite opposition, this Note operates on the presumption that such a tax is foreseeable given changes in consumption habits and foreign trends to tax the same.[9] Furthermore, the purpose of this Note is not to debate moral wrongs; nor will this Note delve into concerns about copyright, privacy, constitutional issues, or data security, which have so often been regarded as the focal point of cloud concerns in academia. Rather, the purpose of this Note is to consider how such a tax on online media might mechanically function. The goal is not to evaluate Chicago's Cloud Tax for Chicago's sake so much as it is to model what a cloud tax should resemble in a given jurisdiction.

(Aug. 6, 2015, 5:38 PM), http://www.huffingtonpost.ca/2015/08/06/tax-on-services-like-netflix-inevitable-as-more-services-go-online-experts-say_n_7951644.html [https://perma.cc/NS53-HN5H] (discussing the "loophole" created by tax-free online purchases and the likelihood future governments will exploit it as a new source of revenue).

6. *See* Sofia Morales, *The Amazon Tax: Collecting the Use Tax in the Aftermath of the New York Appellate Court's Recent Holding*, 13 HOUS. BUS. & TAX L.J. 56, 70 (2013) (estimating state losses as high as $7.7 billion for purchases from out-of-state vendors).

7. The changing media landscape and mass transition to general Internet consumption has left state and local jurisdictions without a means to tax many remote vendors. Such an inability to collect taxes has resulted, or at least will result, in the loss of millions of dollars in essential revenue. The *Oxford Dictionary* defines a "cord cutter" as "[a] person who cancels or forgoes a cable television subscription or landline phone connection in favor of an alternative Internet-based or wireless service." *Cord cutter*, OXFORD DICTIONARIES, http://www.oxforddictionaries.com/us/definition/american_english/cord-cutter [https://perma.cc/293V-GAXQ]. And, with changing generations, it is not just cord cutters one need worry about, but also "the far more common 'cord-nevers' who had never signed up in the first place." Keach Hagey, *Cord-Cutting Is Accelerating: By 2018, 21% of U.S. Households Won't Pay for Traditional TV, eMarketer Says*, WALL ST. J. (Dec. 10, 2015, 6:00 AM), http://www.wsj.com/ articles/cord-cutting-is-accelerating-1449745201 [https://perma.cc/C4ZH-RNHB]; *see also* Cynthia Littleton, *Cord Cutting Survey: 19% of Young Adults Have Dropped Cable or Satellite TV Service*, VARIETY (Dec. 22, 2015, 12:30 PM), http://variety.com/2015/biz/news/cord-cutting-19-young-adults-24-pew-research-center-1201666723/ [https://perma.cc/V9R5-SKHX].

8. Cheryl Corley, *Chicago's 'Cloud Tax' Raises the Cost of Streaming Videos*, NPR (July 10, 2015, 5:06 AM), http://www.npr.org/2015/07/10/421483715/chicagos-cloud-tax-raises-the-cost-of-streaming-videos [https://perma.cc/K6PX-WAWW].

9. *See infra* Part III.B.

Part I introduces Chicago's tax rulings, contextualizing them within the city's tax initiatives, as well as state and local tax policy.[10] Additionally, Part I discusses why a jurisdiction would seek to impose a tax on cloud media, as well as points out some of the failures of Chicago's plan. Part II picks up from these failures and analyzes how they fall in line with current case precedent. Specifically, Part II considers some of the inherent problems with taxing remote vendors—especially online remote vendors—under the Supreme Court's precedent established in *Quill Corp. v. North Dakota*.[11] Part II then uses the Illinois-specific case law as applied to Chicago's amusement tax to formulate a framework through which to understand and evaluate an amusement tax as applied to Internet media. From the framework established in Parts I and II, Part III then offers a proposal on how a cloud tax might work. The proposal pays particular attention to the most common problems with past attempts, as well as those problems that are most overlooked and Internet-specific. The proposal aims to—as simply

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10. It should be noted that throughout this Note much of the analysis relies on state and local tax policy, as well as academia on sales and use tax, as opposed to strict analysis of amusement tax policy, which would be near impossible. For example, a Westlaw search for "amusement tax" within Law Reviews and Journals proffers fewer than one hundred results, and only a fraction of that number in the last three years. Search Results of "amusement tax" in Law Reviews & Journals, WESTLAW, http://next.westlaw.com (search "amusement tax" in global search bar; then view "Secondary Sources;" then view Publication Type "Law Reviews & Journals"). Of those results, many touch on only sports—or sport stadiums to be more precise—and limit discussion of amusement tax policy, if any, to only a few lines. *Id.* As discussed later, the idea of an amusement tax approach for online media offers specific advantages over a strict sales tax, *see infra* Part III, but borrowing from state sales and use tax policy offers a structured, albeit theoretical, framework for understanding taxing the cloud.

For context it is important to understand the difference of the sales and use tax as opposed to the amusement tax defined above. *See Amusement Tax*, *supra* note 3. A "[s]ales tax is a tax on the gross receipts from the sale or lease of tangible personal property as well as certain services." DAVID E. HARDESTY, ELECTRONIC COMMERCE: TAXATION & PLANNING ¶ 14.02 (2016). A use tax, however, operates to collect on receipts for purchases not covered by a sales tax, and it is a tax on use of the exempt property within a taxing jurisdiction. *See id.* In function, the use tax operates much the same way as a sales tax. *See id.* Use taxes are a means to collect on sales outside of a taxing jurisdiction that will be *used* in that jurisdiction; policy would suggest that "[u]se taxes are designed to discourage the purchase of products that are not subject to the sales tax." *Use Tax*, BLACK'S LAW DICTIONARY (10th ed. 2014). For that reason, this Note will address the sales and use taxes as nondistinct components.

11. 504 U.S. 298, 317-18 (1992) (holding in favor of a bright-line, physical presence test to establish a nexus for a state sales tax against an out-of-state vendor, at least until Congress, free to make its own decisions, legislates otherwise).

and wholly as possible—distinguish between different types of Internet media and develop a plan that discerns the license-based subscription services from the transactional purchases in a tax plan that is sound, functional, and uniform. Part III then contrasts this proposal with other past and future approaches to tax streaming media. Again, this Note, for purposes of this discussion, assumes a tax is inevitable, and instead of asking why, should, or when, it seeks the more pressing question of *how*. After all, in the end this is a question best left for Congress.

I. THE CHICAGO CLOUD TAX: WHY IT EXISTS, THE POLICY BEHIND IT, AND WHERE IT FAILS

A. Why Tax the Cloud?

Why Chicago or any municipality would want to tax streaming data is understandable. In 1998, the state income tax replaced the sales and use tax as the most important tax revenue for states, proving that sales taxes are losing weight in a changing economy.[12] Further, the fear that e-commerce adds to this "already eroding tax base" exacerbates the perceived necessity of taxing online media.[13] E-commerce places burdens on states and, in particular, small, local jurisdictions by limiting their tax reach: unlike in-state brick and mortar establishments, nexus requirements prevent jurisdictions

12. *See* DAVID BRUNORI, STATE TAX POLICY: A POLITICAL PERSPECTIVE 7-8 (2d ed. 2005). For an exacting breakdown of state tax collections by state, the Census Bureau's classification of tax types, and the percentages of each within each state, see CHERYL LEE ET AL., U.S. CENSUS BUREAU, G14-STC, STATE GOVERNMENT TAX COLLECTIONS SUMMARY REPORT: 2014 (2015), http://www2.census.gov/govs/statetax/G14-STC-Final.pdf [https://perma.cc/MB3S-AFPV]; *see also* Tracy A. Kaye, *Show Me the Money: Congressional Limitations on State Tax Sovereignty*, 35 HARV. J. ON LEGIS. 149, 184-85 (1998) (warning that, despite the state sales tax being the leading source of state tax revenue in 1995, a shift to a service-oriented economy will limit sales tax revenue); Kirk J. Stark, *The Federal Role in State Tax Reform*, 30 VA. TAX REV. 407, 420 (2010) (detailing varying compositions of state tax bases across income, sales, and property taxes).

13. BRUNORI, *supra* note 12, at 61 (footnote omitted). E-commerce refers to "[t]he practice of buying and selling goods and services through online consumer services and of conducting other business activities using an electronic device and the Internet." *E-Commerce*, BLACK'S LAW DICTIONARY (10th ed. 2014).

from collecting taxes from many e-commerce vendors.[14] Estimates suggest these losses cost the states as much as $7.7 billion.[15] In an effort to understand the effect on a single state, consider that North Carolina alone claims losses of up to $145 million.[16] Some worry that without a means to ensure tax revenue, "local governments could be weakened to the point of irrelevance."[17]

Even though the numbers detailed above consider e-commerce as a whole, it is important to couple them with an understanding of online media consumption in context. During the past decade, consumption markets have changed. The traditional market for ownership has shifted to a market for temporary access, conceptualized as "access-based consumption."[18] Television has been fending off threats since the introduction of home VCRs in the 1970s, followed by more modern advancements like DVR, TiVo, and on-demand viewing.[19] This trend not only shifted viewers from prime-time viewing, but also provided a means to fast-forward through paid advertising, or skip it altogether, creating a rift in how programming earned its profits.[20] The Internet, however, has made the

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14. *See* Morales, *supra* note 6, at 70. "Nexus" is defined simply as an often-causal connection or link. *Nexus*, BLACK'S LAW DICTIONARY (10th ed. 2014). In the context of e-commerce, nexus refers to the minimum requirements of connection that a taxing jurisdiction must have to tax an out-of-state vendor. *See* HARDESTY, *supra* note 10, ¶ 14.03. See also *infra* Part II for a discussion of the nexus standard.

15. Morales, *supra* note 6, at 70.

16. *Id.* But any reliance on revenue projections resulting from e-commerce should be measured with some restraint. *See* HARDESTY, *supra* note 10, ¶ 19.02 ("There is little reliable information as to the amount of sales and use tax revenue raised from online transactions and the amount of tax revenue lost because of the failure to collect tax on such transactions.").

17. DAVID BRUNORI, LOCAL TAX POLICY: A FEDERALIST PERSPECTIVE 2 (2d ed. 2007).

18. Fleura Bardhi & Giana M. Eckhardt, *Access-Based Consumption: The Case of Car Sharing*, 39 J. CONSUMER RES. 881, 881 (2012) ("We define access-based consumption as transactions that may be market mediated in which no transfer of ownership takes place. The consumer is acquiring consumption time with the item, and, in market-mediated cases of access, is willing to pay a price premium for use of that object. Consumers are able to access objects or networks that they could not afford to own or that they choose not to own." (citation omitted)). Granted, cable television in and of itself is not ownership but access to forms of paid programming; however, the idea of access-based consumption touches on changing views on consumption such as timeliness, immediacy, access, and shared community benefits. *See id.* at 895-96. Companies like Netflix provide a means for consumers to gain access "through sharing or pooling of resources" that can better reflect "consumers' relationship to products and services and their preferences, values, and desires." *Id.* at 881-82.

19. *See* Lisa Lapan, Comment, *Network Television and the Digital Threat*, 16 UCLA ENT. L. REV. 343, 345-46 (2009).

20. *See id.*

greatest impact: it has instant distribution and access, limited—if any—advertising, zero cost margin, and all at the click of a mouse or swipe of a finger.[21] Cable has not lost viewers solely to cord-cutting. Digital media gives access to three screens—the television, the computer, and the mobile device—fragmenting advertising costs, and decreasing revenue for networks.[22] As of 2008, 76 percent of consumers watched video from a computer, and 32 percent from a mobile device.[23] It would be no stretch to deduce that these numbers have increased drastically since then.[24] More to the point, in 2012 alone, Internet traffic in the United States increased 36 percent, and that traffic is expected to triple by 2017.[25] In the same year, prime-time traffic grew 41 percent, with Netflix solely generating one-third of all downstream traffic in the United States during those hours.[26] This suggests not only increased Internet use, but, specifically, cord-cutting trends and the necessity to look to the Internet for tax revenue.

Some argue that e-commerce on the whole should be exempt from tax under theories of "infant industry," the socioeconomic "digital divide" of Internet access, the lack of benefit to the burdened remote vendors charged with collecting the tax, and economic benefits of encouraging competition among remote vendors.[27] But there is evidence that some online vendors collect taxes across various states "without major difficulties."[28] For example, Netflix collects sales taxes for its DVD rentals "in practically every state."[29] Netflix can do this "easily and cheaply" by using a company specializing in collecting and complying with tax laws across different jurisdictions.[30] Netflix is not alone; per its terms and conditions, Apple's

21. *See id.*
22. *See id.* at 345.
23. *Id.* at 355.
24. *See* Hagey, *supra* note 7 (suggesting 17 percent of U.S. households will not subscribe to cable by the end of 2015, and 23 percent will not subscribe by the end of 2019).
25. Daniel A. Lyons, *Internet Policy's Next Frontier: Usage-Based Broadband Pricing*, 66 FED. COMM. L.J. 1, 3 (2013).
26. *See id.* at 3 n.2.
27. Charles E. McLure, Jr., *Thinking Straight About the Taxation of Electronic Commerce: Tax Principles, Compliance Problems, and Nexus*, 16 TAX POL'Y & ECONOMY 115, 124-25 (2002).
28. Morales, *supra* note 6, at 71.
29. *Id.*
30. *Id.*

iTunes Store also collects taxes for various states, and can still turn a profit on sales as low as sixty-nine cents.[31] Thus, rather than introducing new problems, e-commerce merely shines a light on problems already in play—namely, nexus and uniformity.[32]

B. Chicago's Cloud Tax Ruling and Municipal Code

Before analyzing and proposing an approach to taxing streaming media in the cloud, it is important to place the Chicago rulings in context. The Chicago Municipal Code defines an "amusement" as "(1) any exhibition, performance, presentation or show for entertainment purposes, ... (2) any entertainment or recreational activity offered for public participation or on a membership or other basis ... or (3) any paid television programming, whether transmitted by wire, cable, fiber optics, laser, microwave, radio, satellite or similar means."[33] The Code calls for a 9 percent tax on fees paid in consideration for "the privilege to enter, to witness, to view or to participate in such amusement," to be collected and remitted by every owner, operator, or reseller of an amusement.[34] The Chicago Personal Property Lease Transaction Tax Ordinance, however, places a 9 percent tax on "(1) the lease or rental in the city of personal property, or (2) the privilege of using in the city personal property that is leased or rented outside the city."[35] Despite calling for a tax on any

31. *See id.* In the past, Apple explicitly stipulated that any applicable tax would be included in the total price and calculated according to the purchaser's billing address. *Apple's iTunes Terms and Conditions*, APPLE.COM, https://perma.cc/8LZE-B4B4 ("Your total price will include the price of the product plus any applicable tax; such tax is based on the bill-to address and the tax rate in effect at the time you download the product."). However, as of September 13, 2016, the terms have changed: the language of the "bill-to address" and "total price" has been removed, replaced by the curt but malleable "including any applicable tax." *Apple's iTunes Terms and Conditions*, APPLE.COM, http://www.apple.com/legal/internet-services/itunes/us/terms.html [https://perma.cc/VG43-X54E] (last updated Sept. 13, 2016) ("Apple will charge your payment method (such as your credit card, debit card, gift card/code, or other method available in your Home Country) for any paid Transactions, including any applicable taxes.").

32. *See* McLure, *supra* note 27, at 117 ("For the most part, the advent of electronic commerce has highlighted problems that were there all along; it did not create them. Most of these problems—but not all—stem from the lack of uniformity of the taxes imposed by the states ... and their numerous political subdivisions.").

33. CHI., ILL., MUN. CODE § 4-156-010 (2016).

34. *Id.* §§ 4-156-010 to -030. For a listing of exemptions, see *id.* § 4-156-020(B).

35. *Id.* §§ 3-32-010 to -030.

rental or lease on personal property other than real property, the ordinance explicitly exempts the lease, rental, or use of a motion picture film.[36]

Widawsky's amusement tax ruling interprets the amusement tax to include not only those amusements witnessed in person, but also those that are "*delivered electronically*," including television shows, movies, videos, electronically delivered music, and online games.[37] The amusement tax, however, revolves around the idea of privilege, and "does not apply to *sales* of shows, movies, videos, music, or games (normally accomplished by a 'permanent' download). It applies only to *rentals* (normally accomplished by streaming or a 'temporary' download)."[38] Accordingly, the ruling explains that the amusement tax applies to "subscription fees, per-event fees or otherwise."[39] Neither the Code nor the ruling distinguishes between the types of fees paid.[40] The ruling does, however, make an effort to approach those fees, or "bundled" charges, that include both taxable and nontaxable elements.[41] Relying on a previous Personal Property Lease Transaction Tax Ruling, Widawsky mandates that if a bundled charge does not separate the taxable amusement charge from the nontaxable, then the entire price is presumed taxable if it is primarily for a privilege to witness an amusement.[42]

Finally, as to the question of nexus, although the ruling reinforces that the tax applies whenever an amusement takes place in Chicago, the vendor itself decides whether it has an obligation to collect.[43] This places a burden on the vendor not only to collect and

36. *Id.* § 3-32-050.

37. Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 8.

38. *Id.* ¶ 10.

39. *Id.*

40. CHI., ILL., MUN. CODE § 4-156-020(A) (2016) ("The rate of the tax shall be equal to nine percent of the admission fees or other charges paid for the privilege to enter, to witness, to view or to participate in such amusement."); Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 10 ("The charges paid ... may be subscription fees, per-event fees or otherwise.").

41. Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 12.

42. *See id.* (quoting Dep't of Fin., City of Chi., Personal Property Lease Transaction Tax Ruling #3 (June 1, 2004)). As discussed in Part II *infra*, the bundled approach has particular implications for services like Amazon Prime, which offers members certain shipping privileges coupled with streaming access to select titles in Amazon's online database. *See Prime Member Exclusives*, AMAZON, https://www.amazon.com/gp/help/customer/display.html?nodeId=200444160 [https://perma.cc/49UE-KQFU].

43. Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 14.

remit a tax if the vendor has such an obligation, but also to determine both its own nexus to the jurisdiction and whether a patron is using its service within the city of Chicago.[44] For online amusements, the amusement tax "will apply to customers whose residential street address or primary business street address is in Chicago, *as reflected by* their credit card billing address, zip code or other reliable information."[45]

The Personal Property Lease Transaction Tax Ruling applies to nonpossessory computer leases that allow a user to use a provider's computer "to input, modify, or retrieve data or information," as in a legal research database, such as Westlaw; real estate, car, stock, and job listings; or online word, data, or tax processing.[46] The Personal Property Lease Transaction Tax Ruling, however, exempts all entertainment materials—copyrighted books, music, recordings, and feature-length and episodic films.[47]

Some contend that these rulings are not so much interpretations and implementations of existing taxes, but that they are new taxes exceeding the scope and power of the Comptroller's authority.[48] Although outside the scope of this Note, the Comptroller's authority is repeatedly and explicitly stated: to adopt, promulgate, and enforce every tax ordinance contained in the Municipal Code of Chicago.[49] Still, this begs the question *why*. Before developing a framework of state and local tax policy, one must speculate on whether such a tax is sensible within local initiatives. Chicago is in the midst of a technology push, committing to double Chicago's tech economy by

44. *See id.* ¶¶ 9, 13-14.

45. *Id.* ¶ 13 (emphasis added).

46. Widawsky, Personal Property Lease Transaction Tax Ruling, *supra* note 1, ¶ 6.

47. *Id.*

48. *See, e.g.*, Labell Complaint, *supra* note 4, ¶¶ 40-42, 52-54, 56-57, 64-66, 68-69; Harris, *supra* note 1 (noting opinions that a streaming tax should be left to state—not local—tax, and should be implemented through legislation, not a ruling by a comptroller).

49. *See, e.g.*, CHI., ILL., MUN. CODE § 3-4-150(A)(1) (2016) ("[T]he comptroller is empowered to adopt, promulgate, and enforce rules and regulations pertaining to the administration and enforcement of the provisions of this chapter and any tax ordinance."); *id.* § 2-32-080 ("[T]he city comptroller shall have the power[ ] ... [t]o administer and enforce all the responsibilities, powers and duties delegated to him in every tax ordinance presently contained in or to be included in the Municipal Code of Chicago."); *id.* § 4-156-034 (stating that "the comptroller is authorized to adopt, promulgate and enforce rules and regulations pertaining to the interpretation, administration and enforcement of" the amusement tax).

2023 and create 40,000 jobs in the technology sector.[50] It might seem counterintuitive to simultaneously encourage and tax tech companies, especially startups. But, many of these arguments may be moot because the city is considering exemptions to tech startups based on revenue.[51] As discussed in Part III, this exemption may be key to the fairness of a cloud tax, especially to those companies that may be outside of the jurisdiction.

C. State and Local Tax Policy

It is a "shibboleth among tax lawyers that an old tax is a good tax," but a changing economy and e-commerce market have damaged the efficiency with which old tax plans can collect revenue.[52] Rather than implementing a tax plan to account for growing e-

50. *See Mayor Rahm Emanuel Announces Commitment To Doubling Chicago Tech Economy In Next Ten Years*, CITY OF CHI. (Nov. 5, 2013), http://www.cityofchicago.org/city/en/depts/doit/provdrs/software_development/news/2013/nov/mayor_rahm_emanuelannouncescommitmenttodoublingchicagotecheconom.html [https://perma.cc/R6PT-N3WW] (detailing Chicago's tech sector goals and three major initiatives: the Lollapalooza venture capital summit, Purdue University's weekend MBA program, and recruitment from the country's top five business schools); *see also, e.g.*, *City of Chicago Adopts Cloud Computing Strategy for City-wide Email and Applications*, CITY OF CHI. (Jan. 3, 2013), http://www.cityofchicago.org/city/en/depts/doit/provdrs/software_development/news/2013/jan/city_of_chicago_adoptscloudcomputingstrategyforcity-wideemailand.html [https://perma.cc/XL4A-R73U]; *Mayor Emanuel Launches 'Chicago Digital' Website to Connect Public to City's Digital Innovation Projects*, CITY OF CHI. (Jan. 6, 2013), http://www.cityofchicago.org/city/en/depts/doit/provdrs/software_development/news/2013/jan/mayor_emanuel_launcheschicagodigitalwebsitetoconnectpublictocity.html [https://perma.cc/2TE6-W3SN]; *Mayor Emanuel Releases City of Chicago's First Ever Technology Plan*, CITY OF CHI. (Sept. 17, 2013), http://www.cityofchicago.org/city/en/depts/doit/provdrs/software_development/news/2013/sep/mayor_emanuel_releasescityofchicagosfirstevertechnologyplan.html [https://perma.cc/3JQB-GV8X].

51. *See* Amina Elahi, *Chicago May Exempt Startups from 'Cloud Tax*,' CHI. TRIB. (July 8, 2015, 8:29 AM), http://www.chicagotribune.com/bluesky/originals/ct-chicago-cloud-tax-david-huges-6si-20150707-story.html [https://perma.cc/A9WJ-RGW6]; *see also* Corley, *supra* note 8. For the Personal Property Lease Transaction Tax, Chicago lowered the 9 percent rate to 5.25 percent for certain cloud products and exempted startups that are less than five years old and that received less than twenty-five million dollars in yearly sales. *Information Bulletin: Nonpossessory Computer Leases*, CITY OF CHI. (Nov. 19, 2015), http://www.cityofchicago.org/city/en/depts/fin/provdrs/tax_division/news/2015/june/NonpossessoryComputerLeases.html [https://perma.cc/9Z7C-DEB2].

52. BRUNORI, *supra* note 12, at 2; *see also* Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269, 318 (1997) ("It is more difficult to monitor the transmittal of electronic signals than to monitor trade in tangible products, especially when the transmission network is becoming so widely decentralized and location plays such a small role.").

commerce and a shift to a service-based economy, political pressures instead promoted broad exemptions to traditionally taxable products.[53] Currently, with an increasingly mobile and tech-dependent economy, interjurisdictional competition creates a dilemma for municipalities: provide high-quality public services to its denizens via higher tax revenues, or entice businesses to remain or relocate through targeted tax incentives.[54] Furthermore, old tax plans may not apply because access-based consumption is "ultimately ... unique" and neither in the realm of purchase for ownership nor sharing.[55] But it may still be necessary to formulate an approach through an understanding of sales and use tax, and this makes sense.[56] Even though taxes are generally disliked, public opinion suggests that many "identify levies on consumption as among the most acceptable forms of taxation."[57]

A "good" tax should not distort behavior.[58] Along with meeting the purposes of the jurisdiction imposing the tax, a good tax should be both economically neutral and compliance friendly.[59] Arguably, the simplest (theoretically—not in practice) method would be to tax all

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53. *See* BRUNORI, *supra* note 12, at 7-8.

54. *See id.* at 35. For a discussion of both vertical tax competition—between state and local governments taxing the same or overlapping tax base—and horizontal tax competition—between local governments—see Erin Adele Scharff, *Powerful Cities?: Limits on Municipal Taxing Authority and What to Do About Them*, 91 N.Y.U. L. REV. 292, 321-26 (2016). However, some argue these local tax incentives encourage relocation in-state only to a certain extent, and the incentives "often only encourage intrastate business relocation." *Id.* at 324-25. "Further, some studies suggest that many businesses would make the same location decisions even absent local tax incentives, turning these programs into windfalls for these businesses to the detriment of local revenue and other taxpayers." *Id.* at 325.

55. Bardhi & Eckhardt, *supra* note 18, at 882; Vlad Frants, *The Evolution of Cloud Computing Taxation: Characterizing and Sourcing Cloud Computing Payments in an Uncertain World*, A.B.A., http://www.americanbar.org/groups/young_lawyers/publications/the_101_201_practice_series/the_evolution_of_cloud_computing_taxation.html [https://perma.cc/6W5P-7DT7].

56. For an understanding of the distinguishing factors of a sales tax versus a use tax, see McLure, *supra* note 27, at 117 n.3 ("Strictly speaking, remote vendors that have a nexus in a state are required to collect the *use tax*, which is legally imposed on in-state purchaser's use of the purchased item, rather than the *sales tax*, which is imposed on in-state sales and cannot be collected on sales originating outside the state.").

57. BRUNORI, *supra* note 12, at 54-55.

58. Steven Maguire, *Internet Transactions and the Sales Tax*, *in* INTERNET TAXATION 1, 5 (Albert Tokin ed., 2003).

59. *See* McLure, *supra* note 27, at 118.

consumption, taxing sales by local and remote vendors equally.[60] Even though this would be functionally neutral and uniform, the results would not be.[61] Sales taxes in themselves are inherently regressive, disproportionally affecting the poor and having lesser impact on the wealthy.[62] Ideally, a good tax would balance these concerns. But a tax system has another primary purpose: raising revenue.[63]

The revenue must satisfy the needs of public programs and policies initiated for its citizens.[64] Here, Chicago expects $12 million in additional revenue from the rulings on its property lease and amusement tax ordinances.[65] Whether the $12 million is adequate for Chicago's needs remains to be seen, but it is not a trivial figure and allows some recapture from the shift away from taxable cable viewing.[66]

A neutral tax should minimize effects on a consumer's decision-making, which is generally realized through a broad tax base and low rates.[67] The cloud tax does not call for a higher tax than historically nonelectronic media,[68] and part of its problem may be that its tax base is too broad. Furthermore, in the grand scheme, a 9 percent tax on a low monthly Netflix subscription might not seem so crippling, especially if cable plans would carry the same tax percentage on a higher cable bill.[69]

Fairness should exhibit both horizontal equity—those alike pay alike—and vertical equity—those with the ability to pay more pay more.[70] This contention plays an important distinction in the realm of cloud taxing. Namely, cloud taxing ultimately requires a means to distinguish between not only the types of consumption within the

60. *See id.* at 118-19.

61. *See* BRUNORI, *supra* note 17, at 8-9.

62. *See id.*; Donna M. Byrne, *Progressive Taxation Revisited*, 37 ARIZ. L. REV. 739, 742 (1995).

63. *See* BRUNORI, *supra* note 12, at 13.

64. *See id.*

65. *See* Corley, *supra* note 8.

66. *See supra* Part I.A.

67. *See Too Reliant on the Few*, ECONOMIST (Sept. 20, 2014), http://www.economist.com/news/leaders/21618784-taxes-are-best-raised-broad-base-many-countries-it-worryingly-narrow-too-reliant [https://perma.cc/8RXK-3CKY].

68. *See* CHI., ILL., MUN. CODE § 4-156-020(A) (2016).

69. *See* Subramanian, *supra* note 5.

70. BRUNORI, *supra* note 12, at 16-19.

cloud, such as subscription fees, pay-per-event transactions, and the hybrids like Amazon Prime, but also the volume of consumption by individual taxpayers—the occasional viewer versus the binge viewer.[71]

Ease of administration and compliance requires a balancing of efficiency, revenue, and simplicity.[72] Difficulties arise as to not only what is taxable in the cloud,[73] but also who should the government tax, *when* they should be taxed, if a vendor satisfies the required nexus, and to what extent a municipality can burden remote sellers to collect and remit a tax.[74] A more complicated scheme may lead to greater costs of taxpayer compliance, shuttling time and money that could be better spent on fiscal planning.[75] Applied to a cloud tax, additional risks arise as to means of tax avoidance—bypassing increased tax fees to rely instead on free, ad-sponsored programming, or worse, illegal streaming.[76]

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71. *See infra* Part III. "A survey released ... by TiVo ... finds that 9 out of 10 people are engaging in 'binge viewing,' which the digital video recording company defines as watching more than three episodes of a particular TV show in one day." Tom Huddleston, Jr., *Survey: Pretty Much Everybody is Binge-Watching TV*, FORTUNE (June 30, 2015, 1:27 PM), http://fortune.com/2015/06/30/binge-viewing-study/ [https://perma.cc/8HSV-Q5RY]. Binge viewing is a contentious subject. *See* Ian Crouch, *Come Binge with Me*, NEW YORKER (Dec. 18, 2013), http://www.newyorker.com/culture/culture-desk/come-binge-with-me [https://perma.cc/42HK-XBAF] ("Somewhere in our response to the experience of watching multiple hours of television there is, if not shame, the discomfiting feeling of being slightly out of control.... Part of the problem is the phrase itself: binging on something is not traditionally considered an admirable behavior."). But, "[n]ot surprisingly, binge-watching is also less frowned upon ... compared to two years ago." Huddleston, *supra*. Even so, "31% of respondents to TiVo's survey said they have lost sleep to their binging habit while another 37% said they have spent an entire weekend binging on a show." *Id.*

72. *See* BRUNORI, *supra* note 12, at 19-21.

73. In the past, Netflix argued that its offerings were not subject to sales tax because it was distinguishable as a "streaming *service*": subscribers are paying not for ability to rent and stream film, but for Netflix coding allowing viewable content across multiple platforms, the ability to search its online access (much like Westlaw), a user interface incorporating algorithms to predict preferences for each customer, and for the ability to stream, as opposed to renting or even downloading a video. Diane Holman, Senior Sales Tax Manager, Netflix, Inc., Statement by Netflix, Inc., at the Idaho State Tax Commission Commissioner's Open Meeting 1 (Nov. 19, 2014), https://tax.idaho.gov/pubs/rulesdoc_4jRyl4hQR9TnS.pdf [https://perma.cc/F8RK-U4XD].

74. *See infra* Parts II, III.

75. *See* BRUNORI, *supra* note 12, at 20, 56.

76. Gary Shapiro, *Commentary: No One's Smiling About Chicago's 'Amusement Tax,'* CHI. TRIB. (Aug. 24, 2015, 4:52 PM), http://www.chicagotribune.com/news/opinion/commentary/ct-amusement-tax-streaming-netflix-hulu-perspec-0825-20150824-story.html [https://perma.cc/

Accountability requires transparency from government in the creation, enforcement, and benefits of any tax plan.[77] Even so, it is likely the importance of accountability will rise to much greater prominence if and when digital tax comes to the forefront.[78] Clarity, however, may benefit all involved.

Despite these tax principles, local tax policy might be a lost cause. Local tax policies and plans are flexible, changing at the hands of local politics rather than begrudgingly slow state and federal legislation.[79] Coupling this with difficulties of implementing a sales tax against remote vendors and costs of enforcement for smaller localities leads to the argument that "[w]ithin the framework of sound local tax policy, the property tax is the only viable source of own-source tax revenue for local governments."[80] Unlike sales in a changing economy, property remains a steady source, tracking land and parcels is commonplace, evasion is difficult, and property has a clear—literally physical—link to the source of the tax and the community it serves to support.[81] Localities like Chicago, however, have a different incentive buttressing the desire to retain a sales tax: a "local sales tax is particularly attractive for urban communities because it allows some of the tax burden to be exported to nonresidents."[82] Yet, this shred of hope withers with the implementation strategy of a local cloud tax; the tax relies on a Chicago address—residential or billing—for proof that the amusement took place in Chicago.[83] Compare this with the personal property lease

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77. *See* BRUNORI, *supra* note 12, at 21-22.

78. *See* Robert P. Strauss, *Administrative and Revenue Implications of Alternative Federal Consumption Taxes for the State and Local Sector*, 14 AM. J. TAX POL'Y 361, 363 (1997) (warning that governments must compromise between collecting tax revenue and protecting public concerns of privacy, due process, and equal protection).

79. *See* BRUNORI, *supra* note 17, at 22.

80. *Id.*

81. *See id.* Property taxes provide local municipalities with the "largest source of own-source revenue." Scharff, *supra* note 54, at 303-04. Furthermore, not all municipalities have the authority to impose sales tax, and even less have authority to impose additional income taxes. *See id.* at 303; *see also* Edward A. Zelinsky, *The Once and Future Property Tax: A Dialogue with My Younger Self*, 23 CARDOZO L. REV. 2199, 2200-01 (2002) ("[T]he local property tax survives for many reasons; chief among these is that the tax has distinct theoretical and practical advantages.").

82. BRUNORI, *supra* note 17, at 70.

83. *See* Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 13.

transaction tax, which determines the location of a transaction by the location of the terminal or device through which the consumer gains access.[84] Whether right or wrong, the cloud tax only applies to Chicago residents, forfeiting one of the benefits of a local sales tax in a major city.[85]

II. *QUILL*'S NEXUS AND THE ILLINOIS FRAMEWORK OF AMUSEMENT TAX ANALYSIS

A. Quill *and the Nexus Dilemma*

In addressing a sales tax on remote vendors—albeit on mail-order purchases rather than online e-commerce—the Supreme Court held that a state sales and use tax cannot require an out-of-state vendor to collect and remit taxes unless said vendor has a physical presence in the state.[86] Even though the Court held that a remote mail-order vendor would be susceptible to a sales and use tax under the Due Process Clause "minimum contacts" test, the same was not true under the Commerce Clause's required "substantial nexus."[87] Because of this, however, the Court opened up the ability for Congress to make a change:

> [T]he underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve.... Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.[88]

Until such a change comes, *Quill* remains the standard for analyzing nexus for remote, online vendors; however, both academia and legislation challenge its interpretation.[89] One interpretation is

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84. *See* CHI., ILL., MUN. CODE § 3-32-020 (2016).
85. *See* Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 13.
86. Quill Corp. v. North Dakota, 504 U.S. 298, 317-18 (1992).
87. *Id.* at 312.
88. *Id.* at 318 (footnote omitted).
89. *See, e.g.*, David Gamage & Devin J. Heckman, *A Better Way Forward for State Taxation of E-Commerce*, 92 B.U. L. REV. 483, 484, 516-17 (2012). Another, more drastic interpretation is that *Quill* only applies to sales and use taxes, and not other forms, *see supra*

that *Quill* should prevent taxing remote vendors only when the tax burdens interstate commerce.[90] Under this approach, a tax is a burden if "an out-of-state vendor bears reporting or compliance costs as a result of a state's imposing tax collection duties on the out-of-state vendor."[91] A proposed solution would see states compensating vendors for these compliance costs as a means of eliminating the burden under *Quill*.[92] Potential benefits abound under such an approach, including recouping losses from out-of-state e-commerce; an even playing field between in-state and out-of-state vendors; and simplified tax schemes due to the internalized costs imposed on the taxing jurisdictions.[93]

Legislative attempts around *Quill* have been less inventive.[94] One of the first attempts was New York's 2008 "Amazon tax."[95] Challenging the *Quill* physical presence requirement, the New York law aimed to establish nexus of an out-of-state vendor through its use of in-state, click-through advertisements.[96] The law required those online vendors to collect and remit taxes on purchases by New York residents.[97] Not only did the Court of Appeals of New York hold the plaintiffs failed to prove the statute unconstitutional under the Commerce Clause or the Due Process Clause, but the United States Supreme Court denied writ of certiorari to this case and its companion case.[98]

In Colorado, efforts to circumvent the *Quill* decision demanded out-of-state vendors who failed to collect sales and use taxes to notify purchasers that a tax was due to the state, as well as to

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note 3, which may leave an opening for an amusement tax scheme.

90. *See* Gamage & Heckman, *supra* note 89, at 486-87.

91. *Id.*

92. *See id.* at 487.

93. *See id.* at 488. But some argue that allowing taxation on e-commerce could affect online spending habits, estimating 75 percent of online buyers "would buy less on the Internet if a sales tax were imposed." Hal R. Varian, *Taxation of Electronic Commerce*, 13 HARV. J.L. & TECH. 639, 639 (2000).

94. For example, Michigan and Wisconsin attempted to have taxpayers self-report out-of-state purchases to collect use taxes, albeit unsuccessfully. *See* Varian, *supra* note 93, at 640.

95. *See* Gamage & Heckman, *supra* note 89, at 517.

96. *See* Overstock.com, Inc. v. N.Y. State Dep't of Taxation and Fin., 987 N.E.2d 621, 622-23 (N.Y. 2013), *cert. denied*, 134 S. Ct. 682 (2013); Morales, *supra* note 6, at 62-63.

97. *See* Morales, *supra* note 6, at 62.

98. *Overstock.com*, 987 N.E.2d at 622-23.

provide the state with contact information for those purchasers.[99] Even though the bill reached the Supreme Court on other grounds, Justice Kennedy called for a change: "[G]iven these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms states to a degree far greater than could have been anticipated."[100]

Possibly the most compelling challenge to *Quill* is an additional de minimus threshold test.[101] Rather than ridding states of *Quill*'s physical presence test, states could implement an additional economic nexus standard.[102] A remote vendor could satisfy substantial nexus to a taxing jurisdiction if it either fulfilled *Quill*'s physical presence or met a predetermined de minimis economic threshold.[103] The de minimis threshold would operate via a dollar cap—for larger, remote companies—at which point a remote vendor would be required to collect and remit a tax to the taxing jurisdiction, or through a percentage-of-sales framework—targeting smaller yet still relevant remote vendors—where nexus is met if sales to a taxing jurisdiction make up a significant percentage of that vendor's revenues.[104] Granted, this would still require implementation through Congress.[105]

B. Amusement Tax Analysis

An understanding of the *Quill* precedent is necessary for placing the Chicago amusement tax in context because the *Quill* decision also deals with nexus, and because most efforts to tax cloud streaming will likely take a form other than a strict amusement tax.[106] The amusement tax framework, however, carries an additional wrinkle that may aid in understanding how a cloud tax on

99. *See* Morales, *supra* note 6, at 75-76.
100. Direct Mktg. Ass'n v. Brohl, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring).
101. *See* John A. Swain, *State Sales and Use Tax Jurisdiction: An Economic Nexus Standard for the Twenty-First Century*, 38 GA. L. REV. 343, 345 (2003).
102. *See id.* at 345, 366.
103. *See id.*
104. *See id.*
105. *See id.* at 346.
106. *See infra* Part III (discussing past and future proposals for taxing streaming entertainment in the cloud).

streaming entertainment may operate, especially as to the different forms of online media entertainment and their differing and respective pay schemes.[107]

1. *Membership Fees Involving Amusement and Nonamusement Components*

Fittingly, the chronological evolution of the case law in Illinois provides a series of decent benchmarks through which to analyze the Chicago amusement tax rulings and a general cloud tax. In an early challenge to an application of the amusement tax to health and racquetball clubs, the Supreme Court of Illinois held in *Chicago Health Clubs, Inc. v. Picur* that an amendment including a tax on membership fees was unconstitutional.[108] Chicago challenged that because "at least *some* amusement activities occur at health and racquetball clubs, a tax imposed on the receipts of such establishments [was] proper."[109] Because the clubs at issue exhibited both amusement and nonamusement components, and the ordinance did not call for distinguishing between these components in its tax, the court would not justify a tax on membership fees unless the fee taxed predominately covered amusements.[110]

In its decision, the court relied on the plain language of the ordinance, which did not distinguish between amusement and nonamusement components.[111] In the most recent tax ruling, however, Widawsky did just that.[112] Even though the court did not reach the question as to how it would rule had such language been present in the ordinance, the language would do little to help in compliance. This is a particular problem for membership fees like Amazon Prime that, for a ninety-nine dollar fee, provides access to an array of multiple benefits: free expedited shipping and delivery, unlimited photo cloud storage, reserved deals and discounts, and—perhaps

107. For a brief discussion of issues relating to cloud usage and specifically the struggles of distinguishing between leases and subscriptions as they apply to a potential tax, see Jordan M. Goodman & Marilyn A. Wethekam, *Emerging Tax Issues Connected to Cloud Usage*, 12 DEPAUL BUS. & COM. L.J. 455, 462-63 (2014).

108. 528 N.E.2d 978, 984 (Ill. 1988).

109. *Id.* at 983 (emphasis added).

110. *See id.* at 983-84.

111. *See id.* at 984.

112. *See* Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 12.

most important at issue here—free, unlimited access to streaming movies, television, and ad-free music.[113] It would be nearly impossible for Amazon to determine if its fee is predominately amusement, as such would deviate from person to person.

2. The Risk of the Occupational Tax

Under the Illinois Constitution—and in general—a tax should not operate to punish a particular occupation.[114] Illinois courts have defined an occupational tax as a tax "that in practical effect imposes a tax upon a given occupation or the provider of particular services."[115] The challenge at issue in *Communications & Cable of Chicago, Inc. v. City of Chicago* was whether an amendment to the amusement tax to include paid television programming was an occupational tax against cable providers because many of the same or similar programs were available from video rental stores, online services, or other nontaxable means.[116] In its analysis, the Appellate Court of Illinois relied on a three-prong test: (1) who collected and remitted the tax; (2) who held the responsibility for payment if the patron failed to pay; and (3) who was subject to penalty if the patron failed to pay.[117] Even so, the court reserved a caveat that an occupational tax would survive if specifically authorized by the General Assembly.[118]

The court held that the tax at issue taxed the activity of watching television itself, not a specific occupation or provider.[119] This is important to the survival of the cloud tax for several reasons. In the most basic sense, this is justification for a tax on paid cable services, which is not far from the current state of many paid online video services, especially at a time when online services such as Netflix, Amazon, and Hulu are not only offering access to previously released materials but also producing, distributing, and streaming

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113. *About Amazon Prime*, AMAZON.COM, https://www.amazon.com/gp/help/customer/display.html?nodeId=200444160 [https://perma.cc/VSH9-TCBG].

114. *See* Commc'ns & Cable of Chi., Inc. v. City of Chicago, 668 N.E.2d 1032, 1036 (Ill. App. Ct. 1996).

115. *E.g.*, *id.*

116. *Id.* at 1034-35.

117. *Id.* at 1036.

118. *See id.* at 1038.

119. *See id.* at 1039.

their own programming.[120] And, in a step away from the ruling in *Picur*, the court refused to adopt a standard that would require an analysis of a provider's content to determine what was and was not amusement.[121]

Another benefit of this ruling is one of the general fairness of a cloud tax. The three-prong occupational tax test is not so much important for its goal in defining an occupational tax, as it is a benchmark for fairness of a cloud tax on entertainment. If a cloud tax meets the test for an occupational tax, then it may be fundamentally unfair to vendors, especially those out of state. If, in the plain language of a cloud tax, an ordinance calls for online vendors to not only collect and remit the tax, but also bear responsibility for a consumer's inability to pay and then be subject to penalty for that consumer's inability, then the ordinance should fail on its face.

3. Uniformity and the Cloud Tax

In *Communications & Cable of Chicago, Inc.*, the Appellate Court of Illinois also touched on another aspect crucial to a successful cloud tax: uniformity.[122] Classifications within the context of an amusement tax or a cloud tax "must be based on real and substantial differences between those taxed and those who are not and must also bear some reasonable relationship to the object of the legislation or public policy."[123] When faced with the argument that a tax on paid television programming was not uniform, the court shrugged it off.[124] The fact that the tax would apply differently to paid programming as opposed to video rentals (at the time), free broadcast television, or print media was so convincing as to make the tax impermissible when similar distinctions were deemed

120. *See, e.g.*, *Orange Is the New Black* (Lionsgate Television 2013-present) (Emmy Award-winning "Netflix Original"); *Transparent* (Amazon Studios 2014-present). *Transparent* marked the first online streaming series to win a Golden Globe. Jenelle Riley, *Amazon, 'Transparent' Make History at Golden Globes*, VARIETY (Jan. 11, 2015, 6:52 PM), http://variety.com/2015/tv/news/amazon-transparent-make-history-at-golden-globes-1201400485/ [https://perma.cc/E6HG-NBLX].

121. *Commc'ns & Cable of Chi.*, 668 N.E.2d at 1039.

122. *Id.*

123. *Id.*

124. *See id.*

reasonable in the past.[125] Here, on the contrary, the Chicago ruling seeks to extend the tax on the traditional "privilege" of watching television and movies to the online equivalent.[126] But, the question of uniformity is particularly pertinent to the proliferation of free, ad-supported programming on the Internet—through services like Pandora or Spotify, or even network and third party websites, such as ABC, CW, or Hulu—as well as illegal streaming. The presence of free alternatives should not hinder a tax on paid equivalents when public policy supports the tax, as it does in the efforts of a cloud tax to recoup the losses of programming that would otherwise be taxable had it been consumed via traditional means like cable.[127]

4. The Internet Tax Freedom Act and Discrimination

In *City of Chicago v. StubHub!, Inc.*, StubHub! refused to collect taxes on ticket sales under the amusement tax; however, it was willing to furnish taxing information to individual jurisdictions to collect for themselves.[128] Understandably, rather than collecting from thousands of individuals for dollars on the taxpayer, Chicago preferred that StubHub!, and similar services, collect and remit the taxes to minimize the number of parties involved in collection.[129] The Seventh Circuit looked to the Internet Tax Freedom Act (ITFA) for its answer.[130] The ITFA, in an effort to encourage Internet access to the public, prevented state and local governments from (1) imposing a tax on Internet *access*, or (2) implementing either multiple or discriminatory taxes on e-commerce.[131]

The court held that the Chicago amusement tax was not barred under the multiple tax prohibition of the ITFA because the tax only applied to tickets for events in Chicago, and therefore ensured no

125. *Id.* at 1040.
126. Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 8.
127. *See Commc'ns & Cable of Chi.*, 668 N.E.2d at 1040.
128. 624 F.3d 363, 364 (7th Cir. 2010).
129. *Id.*
130. *See id.* at 365-67.
131. Nonna A. Noto, *Extending the Internet Tax Moratorium and Related Issues*, *in* INTERNET TAXATION, *supra* note 58, at 17, 17-18. As the cloud streaming tax at issue here is not so much a tax on access to the Internet as it is on entertainment, and even then on only paid streaming entertainment, this Note continues on the assumption that the ITFA's prohibition on a tax to Internet access does not come into play.

other municipality could collect the tax.[132] In theory and on its face, the cloud tax does just that: the amusement tax applies to only those charges for the privilege to witness amusements "in the City," including, for online amusements, only those delivered electronically in the City.[133] Reality, however, is less certain. Even though the ordinance calls—albeit questionably—for a means to determine customers *from* Chicago, it does not provide a framework to determine if and when consumption occurs *in* Chicago.[134] This is not a problem for traditional amusements under the tax; theaters, concerts, and the like are not so different from the brick-and-mortar retailer in that they physically exist in the taxing jurisdiction. But, it is not impossible. Services like Netflix track account activity and log-in location.[135] Still, this may be an unfair burden to online vendors—especially against smaller vendors who may not have such tracking algorithms already in place.

Similarly, the court held that the amusement tax on ticket resellers was not discriminatory under the ITFA because the tax applied to both physical ticket resellers as well as online sellers like StubHub!.[136] Under the ITFA, a discriminatory tax "includes any ... local tax on electronic commerce that is not levied in the same way, at the same rate, or on the same person or entity."[137] Because of this limitation by the ITFA, a blanket tax on streaming amusement, like Chicago's 9 percent cloud tax, is too broad.

On its face, the Chicago Amusement Tax Ruling faces several hurdles under the discriminatory prohibition. Requiring online

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132. *StubHub!, Inc.*, 624 F.3d at 366.

133. Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 8.

134. *See id.* ¶ 13.

135. *See, e.g.*, *Recent Account Activity*, NETFLIX, https://www.netflix.com [https://perma.cc/294S-TNDE] (follow "Your Account" hyperlink; then follow "Viewing Activity" hyperlink; then follow "See recent account access").

136. *StubHub!, Inc.*, 624 F.3d at 366-67. The court reserved the question of whether municipalities may require intermediaries to collect and remit amusement taxes to the state high court. *Id.* at 368. The Supreme Court of Illinois later held that Chicago could not force Internet auction listing services to collect the tax; however, it explicitly distinguished Internet auctioneers, who cannot be made to collect and remit the tax, from sellers and resellers of tickets, who "may be made to collect the tax." City of Chicago v. StubHub, Inc., 979 N.E.2d 844, 856-67 (Ill. 2011).

137. Noto, *supra* note 131, at 30. *But see supra* notes 114-18 and accompanying text (detailing possibly incongruent approaches within the Chicago state courts, prohibiting taxes not predominately for amusement, but allowing taxes for amusements where similar outlets are free or nontaxable).

vendors to determine not only consumers in Chicago, but also when their consumption takes place within the confines of Chicago places extreme burdens on the vendors, potentially risking unequal tax treatment.[138] Returning to principles of neutrality, an ideal tax "would not discriminate between types of consumption, would not distort choices of techniques of production and distribution, would treat local and remote vendors the same, and would not distort the location of economic activity."[139]

In the case of digitized content, there is some risk of manipulation and consequently uneven tax treatment because a vendor may not know or have means to know where a buyer is located.[140] Using a billing address as a proxy—as called for in Chicago's ruling, and possibly the most logical start—might not be enough.[141] Potential for inconsistency abounds when one provider may rely on a residential address and another on a billing statement.[142] A prime example could be the out-of-state or out-of-city college student or recent movers to the city. If these taxpayers retain a billing address—such as for a parent's credit card—outside of the taxing jurisdiction, and a vendor utilizes a consumer's billing address to source its tax obligations, the city would not only miss out on a viable tax source based on the generational affinity for streaming media, but it could also

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138. *See supra* notes 126-28 and accompanying text.

139. McLure, *supra* note 27, at 118-19.

140. *See id.* at 121-22.

141. *See id.*

142. While a noble effort as a proxy for sourcing Chicago residents, the "as reflected by" language may jeopardize fair implementation of the tax, or a cloud tax in general. *See* Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 13; *see also* McLure, *supra* note 52, at 319 ("While the billing address of credit cards may be instructive in determining the destination of sales, it need not be, as it can be manipulated easily. Moreover, in some developing technologies for making payments, vendors do not receive credit card information, in order to reduce the risk of theft of credit card numbers.").

Yet another wrinkle is the ease of sharing passwords, a practice not necessarily combated by the streaming giants:

> Internet video-subscription services will lose as much as $500 million in 2015 due to illicit password sharing.... [T]he practice appears to be quite commonplace: In a recent Consumer Reports survey, 46% of American adults said they shared log-ins for streaming media services with people who were not part of the same household.

Brad Tuttle, *The Real Rules for Sharing Passwords at HBO Now, Netflix, Amazon Prime, and Hulu*, TIME (Sept. 21, 2015), http://time.com/money/4043147/hbo-netflix-amazon-prime-share-account-password/ [https://perma.cc/3ZNP-MT8F]. But, executives do not necessarily want to penalize the practice as it may encourage paying customers in the future. *See id.*

risk discriminating against dutiful taxpayers within the city. Furthermore, this is under the assumption that these are innocently missed opportunities, and not intentional manipulations to avoid a tax.

The disparity between different online media forms and their respective fees makes the risk of discrimination all the more apparent. Even though the design of the ordinance seeks to tax the privilege to experience an amusement, not all privileges are equal. The privileges, or rather their fees, exist in three basic categories: the per-transaction fee, the subscription fee, and the hybrid, consisting of subscription and transaction elements and even nonamusement components.[143]

First, the per-transaction fee, most easily understood through the example of an iTunes rental, provides the consumer temporary access, often through the form of a temporary download over a twenty-four or forty-eight hour period.[144] Second, subscription fees, such as those paid to Netflix or Hulu, are recurring fees offering unlimited access to select items in their libraries.[145] Finally is the hybrid model, like Amazon Prime. It is neither a subscription fee for the sole purpose of access to amusement, nor is it a per-transaction cost (though it provides that option on non-Prime titles).[146]

Under the different fees, watching the same film could result in drastically different results. Because we are in the legal realm, take, for example, *To Kill a Mockingbird*,[147] currently available on Net-

143. For sake of clarity, note that the Chicago amusement tax applies only to rentals, not sales. Widawsky, Amusement Tax Ruling, *supra* note 1, ¶ 10. Additionally, the tax only applies to paid privileges, and does not take into account privilege to access ad-supported programming. *See id.* ¶ 8.

144. *See, e.g.*, *About Renting Movies from the iTunes Store*, APPLE.COM, https://support.apple.com/en-us/HT201611 [https://perma.cc/23FE-AYWS].

145. *See, e.g.*, *How Does Netflix Work?*, NETFLIX, https://help.netflix.com/en/node/412 [https://perma.cc/5DQ5-KB7H]. This may occur through streaming or download depending on the provider. As discussed earlier, Netflix has in the past challenged the assumption that it is subject to sales and use tax under the theory that it is a service and that streaming and downloads deserve separate treatment. *See supra* note 73.

146. *Amazon Prime Terms*, AMAZON.COM, http://www.amazon.com/gp/help/customer/display.html/ref=amblink3737305823?ie=UTF8&nodeId=13819201&pfrdm=ATVPDKIKX0DER&pfrds=cent [https://perma.cc/GX52-R7E5]. This hybrid may also include on-demand rental services through cable providers like Comcast or Cox if the specific rental transactions are not already covered by a tax on the cable service itself.

147. TO KILL A MOCKINGBIRD (Universal Studios 1962).

flix.[148] Rounding for ease of explanation, an iTunes rental of HD quality costs approximately four dollars,[149] with a 9 percent tax costing thirty-six cents.[150] This rental can be viewed on one device over a period of twenty-four hours.[151] The current Netflix subscription costs ten dollars per month, with a 9 percent tax costing ninety cents.[152] Not only does this provide HD quality access, but access to two screens at a time.[153] Assuming the same title is available on Amazon Prime for unlimited streaming at ninety-nine dollars per year, the tax would come to $8.91. Taking the example to the extreme, suppose an aspiring law student desires to play the film twenty-four hours each day for the entire year before applying to law school. The Amazon Prime tax remains $8.91; the Netflix tax comes to $10.80 (without taking into account this law student could watch it on two screens simultaneously for that entire year); and the tax on iTunes would come in at $131.40, or $131.76 on a leap year (at 9 percent for a four dollar rental each day). A new release would be even more extreme under the iTunes per-transaction framework.

Granted, the above example borders on the absurd, but it has some merit.[154] It might not be all that uncommon for a consumer without subscription access to rent two films over the course of a weekend. At that point, that consumer, assuming the same prices above, will have spent eight dollars, accumulated a tax obligation of seventy-two cents, and had access to two films for twenty-four hours each. This consumer is in the same financial position as the monthly Netflix subscriber who has access to thousands of titles, on multiple

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148. Available, at least, at the time of this writing.

149. *iTunes Store*, APPLE, https://itunes.apple.com/us/movie/to-kill-a-mockingbird/id283068031 [https://perma.cc/DFS7-A7JT] (search in search bar for "To Kill a Mockingbird," then follow "Rent HD" hyperlink).

150. Additionally, for sake of simplicity, the following calculations assume that the tax is being added on top of the listed price, and not totaled into that listed price.

151. *See Apple's iTunes Terms and Conditions*, *supra* note 31.

152. *See How Does Netflix Work?*, *supra* note 145.

153. *Frequently Asked Questions About Netflix Billing*, NETFLIX, https://help.netflix.com/en/node/41049 [https://perma.cc/NB6X-6Q6E] (indicating that Netflix costs $9.99 per month for two-screen access).

154. In 2015, for persons age fifteen and over, watching television occupied more time than any other leisure activity at approximately 2.8 hours per day, according to the Bureau of Labor Statistics. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, USDL-16-1250, AMERICAN TIME USE SURVEY—2015 RESULTS 2 (2016), http://www.bls.gov/news.release/pdf/atus.pdf [https://perma.cc/P8B9-ZBRQ].

screens, for a month (or, 720 hours in a thirty-day month). On the contrary, another consumer may pay the yearly Amazon Prime fee and never stream a video, taking advantage, instead, of its shipping benefits.

This disparity seems ripe for discriminatory review and questions the purpose of a cloud tax. If the purpose is to recoup losses as quickly as possible from the cord-cutting generation without regard to fairness, then maybe the tax succeeds. If, however, the goal—punitive or not—is to tax streaming activity, then maybe the tax fails. Although the tax may not reward binge watching, it certainly incentivizes it. Rather than taxing those most likely to stream to excess, it taxes the sensible, occasional viewer. These incongruities highlight the necessity for a new proposal and framework for taxing entertainment within the cloud.

III. A New Proposal and a Response to Others Past, Present, and Future

A. A Privilege-Based Framework

Rather than rely on a blanket tax on any fee charged for the privilege to stream online media, a successful tax should distinguish between the three types of paid, privileged access: per-transaction privilege; subscription privilege; and the hybrid privilege.

1. Per-Transaction Privilege

Transaction-based amusement is straightforward: tax per transaction. Transaction-based amusement should, like the Chicago amusement tax, call for a tax on the charge paid for that particular transaction. But transaction-based amusement should be levied at a lower tax rate than subscription services. The purpose of the lower rate is to maintain the balance between the unlimited access of subscription services and the temporary access for per-transaction privileges. iTunes is the most common relevant example.[155]

155. *See, e.g.*, *About Renting Movies from the iTunes Store*, *supra* note 144.

2. Subscription Privilege

On the whole, the tax plan should attempt to balance the tax imposed based on the amount of consumption, measured in terms of hours or data transfer, rather than charge paid. Subscription plans should implement an algorithm to account for individual viewing and listening habits. Although this is a greater administrative burden, it is not necessarily so extreme. Many vendors already have such systems in place, even down to the minutes viewed in some cases.[156] If a vendor does not already have such an algorithm, the burden should be on the taxing jurisdiction to either provide such an algorithm or subsidize the costs of implementing one through a third party. Apply this history and tracking to the monthly subscription fee to calculate the accrued tax.

A fitting parallel is broadband pricing. Even though flat-rate broadband pricing is simple and predictable, forcing each consumer to pay the same price for unlimited broadband access, it forces light Internet users to subsidize the heavy Internet users.[157] "Usage-based pricing," or "metering," bills Internet users based on the amount of data used.[158] In particular, a "two-part tariff," in which a consumer pays a fixed monthly rate coupled with an additional fee beyond a set limit, allows all consumers to contribute some amount to common cost in providing broadband service, while still shifting some additional cost onto the heaviest users.[159] In other words, the low-level users still carry some of the cost of the heaviest users, without abusing the heaviest users who bear an additional cost.[160] Much like the blanket cloud tax, "[u]nder a flat-rate pricing system, lighter users end up paying a disproportionate share of overall network costs."[161] Forcing lower use consumers to subsidize heavy users could discourage poorer consumers from purchasing broadband services, even going so far as limiting their access to them.[162]

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156. *See supra* note 135 and accompanying text.
157. Lyons, *supra* note 25, at 3-5.
158. *Id.* at 6-7.
159. *Id.* at 7.
160. *Id.*
161. *Id.* at 13.
162. *Id.* ("These consumers demand less from the Internet each month than the average user, and therefore may not place a high premium on unlimited access, though they might be willing to pay a lower rate for the small amount of monthly data to meet their needs.").

The same two-tier approach should be implemented in the context of a cloud tax on subscription fees. There is a caveat within this proposal, however. As the purpose of this proposal is to increase revenue while balancing a tax to the individual usage without punishing viewing habits, this proposal includes an upper cap on the amount taxed for any subscription-based service. Determining this upper cap would fall on the finance department of the taxing jurisdiction, based both on a calculation of averages of monthly fees across different services and on daily average viewing habits within that jurisdiction. Additionally, if a particular provider should disagree with this calculation, believing its subscribers' habits are substantially different from the averages used, then that provider should have the right to request a particular price cap. The burden of any calculation should fall on the state or local jurisdiction imposing the tax, not the provider.

3. Hybrid Privilege

The hybrid fees are potentially the most challenging. Hybrid services like Amazon Prime raise issues of bundled charges including taxable and nontaxable components.[163] Ideally, such providers could provide a breakdown of their own costs and how much of the membership fees apply to amusement; however, fairness would require the provider to present such a breakdown for each consumer because of differing consumption habits. To be subject to the tax, this would also require the provider to determine that each consumer is using its services predominately for amusement.[164] A potential solution would be an opt-in provision. If a consumer partakes in a hybrid service, he agrees to be subject to the tax in order to gain access to the amusement privileges, from which point the tax is calculated pro rata based on consumption history and subject to an upper cap like the standard subscription services.

163. *See supra* Part II.B.1.
164. *See supra* Part II.B.

4. Nexus

As to remote vendors, Professor John Swain's framework would be ideal in establishing nexus—forcing a remote vendor to collect or remit a tax only if the vendor meets a satisfactory physical presence, or a de minimis economic presence within the taxing jurisdiction.[165] But this would require input from Congress.[166] Additionally, a problem remains in determining if and when an amusement takes place within a taxing jurisdiction. The billing address proxy, as discussed above, while lacking, may be the least invasive and least burdensome approach.[167] A more accurate approach would call for an algorithm, like that in the subscription fee proposal, which tracks location, again, with the burden being on the city to provide such an algorithm, and then only to those vendors with substantial nexus.[168] Finally, in an effort to ease the burdens on out-of-state vendors forced to collect a tax for multiple local jurisdictions within a single state, vendors could employ a "*blended rate* that reflects the average of all local rates in a given state."[169] Better still, taxing jurisdictions could create a uniform system to ease remote-vendor treatment across state and local lines.[170]

B. Other Proposals, Analogues, and Nontax Alternatives

Even though Chicago's approach distinguishes itself from others as an amusement tax, with a specific emphasis on streaming entertainment within the cloud, other proposals have attempted to recoup losses from the changing media market and the trend toward e-commerce in general.[171]

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165. *See supra* notes 101-04 and accompanying text.
166. *See supra* note 105 and accompanying text.
167. *See supra* Part II.B.4.
168. *See supra* Part III.A.2.
169. McLure, *supra* note 27, at 122. This approach, however, might be subject to judicial scrutiny without input from Congress; although a blended rate would impose less burden on a vendor, it may be unfair to those jurisdictions with a rate higher than the blended rate subject to potential losses. *See id.*
170. *See infra* Part III.B.
171. And, Chicago is not alone in attacks on the colloquial moniker—Chicago has the "Cloud Tax," whereas Canada and Australia have the "Netflix Tax." *See, e.g.*, Joe Harpaz, *More Countries Jump on 'Netflix Tax' Bandwagon*, FORBES (Sept. 3, 2015, 3:51 PM), http://www.forbes.com/sites/joeharpaz/2015/09/03/more-countries-jump-on-netflix-tax-

The European Union, for example, planned a value-added tax against providers of broadcasters based on the locations of customers, rather than providers.[172] Even though it had the same goals of securing tax revenue from consumption within its jurisdiction, administrative problems caused trouble.[173] In particular, applying the value-added tax across the European Union creates fairness concerns because it forces providers to collect and remit to jurisdictions under different tax regimes.[174] Despite these problems, the European Union expects the value-added tax could create an additional $1 billion in annual revenue.[175]

The European Union approach introduces another problem. Many of the larger companies do not plan on raising prices, causing them to suffer a 30 percent cut from each sale.[176] Granted, this is better for consumers. However, because this removes some of the benefits of jurisdiction shopping for better tax rates for corporations, it may encourage once low-tax jurisdictions to raise taxes, as proposed in Luxembourg.[177] The proposal here, while not completely eliminating the problem, may offer some headway. Rather than implementing a per-transaction privilege, tailoring the tax to reflect user consumption, as well as placing caps for excessive viewers, allows corporations to take less of a cut from profits to account for the different privilege types.

Countries outside of the European Union are also contemplating means to collect from foreign online providers. New Zealand, claiming overlooked revenue of $180 million per year—$40 million

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bandwagon/ [https://perma.cc/2MKA-C7PZ]; Mathew Katz, *Canada's Big Election Issue: The Netflix Tax*, TIME (Aug. 6, 2015), http://time.com/3987607/canada-netflix-tax/ [https://perma.cc/TEL4-W8HR].

172. *See* Harpaz, *supra* note 171 (discussing problems of implementing a universal value-added tax based on customer locations when one regime taxes 15 percent and another taxes 25 percent). For perspective, see *Value-Added Tax*, BLACK'S LAW DICTIONARY (10th ed. 2014), for a definition of value-added tax: "A tax assessed at each step in the production of a commodity ... which is levied in several European countries—effectively acts as a sales tax on the ultimate consumer."

173. *See* Harpaz, *supra* note 171.

174. *See id.* (comparing a Luxembourg 15 percent value-added tax to Sweden's higher 25 percent value-added tax).

175. Mark Scott, *Digital Tax Increase to Take Effect in Europe*, N.Y. TIMES (Jan. 1, 2015), http://www.nytimes.com/2015/01/02/business/international/digital-tax-increase-to-take-effect-in-europe.html [https://perma.cc/8EXC-4NZW].

176. *See id.*

177. *See id.*

from the likes of iTunes, Netflix, and Spotify—proposed lowering the tax-free duty threshold on a goods and services tax so as to collect from offshore vendors. Such an approach, however, is likely limited to collecting from only the largest companies.[178] Similarly, Japan issued an 8 percent consumption tax on remote vendors providing electronic services to consumers in Japan.[179]

Jurisdictions within the United States have also made several attempts to tax online services. For example, Idaho attempted to cull streaming services from usually nontaxable services and place them under the sales tax; other states—Arizona, Indiana, New York, Texas, and Washington—made similar attempts to apply cloud streaming to sales taxes as well.[180] Idaho organized its tax as an extension of sales and use, including cloud software.[181] Not only did this create backlash from companies, but it also created arguments that such a tax places what are arguably licenses or services under the umbrella of a sales and use tax.[182] Most recently, Pennsylvania implemented a 6 percent sales and use tax on electronically transferred digital products.[183] Pennsylvania's tax on digital products is considerably striking not only for its structure as a sales and use tax, but also its application to all electronically transferred digital products, be it a subscription service, rental, or purchase.[184] These examples highlight an important benefit of the Chicago amusement tax, or any plan specialized for taxing paid, online media. Singling out amusement may avoid attacks under theories that a license or service should not fall under a sales and use tax scheme, and concerns that a double tax may result merely because of the avenue of delivery.

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178. *See* Isaac Davison, *NZ's 'Netflix Tax' Set to Rise as GST Changed on Digital Downloads*, N.Z. HERALD (Aug. 18, 2015, 11:38 AM), http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11499034 [https://perma.cc/3VMH-SVLN].

179. *See* Harpaz, *supra* note 171.

180. Steven D. Jones, *Idaho Wants to Tax the Cloud*, WALL STREET J. (Feb. 6, 2013, 9:14 PM), http://www.wsj.com/articles/SB10001424127887323452204578287793482679304 [https://perma.cc/79YR-LQY4].

181. *See id.*; Betsy Z. Russell, *Idaho Relaxes Software Taxes*, SPOKESMAN-REV. (June 1, 2014), http://www.spokesman.com/stories/2014/jun/01/idaho-relaxes-software-taxes/ [https://perma.cc/7D6G-MNZM].

182. *See* Jones, *supra* note 180; Russell, *supra* note 181.

183. *See supra* note 1.

184. *See Digital Products*, *supra* note 1.

Another obvious, though less lucrative, proposal is the nontax proposal: exempt cloud services from sales taxes. Several states reached this conclusion.[185] The nontax proposal has some traction in academia, as well as in the government.[186] Another nontax approach would call for implementing a charge akin to a user fee, license fee, or service charge, rather than a sales tax.[187] This approach would equate a fee for Internet access to streaming media to fees charged for tuition, public health care, access to parks, recreation, and highways, or permissions for professional licensing of an attorney or doctor.[188] On first glance, the idea of a user fee approach may seem strange; however, for local jurisdictions, user fees and charges are the second-most significant resource of nontax revenue behind intergovernmental aid, and nearly every local government imposes a fee on parks and recreation, sanitation, and the like.[189] But each of the nontax proposals fail. Obviously, the goal of recouping total losses to cord-cutters is impossible. Furthermore, a user fee, although fair in the sense that anyone wishing to use a service is taxed, does not account for consumption habits and would either result in low consumption taxpayers subsidizing high consumption taxpayers or in a lower revenue overall.[190]

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185. Kansas, Nebraska, Rhode Island, Tennessee, Virginia, and Wisconsin have considered the nontax approach in the past. *See* Jones, *supra* note 180.

186. *See* Varian, *supra* note 93, at 644-49 (suggesting various nontax proposals: no out-of-state tax, no e-commerce tax, or elimination of a sales tax entirely coupled with an overall increase in income tax); *supra* note 4; *see also supra* notes 79-80 and accompanying text (contending property tax is the only viable local tax). Some view that equal rights to information and technology should outweigh any cause to tax the Internet. *See, e.g.*, Joshua L. Friedman & Gary C. Norman, *The Norman/Friedman Principle: Equal Rights to Information and Technology Access*, 18 TEX. J. ON C.L. & C.R. 47, 48-50 (2012) (arguing that freedom of information, especially when using disabled persons as a focal point, should limit any restriction on Internet access, even sources of amusement); *see also* Digital Goods and Services Tax Fairness Act of 2015, S. 851, 114th Cong. (2015).

187. *See* BRUNORI, *supra* note 12, at 113; Scharff, *supra* note 54, at 303-05.

188. *See* BRUNORI, *supra* note 12, at 113.

189. *See* BRUNORI, *supra* note 17, at 103; Scharff, *supra* note 54, at 304 ("[M]unicipalities have also shifted to user fees to supplement general tax revenue in the wake of property tax assessment limits and other restrictions on the local property tax base. One driving force in the shift to user fees is that local governments have a much greater authority to impose such charges without explicit state authorization." (footnotes omitted)). Granted, difficulties arise in justifying the position, as implementing the fee would likely require some link to a public service or benefit to the jurisdiction. Additionally, it is unclear how such a regime would succeed within a state.

190. *See supra* note 161 and accompanying text.

Moving closer to the realm of a sales and use tax is the option of an excise tax: a special tax on levies such as alcohol, fuel, tobacco, hotels, and telecommunications.[191] Fittingly, these taxes generally operate on a tally per unit rather than a cost of the product, such as a tax of cents on the gallon.[192] The goal of such excise taxes is not so different from the goal of taxing streaming services based on the amount of consumption.[193] An excise tax, however, presents two specific problems. First, it generally carries a social concern, more so than collection of revenue; often, these taxes punish undesirable activities, like smoking, or costs imposed on states because of that product's consumption.[194] An argument that an excise tax on streaming media is socially valid exists—excessive binge viewing and sitting can increase health risks like diabetes, risks that may later be borne by the taxing jurisdiction in public health care and benefits.[195] Even so, this may be a stretch. Second, excise taxes are generally collected at the distributor level, rather than at the consumer level, which may lead to administrative duties in collection.[196]

The trend of collecting the excise tax from the distributor leads to another, albeit out-of-the-box, tax regime that would seek to tax the business inputs rather than the consumer.[197] A trend that incorporates an excise tax might lead to easier administration, bypassing the need to collect on behalf of consumers and calculating the consumption of each consumer. But taxing the business inputs will eventually be reflected in a consumer's purchase price, violating the tax principle of accountability and transparency.[198] It may lead not only to potential tax pyramiding, but, more pressing, may eliminate transparency as the cost of the tax will be hidden from the customer, as is the case in a traditional sales tax.[199]

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191. *See* BRUNORI, *supra* note 12, at 100.

192. *Id.*

193. *See supra* Part III.A.

194. BRUNORI, *supra* note 12, at 101-02.

195. *See* Alice Park, *This Is What Binge Watching TV Does to Your Health*, TIME (Apr. 1, 2015), http://time.com/3767458/tv-binge-watching-health/ [https://perma.cc/5E2E-VJ4A].

196. *See* BRUNORI, *supra* note 12, at 100-01.

197. *Id.* at 65.

198. *Id.*

199. *Id.*; *see also supra* Part II. For a discussion of how tax pyramiding results in consumers accounting for taxes on both their individual purchase and the retailer's tax on buying stock, see 85 C.J.S. *Taxation* § 2162 (2016) ("A 'pyramiding of tax' occurs when a product is taxed at a pre-retail stage, and thus, a tax is imposed on successive buyers and

Finally, an adoption of a uniform tax system likely would be the most effective approach. Such a system would create an interstate uniform sales tax regime, adopting uniform definitions of products, taxable and nontaxable events, uniform business treatment, and uniform state and local frameworks.[200] Each taxing jurisdiction would retain the right to create its own tax rates; a vendor would need to implement only a single tax regime against all of its consumers, and would be responsible for changing only the rate for each jurisdiction.[201] Such an initiative is already in place. The Streamlined Sales and Use Tax Agreement is a unified effort of forty-four states, the District of Columbia, local governments, and businesses to create a simplified sales and use tax regime for remote vendors.[202] Currently, twenty-four of the forty-four states have implemented the streamlined regime, representing 33 percent of the total U.S. population.[203] Coupling such a regime with a cloud-specific policy as proposed in this Note would be the ideal method of encouraging uniformity, transparency, ease of implementation, and a means to reflect trends toward an online media market.

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sellers rather than only at the final sale of the product.").

200. *See* McLure, *supra* note 27, at 119.

201. *See id.*

202. *What Is the Streamlined Sales and Use Tax Agreement?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_1 [https://perma.cc/XMK5-V5L7].

203. *How Many States Have Passed Legislation Conforming to the Agreement?*, STREAMLINED SALES TAX GOVERNING BD., INC., http://www.streamlinedsalestax.org/index.php?page=gen_3 [https://perma.cc/2RSE-XKRM].

CONCLUSION

This Note addresses a problem that many taxing jurisdictions are avoiding under the guise of difficult administration or the notion that a tax to cloud entertainment would threaten or hinder advances in digital technology. But society has passed that point. It is unlikely that efforts to tax remote, online vendors would drive consumers and the economy away from the instant and unlimited access the Internet provides.[204] And with the shift to an access-based market, the time has come for a change to the *Quill* precedent. This Note does not call to eliminate the necessity of a nexus standard; rather, it suggests that a physical presence standard is inadequate in the face of ever-evolving online e-commerce. Congress, using its powers under the Commerce Clause should seek a means to create an economic de minimis nexus to supplement the already-present physical standard.

Although a congressional solution to the issue of nexus is likely the first step in a successful fair and nationwide tax on the cloud, cloud taxes must also recognize the differences of fees and services within the cloud. A blanket tax will fail as long as the cloud contains per-transaction fees, subscriptions, and hybrids, especially when it comes to online entertainment. A successful tax plan must account for these differences. The plan should strive to account for consumption habit, without changing a consumer's decisions to engage in that online consumption. Per-transaction fees must be taxed at a rate low enough that these consumers are not unfairly subsidizing the heavy use of subscribers with unlimited access. Similarly, subscription taxes must reflect viewing and consumption habits, placing the heaviest tax burdens on those consuming the most, while still retaining a cap so as to not abuse their habits and draw

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204. From just 2013 to 2014, e-commerce revenues in the United States for services increased 11.8 percent and retail sales increased 14.3 percent, with each category totaling in 2014 at $510 billion and $298.6 billion, respectively. U.S. CENSUS BUREAU, E14-ESTATS, E-STATS 2014: MEASURING THE ELECTRONIC ECONOMY 1-2 (June 7, 2016), http://www.census.gov/content/dam/Census/library/publications/2016/econ/e14-estats.pdf [https://perma.cc/5L5C-ZS6Y]. Compare this to data from 2004 when e-commerce services accounted for $59 billion and retail sales accounted for $71 billion. U.S. CENSUS BUREAU, E-STATS 1-2 (May 25, 2006), http://www.census.gov/content/dam/Census/library/publications/2006/econ/2004reportfinal.pdf [https://perma.cc/9M4Y-2L76]. *But see supra* note 93.

them away from engaging in such subscription services. Finally, the hybrids should be taxed on a pro rata basis of consumption rather than on a total membership fee, especially when nonamusement components may dominate that fee. Under the assumption that the nexus is met, the burden should be on vendors to collect and remit the tax based on their determination of who is consuming and how much is being consumed within a particular jurisdiction. The burden, however, should fall on the revenue-seeking jurisdictions to supply these vendors with a means to calculate consumption habits and location and subsidize those vendors for their efforts to collect and remit the tax.

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