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State Constitutional Limitations to Cities Taxing the Digital Economy

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STATE CONSTITUTIONAL LIMITATIONS TO CITIES TAXING THE DIGITAL ECONOMY

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The digital economy's rapid evolution, most recently with the rise of artificial intelligence, demands a re-evaluation of state constitutional limitations on local taxation of digital transactions. Citizens have long feared excessive or unfair tax burdens, hence the adoption of constitutional amendments that prohibit legislators from increasing taxes or imposing new taxes without a public vote. However, these constitutional limitations are now preventing cities from taxing digital transactions that are taking over the economy. This is a serious financial problem for cities whose traditional sources of tax revenue, such as sales taxes and property taxes, are dwindling due to the digitalizing economy.

Without the ability to enact legislation imposing taxes on digital transactions, cities have gone to extreme measures to tax streaming service revenue. Some cities have brought lawsuits against streaming companies such as Netflix and Hulu alleging that these companies should be paying a franchise fee that was historically only imposed on cable providers. While consumers have cut the cord on cable television and replaced cable with streaming services, these video service provider statutes should not be used to tax streaming services. However, constitutional tax limitations left these cities with no choice but to try to use these statutes to replace lost franchise fees from cable television providers.

While this article specifically discusses streaming services, using Netflix's and Hulu's business models as examples, this article argues that state constitutional tax limitations are preventing cities from taxing all digital transactions and proposes that constitutional tax limitations should not apply to sales or similar transaction-based taxes.

This article makes three contributions to the tax literature. First, it examines lawsuits brought by cities in California, Nevada, and Missouri against streaming service providers Netflix and Hulu and argues that these lawsuits were brought because state constitutional tax limitations prevented these cities from imposing sales tax on streaming service revenues.

Second, this article adds to the tax literature on constitutional tax limitations by analyzing these limitations in the light of the digital economy. In addition, this article analyzes a unique state constitutional provision that

completely prohibits a city from imposing any new sales or similar transaction-based tax.

Finally, this article proposes that constitutional tax limitations should exclude sales and similar transaction-based taxes. The proposal would allow cities to tax revenues from streaming services as well as revenues from the broader digital economy. This article contributes to tax scholarship by evaluating the proposal against tax policy considerations as they relate to constitutional tax limitations on the digital economy.

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I. INTRODUCTION

It's old news now: gone are the days of cheap video streaming services. Video streaming service providers such as Netflix and Hulu are increasing their prices and cracking down on password sharing.[1] After years of revenue growth, shareholders are putting pressure on streaming service companies to increase profitability.[2] For example, Netflix has not been able to show a significant profit increase in its streaming business due to increasing content acquisition costs.[3] These costs include license fees for the rights to stream shows owned by others (e.g., Netflix paid NBCUniversal for the rights to

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[1] Jessica Toonkel, *Netflix Plans Price Increase as Password-Sharing Crackdown Boosts Subscriber Growth*, WALL STREET JOURNAL (Oct. 18, 2023), https://www.wsj.com/business/earnings/netflix-nflx-q3-earnings-report-2023-565748d5?mod=Searchresults_pos13&page=1.

[2] Lillian Rizzo, *Broadcast and Cable Make up Less than Half of TV Usage for the First Time Ever,* CNBC.COM (Aug. 15, 2023), https://www.cnbc.com/2023/08/15/traditional-tv-usage-drops-below-50percent-for-first-time-ever.html.

[3] *See, e.g.*, Netflix, 2022 Annual Report (Form 10-K) (Jan. 26, 2023), at 22, https://s22.q4cdn.com/959853165/files/doc_financials/2022/ar/4e32b45c-a99e-4c7d-b988-4eef8377500c.pdf. (content acquisition costs included in cost of revenues).

stream the legal drama Suits),[4] as well as costs to produce and film its own Netflix originals.[5]

One way for Netflix to increase profitability despite the significant content acquisition costs is to increase revenue. By increasing the number of subscribers (hence the crackdown on password sharing) and increasing subscription prices, Netflix can boost subscription revenue and profitability.[6] Another way to increase profitability is to push consumers into the cheaper ad-supported subscription plans and then sell more advertising revenue.[7]

More subscription revenue leads to more tax revenue in those states and cities that impose sales taxes on streaming services. More advertising revenue leads to more tax revenue from digital services taxes. However, many cities will not be able to tax these revenue sources due to state constitutional limitations that for the most part were adopted decades before the exponential growth of the digital economy. Citizens have long feared legislators increasing taxes or imposing new taxes, hence the constitutional amendments prohibiting new or increased taxes with a public vote. But these constitutional limitations are problematic when cities' traditional sources of tax revenue, such as sales taxes and property taxes, have dwindled due to the digitalizing economy.

Without the ability to impose a new sales tax on digital transactions, cities have gone to extreme measures to tax streaming service revenue. Cities have brought lawsuits against streaming companies such as Netflix and Hulu alleging that these companies should be paying a franchise fee that was historically only imposed on cable providers. While consumers have cut the cord on cable television and replaced cable with streaming services (which were significantly cheaper until recent years),[8] these video service provider statutes should not be used to tax streaming services. However, constitutional tax limitations left the cities with no choice but to try to use these statutes to replace lost revenue from cable television providers.

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4 Tony Maglio, *No Wonder Everyone Is Licensing Shows to Netflix*, INDIEWIRE (Sept. 28, 2023) https://www.indiewire.com/news/business/why-suits-is-on-netflix-1234910470/.

5 NETFLIX, https://about.netflix.com/en/news/governor-murphy-and-netflix-announce-plans-to-build-state-of-the-art-east (last visited Jan. 17, 2024).

6 Toonkel, supra note 1.; Sarah Krouse, *Americans are Canceling More of Their Streaming Services*, WALL STREET JOURNAL (Jan. 2, 2024), https://www.wsj.com/business/media/americans-are-canceling-more-of-their-streaming-services-fb9284c8?mod=Searchresults_pos2&page=1.

7 Oliver Darcy, *The Era of Cheap Streaming is Officially Over*, CNN.COM (Aug. 10, 2023), https://www.cnn.com/2023/08/10/media/disney-plus-streaming-prices-reliable-sources/index.html.

8 Drew Richardson, *2024 is Shaping up to be the Year of the Streaming Bundle*, CNBC.COM (Dec. 26, 2023) https://www.cnbc.com/2023/12/26/2024-year-of-streaming-bundle.html.

This article argues that state constitutional tax limitations are preventing cities from taxing all digital goods and services, not just streaming services such as those offered by Netflix and Hulu. Transactions that historically would have been subject to sales tax, such as the purchase of a physical book or a CD-ROM, escape taxation in some states when purchased in digital form. Such escape from taxation is a windfall for the individual consumer, and a blow to the city who otherwise would have collected a portion of the sales tax revenue.

It would be remiss not to mention that while constitutional tax limitations are an impediment to some cities taxing the digital economy, most states and cities do impose sales tax on streaming services. This is why there is little scholarship relating to constitutional tax limitations on taxing the digital economy. However, constitutional tax limitations are likely to attract attention with the rise of state digital service taxes (DSTs), such as Maryland's digital advertising gross revenues tax.[9]

While DSTs take many forms, a DST is essentially a tax on a digital company's advertising revenues. The amount of such advertising revenues subject to taxation is generally based on the digital company's users or consumers located in a particular taxing jurisdiction. Although the initial intention of DSTs was to tax the advertising revenue of large digital platforms such as Google, Amazon, Facebook (now Meta), and Apple,[10] one could envision a DST applying to the advertising revenue of a large video streaming company such as Netflix (whose advertising revenue is poised to increase substantially in future years).[11]

To date, DSTs have been enacted by foreign countries such as France and Canada, and by just one domestic state: Maryland.[12] While this article does not weigh in on the hotly debated merits of state DSTs, this article does argue that a state with constitutional tax limitations will have difficulty enacting a DST and will fall even further behind when it comes to taxing digital transactions. Thus, this article proposes that state constitutional tax limitations should not apply to sales or similar transaction-based taxes.

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[9] MD. CODE ANN. § 7.5-101, et seq.

[10] *See generally* Reuven S. Avi-Yonah, *Much Ado: Why the United States Should Calm Down About DSTs*, 181 TAX NOTES FEDERAL 1235 (Nov. 13, 2023), https://www.taxnotes.com/tax-notes-today-federal/digital-economy/much-ado-why-united-states-should-calm-down-about-dsts/2023/11/16/7hhtq.

[11] Sarah Krouse, Suzanne Vranica, & Jessica Toonkel, *Netflix is Scrambling to Learn the Ad Business It Long Disdained*, WALL STREET JOURNAL, (Aug. 3, 2022), https://www.wsj.com/articles/netflix-ads-plan-streaming-business-11659538834; Jessica Toonkel, *Netflix Considers Ways to Make Money From Videogames in Possible Pivot*, WALL STREET JOURNAL (Jan. 5, 2024), https://www.wsj.com/business/media/netflix-eyes-ways-to-make-money-from-videogames-in-potential-pivot-705bd3b3.

[12] Md. Code Ann. § 7.5-101, et seq.

While this article specifically discusses streaming services, using Netflix's and Hulu's business models as examples, the policy implications and the proposal are broader than taxing streaming service revenues. This article argues that state constitutional tax limitations are preventing cities from taxing all digital goods and services, not just streaming services such as those offered by Netflix and Hulu. The state constitutional tax limitations are also an impediment to future state taxes on digital advertising revenues. The proposal would allow cities in states such as California, Nevada, and Missouri to tax revenues from streaming services as well as revenues from the broader digital economy.

Part II provides background on the rise of subscription streaming services and then discusses the tax policy considerations relevant to taxing the revenues from such streaming services. Part III explains how states and cities are taxing (or attempting to tax) streaming services through sales taxes, amusement taxes, and video service provider statutes. Part III also examines the lawsuits that have been brought by cities in California, Nevada, and Missouri alleging that Netflix and Hulu owe franchise fees under the states' respective video service provider statutes. Part IV analyzes the state constitutional tax limitations in California, Nevada, and Missouri, and argues that it is these limitations that caused local governments to try to "tax" Netflix and Hulu under the states' respective video service provider statutes. Part V proposes that state constitutional tax limitations should not apply to sales or similar transaction-based taxes. The proposal would allow cities in states such as California, Nevada, and Missouri to tax revenues from streaming services as well as revenues from the broader digital economy. Part V then evaluates the proposal in light of additional tax policy considerations and concludes that broader tax policy considerations support the proposal that there should be no constitutional tax limitations on sales and similar transaction-based taxes. This article adds to the literature by evaluating these policy considerations as they relate to constitutional tax limitations on the digital economy.

II. Digital Streaming Services and Tax Policy Considerations

This Part first provides background on the transformation of traditional viewing entertainment from cable television to movie rentals to streaming services. Since Part III of this article discusses state and local governments' attempts to tax Netflix and Hulu under videos service provider fee statutes, this Part provides a brief history of Netflix's and Hulu's streaming services business. This Part then discusses the policy reasons that support states taxing revenues from streaming services. An important takeaway from the policy analysis is that most states impose sales tax on the purchase or rental of movies in a tangible format (such as VHS, DVDs, or Blu-ray discs), so there is a strong argument that the purchase or rental of movies in an intangible format should also be subject to sales tax.

A. From Cable Television to Digital Streaming Services

Long before there was Hulu or Netflix, there was cable television with its many channels from which to choose. Unlike Hulu or Netflix, a viewer was limited to watching what was playing on that channel at a particular time. For example, to watch *All That* on Nickelodeon, one would have to wait until 7:30 ET for the show to air on the Nickelodeon channel.

Then came the ability to buy or rent movies from brick and mortar stores like Blockbuster.[13] Customers would pay a fee in the range of $1 to $5 to rent a movie, and if the customer returned the movie past the due date, the consumer would be charged a late fee.[14]

Less than fifteen years later, consumers could buy and rent movies from online stores. Netflix launched the first DVD rental and sales website in 1998.[15] A year later, Netflix began offering a subscription service whereby customers who purchased a membership could rent an unlimited number of DVDs without due dates or late fees.[16]

In 2007, Netflix first offered streaming services which allowed customers to instantly watch television series and movies on their personal computers.[17] Technology quickly developed and in 2008 customers were able to stream shows and movies on their televisions through the use of electronic devices including game consoles (such as Microsoft's Xbox 360), Blu-ray

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[13] Blockbuster opened its first video rental store in 1985. Frank Olito & Alex Bitter, *Blockbuster: The Rise and Fall of the Movie Rental Store, and What Happened to the Brand*, BUSINESS INSIDER (Apr. 24, 2023), https://www.businessinsider.com/rise-and-fall-of-blockbuster. The Nickelodeon cable television channel first launched as Pinwheel on December 1, 1977 and then rebranded as Nickelodeon in 1979. *Nickelodean, American television channel*, BRITANNICA (Oct. 29, 2023), https://www.britannica.com/topic/Nickelodeon-American-television-channel (last visited Jan. 17, 2024).

[14] Frank Olito & Alex Bitter, *Blockbuster: The Rise and Fall of the Movie Rental Store, and What Happened to the Brand*, Business Insider (Apr. 24, 2023), https://www.businessinsider.com/rise-and-fall-of-blockbuster.

[15] NETFLIX, https://about.netflix.com/en (last visited Dec. 8, 2023).

[16] *Id.* A customer would select a movie from Netflix's website (with the aid of Netflix's proprietary recommendation service) and Netflix would send the DVD to the customer via U.S. mail. The customer would then return the DVD to Netflix using prepaid mailers provided by Netflix. Once the DVD was returned, Netflix would mail the next DVD in the customer's order queue. Netflix, 2007 Annual Report (Form 10-K) (Feb. 15, 2008), https://s22.q4cdn.com/959853165/files/doc_financials/annual_reports/AR_10K_final_2007.pdf.

[17] NETFLIX, https://about.netflix.com/en (last visited Dec. 8, 2023); *see also* Netflix, 2007 Annual Report (Form 10-K) (Feb. 15, 2008), https://s22.q4cdn.com/959853165/files/doc_financials/annual_reports/AR_10K_final_2007.pdf.

players and television set-top boxes (such as TivO and Roku).[18] In subsequent years, Netflix partnered with consumer electronics brands to offer Netflix streaming on Internet connected televisions and mobile devices.[19] In 2016 Netflix added a download feature whereby customers could download a movie or show to watch offline.[20] In subsequent years, Netflix expanded its streaming content to include video games.[21]

While Netflix's business started with DVD rentals in 1998, Hulu first launched its online streaming of television shows in 2008.[22] Initially, Hulu's streaming service was free to customers and financially supported by advertisements.[23] In 2010, Hulu began to charge customers through its subscription service, Hulu Plus.[24] Today, "Hulu + Live TV" customers have access to live news, entertainment and sports TV channels, in addition to other on-demand movies and TV shows.[25]

B. Tax Policy Considerations

As discussed in Part III of this article, many states are taxing or attempting to tax on the gross revenues of streaming service companies such as Netflix and Hulu. Before discussing how states are taxing these revenues, this article will first discuss the policy considerations that support states taxing these revenues despite the challenges that come along with implementing such taxes.

1. Fairness and Tax Neutrality

Sales tax is generally imposed on the sale or rental of tangible personal property. Thus, many states impose sales tax on the sale or rental of movies in a tangible form such as a VHS, DVDs, and Blu-ray discs. Generally, sales

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[18] NETFLIX, https://about.netflix.com/en (last visited Dec. 8, 2023); Netflix, 2008 Annual Report (Form 10-K) (Feb. 17, 2009), https://s22.q4cdn.com/959853165/files/doc_financials/annual_reports/Final_AR_10K.pdf. The streaming service was enabled by Netflix controlled software that was able to run on these electronic devices.

[19] NETFLIX, https://about.netflix.com/en (last visited Dec. 8, 2023). Streaming services were first offered on Internet connected TV and mobile devices in 2009 and 2010, respectively.

[20] *Id.* In other words, no Internet connection was needed to watch the downloaded entertainment.

[21] Netflix Investors, *2022 Annual Report – United States Securities and Exchange Commission Form 10-K*, NETFLIX SEC FILINGS, 4–5 (Jan. 26, 2023), https://s22.q4cdn.com/959853165/files/doc_financials/2022/ar/4e32b45c-a99e-4c7d-b988-4eef8377500c.pdf.

[22] NETFLIX, https://about.netflix.com/en (last visited Dec. 8, 2023); HULU, https://press.hulu.com/corporate/.

[23] HULU, https://press.hulu.com/corporate/ (last visited Dec. 8, 2023).

[24] *Id.*

[25] *Id.*

tax is not imposed on the sale of intangible property or the sale of services. As a result, a state's sales tax base would only capture digital products (e.g., movie, book, or music downloads) or digital services (e.g., streaming a movie) to the extent the state has explicitly authorized the imposition of such tax. Such authorization could be through a specific statute, regulation, or administrative guidance, or a state court decision ruling that the sales tax base includes digital products or digital services.

Scholars have long noted that it is not fair or efficient to tax a physical product, such as a DVD rental, but not the digital equivalent, such as a movie download.[26] Including digital goods in a state's sales tax base makes for fair competition between digital and non-digital businesses.[27]

Some scholars have expanded on the fairness concept by arguing that a state's sales tax base should include services in order to "eliminate the current arbitrary distinctions between closely related consumer goods and services[.]"[28] For example, from the consumer's viewing perspective there is not much of a distinction between streaming a movie and downloading a movie for a temporary period of time (ignoring other costs such as the ability to access Internet or data fees).[29] If these two ways of viewing a movie are so similar, then both transactions should be included in the tax base and taxed similarly.[30] Including digital services as well as digital goods in the state's sales tax base can improve the sales tax's neutrality by treating like transactions alike.

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[26] *See* Young Ran (Christine) Kim & Darien Shanske, *State Digital Services Taxes: A Good and Permissible Idea (Despite What You Might Have Heard)*, 98 NOTRE DAME L. REV. 741, 763–64 (2022).

[27] *See* Orly Mazur & Adam Thimmesch, *Closing the Digital Divide in State Taxation: A Consumption Tax Agenda*, 98 TAX NOTES STATE 961, 962 (2020), https://www.taxnotes.com/tax-notes-state/tax-reform/closing-digital-divide-state-taxation-consumption-tax-agenda/2020/11/30/2d6x0?highlight=Closing%20the%20Digital%20Divide#2d6x0-0000023.

[28] Gladriel Shobe, Grace Stephenson Nielsen, Darien Shanske, & David Gamage, *Why States Should Consider Expanding Sales Taxes to Services, Part I*, 98 TAX NOTES STATE 1349, 1352 (2020), https://www.taxnotes.com/tax-notes-state/budgets/why-states-should-consider-expanding-sales-taxes-services-part-1/2020/12/21/2d9dx.

[29] There is a distinction between the two transactions from a U.S. federal tax perspective. For federal tax purposes, software that is temporarily downloaded onto a consumer's computer is treated as a rental of property whereas software that is accessed via another person's server (i.e., a software as a service model) is treated as a service. Treas. Reg. § 1.861-18 (2019); Prop. Treas. Reg. § 1.861-19, 84 Fed. Reg. 40317 (Aug. 14, 2019).

[30] Some tax scholars refer to the concept that governments should tax similar transactions in the same way as "horizontal equity". *See* Richard C. Auxier, *Chicago's Streaming Tax Is A Bad Tax But It's Not A "Netflix Tax*, TAX POLICY CENTER (June 11, 2019), https://www.taxpolicycenter.org/taxvox/chicagos-streaming-tax-bad-tax-its-not-netflix-tax.

2. Expand a Shrinking Tax Base

The digital economy continues to experience incredible growth in both technology and in revenues.[31] Consumers are spending less on tangible products, such as books, CDs, and DVDs, and more on digital products (such as e-books) and streaming subscriptions. This is evidenced by consumer spending data generally[32] and more specifically, by Netflix's reported revenues.[33] Businesses are responding to consumer demand: Blockbuster closed all its stores except one[34] and Netflix recently decided to end its DVD rental business.[35]

As discussed below, many states do not include digital products or services in their sales tax base. By expanding the tax base to include consumption spending in the digital economy, states can minimize the tax base erosion that is occurring as consumers spend less on tangible products.[36] This argument can be broadened to suggest that the sales tax base includes all services, in order to capture the shift in consumer spending from tangible goods to

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[31] *See, e.g.*, *infra* note 32 and 33.

[32] *See Personal Income and Outlays, March 2023*, U.S. DEPARTMENT OF COMMERCE BUREAU OF ECONOMIC ANALYSIS (Apr. 28, 2023), https://www.bea.gov/news/2023/personal-income-and-outlays-march-2023 (last visited Dec. 8, 2023).

[33] A review of Netflix's revenues as disclosed in its annual shareholder reports shows significant, rapid growth from 2007, when Netflix first offered streaming services, to 2016, when Netflix first allowed customers to download entertainment for on the go viewing. Netflix Investors, *2016 Annual Report – United States Securities and Exchange Commission Form 10-K*, NETFLIX SEC FILINGS, 1 (Jan. 27, 2017), https://ir.netflix.net/financials/sec-filings/default.aspx. In 2007, Netflix reported $1.2 million of U.S. revenues that came substantially from its various subscription plans (which at the time included both DVD rentals and streaming services). Netflix Investors, *2007 Annual Report – United States Securities and Exchange Commission Form 10-K*, NETFLIX SEC FILINGS, 28, 31 (Feb. 28, 2008),https://ir.netflix.net/financials/sec-filings/default.aspx. In 2016, Netflix reported $5 billion of revenue from streaming services in the United States and $542 million from U.S. DVD-by-mail membership services. Netflix Investors, *2016 Annual Report – United States Securities and Exchange Commission Form 10-K*, NETFLIX SEC FILINGS, 20, 22 (Jan. 27, 2017), https://ir.netflix.net/financials/sec-filings/default.aspx.

In 2022, those numbers increased to $12.9 billion of revenue from streaming services in the United States and Canada and $100 million worldwide from DVD-by-mail rental services. Netflix Investors, *2022 Annual Report – United States Securities and Exchange Commission Form 10-K*, NETFLIX SEC FILINGS, 20, 46 (Jan. 26, 2023), https://ir.netflix.net/financials/sec-filings/default.aspx.

[34] Frank Olito & Alex Bitter, *Blockbuster: The rise and fall of the movie rental store, and what happened to the brand*, BUSINESS INSIDER (Apr. 24, 2023), https://www.businessinsider.com/rise-and-fall-of-blockbuster#today-the-blockbuster-franchise-has-dwindled-to-just-one-store-so-where-is-the-last-blockbuster-its-in-bend-oregon-15.

[35] *Id.* Netflix announced that it would end its DVD rental business on September 29, 2023.

[36] *See* Orly Mazur & Adam Thimmesch, *Closing the Digital Divide in State Taxation: A Consumption Tax Agenda*, 98 TAX NOTES STATE 961 (2020); Peter Enrich et al., *Is it Time to Tax the Digital Economy?*, 99 TAX NOTES STATE 29 (2021), https://www.taxnotes.com/tax-notes-state/budgets/it-time-tax-digital-economy/2021/01/04/2dbcj?highlight=Closing%20the%20Digital%20Divide#2dbcj-0000010.

services.[37] Such a proposal may need to be considered in the near future due to a general decline in state tax revenues.[38]

3. Regressive Nature of Sales Tax

While fairness, tax neutrality, and expanding the tax base are strong policy arguments for taxing digital goods and services, sales taxes by their nature are regressive taxes.[39] A tax is considered regressive when it is structured such that the effective rate of the tax for an individual goes down as the individual's income goes up.[40] Sales taxes are generally more burdensome for low-income taxpayers than high-income taxpayers because low-income taxpayers spend more of their income on goods and services than do high-income taxpayers.[41] Because of their regressive nature, sales taxes are not generally considered a good way to raise revenue from a policy perspective.

On the other hand, the regressive nature of a sales tax could be countered by the fact that low-income taxpayers are more likely to benefit from state programs that are funded with sales tax revenues.[42] Further, a state could also counter the regressive nature of sales tax by exempting necessity items from the sales tax, such as groceries, menstrual products, and family oriented products like diapers and baby wipes, while still subjecting "luxury" items like

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[37] For a discussion on the revenue potential of taxing services as well as the policy considerations, see David Gamage et al., *Weathering State and Local Budget Storms: Fiscal Federalism With An Uncooperative Congress*, 55 U. MICH. J.L. REFORM 309, 343–44 (2022).

[38] For a recent report from the Urban Institute identifying a general decrease in state tax revenues, *see* Lucy Dadayan, *Monthly State Revenue Highlights Continued Downward Trent: State Tax Revenues Decline Again in June,* URBAN INSTITUTE, https://www.dropbox.com/scl/fi/575km9nz6fpvcjy5e12gy/MonthlySTRH_June2023.pdf?rlkey=000azbe45s4l3rccw3bif1fyw&dl=0.

[39] Black's Law dictionary defines a regressive tax as "a tax structured so that the effective rate decreases as the tax base increases." Tax, Black's Law Dictionary (Bryan A. Garner ed., 11th ed. 2019).

[40] *Id.* at 5.

[41] *See How Sales and Excise Taxes Work*, Institute on Taxation and Economic Policy (July 1, 2011) https://itep.org/how-sales-and-excise-taxes-work/ (estimating that low income families spend seventy-five percent of their income on transactions subject to sales tax); Grace Stephenson Nielsen, Gladriel Shobe, Darien Shanske & David Gamage, *How States Should Now Consider Expanding Sales Taxes to Services, Part 2*; 99 TAX NOTES STATE 45 (2021), https://www.taxnotes.com/tax-notes-state/sales-and-use-taxation/how-states-should-now-consider-expanding-sales-taxes-services-part-2/2021/01/04/2db5x.

[42] *See* Grace Stephenson Nielsen, Gladriel Shobe, Darien Shanske & David Gamage, *How States Should Now Consider Expanding Sales Taxes to Services, Part 2*, 99 TAX NOTES STATE 45 (2021), https://www.taxnotes.com/tax-notes-state/sales-and-use-taxation/how-states-should-now-consider-expanding-sales-taxes-services-part-2/2021/01/04/2db5x; David Gamage, Darien Shanske, Gladriel Shobe, Adam Thimmesch, *Weathering State and Local Budget Storms: Fiscal Federalism With An Uncooperative Congress*, 55 U. MICH. J.L. REFORM 309, 346 (2022).

digital streaming, digital downloads, and other digital entertainment to the sales tax.[43]

4. Challenges to Implementing a Tax on Digital Goods and Services

While there are policy reasons supporting a tax on digital goods and services, scholars and practitioners have noted challenges to implementing such a tax.[44] This Part briefly discusses three of the most difficult obstacles to implementing a sales tax on digital goods and services.

First, when drafting a tax law that would expand the sales tax base to include the digital economy there is the question of how the legislature should identify the different types of taxable digital transactions. Given the fast pace at which technology changes, it is difficult to anticipate or describe the digital products that should be subject to tax.[45] For example, a state that updated its sales tax base several years ago to include products that are delivered digitally to a consumer's computer would tax movies that are downloaded to a consumer's computer but not movies that are streamed online.

Second, given the mobile nature of consumers, there is the question of which state or local government has the jurisdiction to tax the consumption of streaming services. Theoretically, the taxing jurisdiction should be the one where the consumer is streaming the video content, but consumers can download and stream video content in multiple jurisdictions.

Lastly, there is the challenge of how to efficiently administer a tax on streaming services, which by their subscription nature are high volume, low value sales.[46] States and local governments have varying tax laws which puts an enormous compliance burden on high volume sellers.

Practitioners and scholars agree that these challenges demonstrate a need for digital tax reform and uniform digital tax laws among the states.[47] In

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[43] Texas recently passed a bill that will exempt menstrual products and family-oriented items such as diapers and baby wipes from sales tax. S.B. 379, 88th Sess. (Tx. 2023) https://capitol.texas.gov/BillLookup/History.aspx?LegSess=88R&Bill=SB379. Missouri is one of 12 states that taxes groceries. MISSOURI BUDGET PROJECT, https://www.mobudget.org/mo-tax-revenue-compare/ (last visited Dec. 14, 2023).

[44] *See* Orly Mazur & Adam Thimmesch, *Closing the Digital Divide in State Taxation: A Consumption Tax Agenda*, 98 TAX NOTES STATE 961 (2020); David Gamage, Darien Shanske, Gladriel Shobe, Adam Thimmesch, *Weathering State and Local Budget Storms: Fiscal Federalism With An Uncooperative Congress*, 55 U. MICH. J.L. REFORM 309 (2022); *Sales Tax on Digital Products*, MULTISTATE TAX COMMISSION, https://www.mtc.gov/uniformity/sales-tax-on-digital-products/ (last visited Dec. 8, 2023).

[45] *See* Orly Mazur & Adam Thimmesch, *Closing the Digital Divide in State Taxation: A Consumption Tax Agenda*, 98 TAX NOTES STATE 961 (2020).

[46] For example, Netflix streaming subscriptions range from $1 to $26 per month. Netflix, 2022 Annual Report (Form 10-K) (Jan. 26, 2023).

[47] *See, e.g.*, Adam Thimmesch, *The Scope of Digital Sales Tax Reform*, 107 TAX NOTES STATE 1181 (2023), https://www.mtc.gov/wp-content/uploads/2023/05/The-Scope-of-Digital-Sales-Tax-Reform-Adam-Thimmesch.pdf.

addition, the Multi-State Tax Commission is working on a white paper that would discuss how states might best adopt their sales tax to include digital products.[48]

This article proceeds under the assumption that there are strong policy reasons for taxing digital streaming services and that implementation challenges can be overcome. As discussed in Part III, this is evident by the fact that many states impose sales tax on digital streaming services. However, this article argues that states such as California, Nevada, and Missouri have constitutional limitations that hinder their ability to tax streaming services and the digital economy as a whole.

III. HOW STATES TAX DIGITAL STREAMING SERVICES

When it comes to sales tax, most cities piggyback on state law. That is, if the state imposes a sales tax on digital streaming services, a city in that state can also impose sales tax on digital streaming services. While the technicalities of local taxation vary by state, Part III of this article begins by discussing how states impose sales tax on digital streaming services. It then proceeds to discuss how cities tax (or attempt to tax) streaming services when the state does not impose sales tax on streaming services.

A. Sales Tax

Most states that tax digital streaming services have done so by subjecting such streaming services to sales tax.[49] Generally, sales and use taxes are imposed on the retail sale or use of tangible personal property. State statutes often contain a long and detailed definition of what is considered tangible personal property.[50] Services are not usually subject to sales tax, but some states impose a sales tax on specific types of services.[51]

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48 *See Discussion Draft of Detailed Outline of a White Paper on Sales Taxation of Digital Products*, Multistate Tax Commission (Feb. 2, 2023), https://www.mtc.gov/wp-content/uploads/2023/02/Draft-Detailed-Digital-Outline-23-02-02.pdf.

49 Research from the Tax Policy Center provides that of the forty-five states with a general sales tax and the District of Columbia, thirty-three of such states impose sales tax on digital streaming services. Richard C. Auxier, *Chicago's Streaming Tax Is A Bad Tax But It's Not A "Netflix Tax"*, TAX POLICY CENTER (June 11, 2019), https://www.taxpolicycenter.org/taxvox/chicagos-streaming-tax-bad-tax-its-not-netflix-tax; *see also* Natalia Garrett & Grant Nülle, *Digital Goods and Services: How States Define, Tax, and Exempt These Items*, TAX NOTES STATE (May 18, 2020) https://www.mtc.gov/wp-content/uploads/MTCImages&Files/MTC/media/Standing-Subcommittee/Digital-Goods-Paper-N-Garrett.pdf.

50 *See, e.g.*, Maryland's statute MD. CODE, TAX-GEN. §§ 11-101(k); 11-109 (2023).

51 Maryland imposes a tax on a "retail sale." Md. CODE, TAX-GEN. § 11-102(a)(1) (2023). Retail sale is defined to include the sale of tangible personal property and the sale of a taxable service. Md. CODE, TAX-GEN. § 11-101(h)(1) (2023). Maryland's definition of

When sales and use tax laws were initially enacted, tangible personal property generally was not defined to include intangible property such as digitally downloaded movies.[52] This is because state sales tax statutes were enacted long before the invention of digital technologies.[53] In order to impose sales tax on digital streaming services, states had to amend their statutes to include digital streaming services in the sales tax base.[54]

One way states have added digital streaming services to their sales tax base is by including digital streaming services in the definition of tangible personal property.[55] For example, Pennsylvania law provides that tangible personal property includes video, "whether electronically or digitally delivered, streamed or accessed and whether purchased singly, by subscription or in any other manner."[56] This amendment to the definition of tangible personal property resulted in digital streaming services being subject to Pennsylvania sales tax.[57]

Rather than amend the definition of tangible personal property to somewhat illogically include a type of intangible property, other states have expanded their sales tax base by adding a new category of property that is subject to sales tax. For example, in 2021 Maryland specifically added "digital products" to its sales tax base.[58] Video streaming services, as well as e-books

"taxable service" that includes services such as cell phone service, security service, cleaning of a commercial building and the production of tangible personal property or a digital product by special order. Md. CODE, TAX-GEN. § 11-101(m) (2023).

[52] *See Discussion Draft of Detailed Outline of a White Paper on Sales Taxation of Digital Products*, Multistate Tax Commission (Feb. 2, 2023) at 2, https://www.mtc.gov/wp-content/uploads/2023/02/Draft-Detailed-Digital-Outline-23-02-02.pdf.

[53] *Id*. Most state sales tax laws were enacted in the 1930s and 1940s.

[54] *Id*. In a similar vein, many states had to amend their statutes when they first started taxing digitally delivered software. When software was delivered on a physical medium, such as a CD-ROM, the software was tangible personal property subject to sales tax. As technology developed and software began to be delivered digitally (i.e., downloaded onto a user's computer) or accessed online (i.e., software as a service), the transactions were no longer subject to tax because they were not sales of tangible personal property. States had to figure out how to change their laws if they wanted these software transactions to be subject to sales and use taxes. *See* Natalia Garrett & Grant Nülle, *Digital Goods and Services: How States Define, Tax, and Exempt These Items*, TAX NOTES STATE, May 18, 2020; Walter Hellerstein & Jon Sedon, *State Taxation of Cloud Computing: A Framework for Analysis*, 117 J. TAX'N 11 (2012).

[55] For example, in 2016 Pennsylvania amended its tax laws to provide that video streaming services were subject to Pennsylvania's sales and use tax laws. 72 PA. CONS. STAT. § 7201(m)(2) (as amended in 2016).

[56] *Id*.

[57] This language would also capture movies that are purchased or rented and subsequently downloaded to the customer's electronic device.

[58] Md. CODE, TAX-GEN. § 11-102(a)(1); 11-101(h)(1)(iii), (iv) (2023). Maryland sales tax is imposed on a "retail sale." Md. CODE, TAX-GEN. § 11-102(a)(1) (2023). The definition of retail sale now specifically includes the sale of a digital code or a digital product. Md. CODE, TAX-GEN. § 11-101(h)(1)(iii), (iv) (2023). These items are listed in addition to tangible personal property and taxable services. *See* Md. CODE, TAX-GEN. § 11-101(h)(1)(i), (ii) (2023).

and video games, are included in Maryland's definition of digital products.[59] As a result, digital streaming services are subject to Maryland's sales tax as a digital product.

Generally, a state's sales tax base must be expanded at the state level, either through legislation, administrative guidance, or a court ruling. Local governments, such as cities and counties, generally cannot expand the sales tax base unless given the authority to do so.[60] As a result, state and local governments that impose sales tax on digital streaming services have generally done so through state legislation with the local governments then piggybacking on the newly enacted state law.[61]

B. Amusement Tax

Some local governments have chosen to tax streaming services through an amusement tax, which functions like a sales tax on specific types of services. For example, the City of Chicago taxes digital streaming services through its amusement tax.[62]

Since local government sales taxes generally piggyback on sales tax statutes enacted by state legislatures, it is worth discussing how a local government such as Chicago has the authority to enact its own amusement tax. There are two sources of law that provide Chicago with the authority to tax amusements: the Illinois constitution and Illinois statutory law.[63] Pursuant to this authority, Chicago first enacted its amusement tax in 1947.[64] The amusement tax is a tax on amounts paid to attend shows, performances, sporting events, and similar events in Chicago.[65] While the patron bears the economic

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[59] Md. CODE, TAX-GEN. § 11-101(2) (2023).

[60] *See* Erin Adele Scharff, *Powerful Cities?: Limits on Municipal Taxing Authority and What to do About Them*, 91 N.Y.U. L. REV. 292 (2016) for a discussion of the legal framework of local government law.

[61] *See* 72 PA. CONS. STAT. § 7201(m)(2); MD. CODE, TAX-GEN. § 11-101(h)(1)(iii), (iv). These statutes were discussed in footnotes 55 and 58, respectively.

[62] CHI., ILL., DEP'T FIN., Amusement Tax Rul. #5 (June 9, 2015), https://www.chicago.gov/content/dam/city/depts/rev/supp_info/TaxRulingsandRegulations/AmusementTaxRuling_5_06_09_2015.pdf. The city of Evanston, Illinois also recently amended its amusement tax to impose the tax on "amusements that are delivered electronically." EVANSTON, ILL., CODE § 3-2-17-1 (2020), https://library.municode.com/il/evanston/codes/code_of_ordinances?nodeId=TIT3BURE_CH2MUOCTA_3-2-17-1TAIM.

[63] The Illinois constitution allows home rule cities to exercise "any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals and welfare; to license; to tax; and to incur debt." ILL. CONST. art. VII, § 6(a). Illinois statutory law gives local municipalities the authority (through the Illinois Municipal Code) to tax shows and amusements. 65 ILL. COMP. STAT. 5/11-42-5. (2011).

[64] CHI., ILL., MUN. CODE § 4-156-020(A) (Am. Legal Publ'g, through Council Journal of Dec. 14, 2023). *See also* Labell v. City of Chicago, 147 N.E. 3d 732, 737 (Il. App. 2019).

[65] CHI., ILL., MUN. CODE §§ 4-156-020(A), 4-156-010 (Am. Legal Publ'g, through Council Journal of Dec. 14, 2023).

responsibility for paying the tax, the ticket "seller" is responsible for collecting and remitting the tax.[66] The amusement tax functions like a sales tax on certain specified entertainment services.

In 2015, Chicago's comptroller issued a ruling stating that the amusement tax applies to charges paid for viewing amusements that are delivered electronically.[67] The ruling specifically provided that the streaming of movies, television shows, music, and games by a person in Chicago[68] would be subject to the amusement tax.[69]

Shortly after the issuance of the amusement tax ruling, several Chicago residents brought a lawsuit challenging the validity of the amusement tax as applied to digital streaming services.[70] The amusement tax was eventually upheld after the court found that the tax did not exceed the city's home rule authority, [71] nor did the amusement tax violate the Internet Tax Freedom Act (ITFA).[72] It is worth analyzing these arguments because, as discussed in Part II, the underlying issues are challenges that a state would need to overcome in enacting a sales tax on digital streaming services.

The plaintiffs' home rule authority argument shows both the legislative drafting and administrative problems of taxing streaming services. In *Labell*, the plaintiffs argued that the amusement tax on streaming services was unconstitutional under Illinois law because the tax presumed that a customer with a billing address in Chicago would use the streaming services in Chicago, when in fact the customer could be using the streaming services outside of the city limits.[73] Under Illinois home rule authority, Chicago can generally only tax within its city limits.[74] The *Labell* court found that the amusement tax did not exceed Chicago's home rule authority because there was "no

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[66] CHI., ILL., MUN. CODE § 4-156-030(A) (Am. Legal Publ'g, through Council Journal of Dec. 14, 2023).

[67] CHI., ILL., DEP'T FIN., Amusement Tax Rul. #5 (June 9, 2015), https://www.chicago.gov/content/dam/city/depts/rev/supp_info/TaxRulingsandRegulations/AmusementTaxRuling_5_06_09_2015.pdf.

[68] *Id.* In addition, the ruling stated that whether a person was in Chicago and subject to the tax was based on the customer's residential street address or primary business address, "as reflected by their credit card billing address, zip code, or other reliable information." *Id.*

[69] *Id.* Such tax was effective as of July 1, 2015.

[70] Labell v. City of Chicago, 147 N.E. 3d 732, 738–39 (Il. App. 2019).

[71] *Id.* at 739. The plaintiffs also argued that (1) the tax on streaming services exceeded Chicago's home rule authority to tax under Illinois Constitution article VII, section 6 because a customer's location was determined based on billing address as opposed to whether a customer was actually using the streaming service in Chicago, and (2) the tax on streaming services violated the uniformity clause of the Illinois Constitution of 1970. The court declined to find for the plaintiffs on either of these arguments. *Id.* at 740–47.

[72] *Id.* at 747–49.

[73] *Id.* at 741–42.

[74] *Id.*

conclusive presumption of taxability based on residence."[75] Rather, the ordinance set forth a rebuttable presumption of residence.[76] *Labell* demonstrates the care legislators need to take in drafting laws that tax streaming services to ensure that such laws can stand up to future legal challenges. The case is also an example of the jurisdictional issues discussed in Part II that arise when taxing mobile customers.

The plaintiffs in *Labell* also argued that Chicago's amusement tax violated the ITFA. The ITFA generally prohibits "discriminatory taxes on electronic commerce."[77] For example, a state law that imposed sales tax on the purchase of a book from an online retailer such as Amazon but did not impose sales tax on the purchase of a book from a brick-and-mortar store would be considered a discriminatory tax. In *Labell*, the plaintiffs argued that the amusement tax was discriminatory because online streaming services were subject to tax and other specified types of in-person amusements were either exempt from the amusement tax or taxed at a lower rate.[78] The court held that Chicago's amusement tax did not violate the ITFA because the online streaming services were not similar to these other specified types of amusements, and thus did not need to be taxed similarly.[79] *Labell* demonstrates that a state wanting to tax digital streaming services needs to carefully review what goods and services are currently subject to tax to ensure that a new tax on digital streaming services is not a discriminatory tax on electronic commerce.

While at least one other city in Illinois has revised its amusement tax laws to tax streaming services,[80] this method of taxing streaming services is still relatively unique. Few local governments have the authority to impose their own amusement tax or amend the existing sales tax laws to capture digital streaming services.[81] Due to this lack of authority and the state constitutional limitations discussed in Part IV, this article argues that cities have attempted to "tax" streaming service revenues under preexisting video service provider fee statutes.

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75 *Id.* at 742.

76 CHI., ILL., MUN. CODE § 4-156-020(G) (Am. Legal Publ'g, through Council Journal of Dec. 14, 2023). The ordinance states: "It shall be presumed that all amusements are subject to tax under this article until the contrary is established by books, records or other documentary evidence." Similar language is included in subsection (G1) for amusements that are delivered electronically to mobile devices. CHI., ILL., MUN. CODE § 4-156-020(G1) (Am. Legal Publ'g, through Council Journal of Dec. 14, 2023).

77 Internet Tax Freedom Act, 47 U.S.C. § 151 note (2018).

78 Labell v. City of Chicago, 147 N.E. 3d at 747–48.

79 *Id.* at 749.

80 *See* EVANSTON, ILL., CODE § 3-2-17 (2023), https://library.municode.com/il/evanston/codes/code_of_ordinances?nodeId=TIT3BURE_CH2MUOCTA_3-2-17-1TAIM (last visited Jan. 11, 2024).

81 *See* Part III.A. *See also* Part IV discussing state constitutional limitations on new digital taxes.

C. Video Service Provider Fee

Many local governments impose a fee or a franchise tax on video service providers. Most of these statutes authorizing such fees were enacted in the mid-2000s as a way of centralizing at the state level the cable television franchise process.[82] Prior to the enactment of these statutes, a cable television operator typically would have obtained a franchise from each local political subdivision in which it sought to provide cable television services.[83] These statutes now require the cable television operator to apply for a single franchise from the state.[84] The statutes imposing such franchise fees have different names and varying definitions of "video service provider," but the legislatures enacting these statutes all generally intended to charge the cable company a fee for the right to construct and use cable wires in the public right of way.[85] The fee is typically a percentage of gross revenues from the cable television services provided within a particular jurisdiction and is capped at five percent per federal law.[86] State law generally gives local governments the ability to enforce and collect the fee from video service providers within the local government's jurisdiction.[87] Hence, the reason these lawsuits against Netflix and Hulu, discussed infra, were brought by local municipalities.

Cable television was at its peak in terms of number of subscribers and revenues in the early 2010s.[88] As consumers cut the cord on their cable service and switched to streaming services, cable company revenues have

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[82] In 2006, California enacted the Digital Infrastructure and Video Competition Act ("DIVCA") in order to establish a state-issued franchise authorization process for cable and video services. CAL. PUB. UTIL. CODE § 5810. *See also* MO. REV. STAT. § 67.2679.

[83] *See, e.g.*, CAL. PUB. UTIL. CODE § 5810(a)(4) (prior to enactment of California's Digital Infrastructure and Video Competition Act, cable operators had franchises with local government entities); *see also* the 9th circuit's discussion of Nevada's law in City of Reno v. Netflix, 52 F.4th 874, 876–877 (9th Cir. 2022).

[84] The stated reasons for moving the franchise process from the local level to the state level included fair competition among all market competitors, promoting widespread access to cable services to all communities regardless of socioeconomic status, and protecting the public right-of-way. *See* CAL. PUB. UTIL. CODE § 5810(a)(2); MO. REV. STAT. § 67.2679.1.

[85] For example, the California legislature intended that the video service provider's franchise fee be a form of rent or toll to compensate the city for the use of public rights-of-way. *See* CAL. PUB. UTIL. CODE § 5810(b). *See also* City of Reno v. Netflix, Inc., 52 F4th. 874, 876 (9th Circ. 2022) ("Historically, cable operators have paid franchise fees to state and local governments in exchange for the use of public rights-of-way.").

[86] 47 U.S.C.A. § 542(b) (effective Feb. 8, 1996).

[87] *See* MO. REV. STAT. § 67.2689; CA. PUB. UTIL. CODE § 5860.

[88] For a brief history on cable television, *see* Brad Adgate, *The Rise and Fall of Cable Television*, FORBES (Nov. 2, 2020), https://www.forbes.com/sites/bradadgate/2020/11/02/the-rise-and-fall-of-cable-television/?sh=7e8039816b31.

decreased.[89] As cable company revenues have decreased, so have the video service provider franchise fees paid to state and local governments.[90] Fees, like sales and property taxes, are an important source of cities revenues.

In search of lost local revenue, some cities brought lawsuits against Internet based streaming service providers, such as Netflix and Hulu, arguing that the streaming service providers should pay the franchise fee on the streaming services revenue.[91] The first of these lawsuits was filed by the City of Creve Coeur, Missouri in 2018,[92] and perhaps it was the plaintiff's early victory here in surviving a motion to dismiss that spurred the filing of many similar lawsuits over the next several years.[93] At the time of this writing, none of the local municipalities have won a lawsuit against a streaming service provider.[94]

This next part of the article briefly summarizes the video service provider (VSP) statutes of California, Nevada, and Missouri and the lawsuits brought by cities in these states alleging that Netflix and Hulu owe fees under these VSP statutes. In addition to providing background on the VSP laws, this Part shows how courts have struggled with applying old, outdated laws to a new technology in the digital economy.[95] Part IV then analyzes the state constitutional limitations in California, Nevada, and Missouri, and argues

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[89] Lillian Rizzo, *Broadcast and Cable Make up Less than Half of TV Usage for the First Time Ever*, CNBC (Aug. 15, 2023, 5:05 PM) https://www.cnbc.com/2023/08/15/traditional-tv-usage-drops-below-50percent-for-first-time-ever.html.

[90] *See Local Government Revenue in Tennessee and the Evolving Market for Cable Television, Satellite Television and Streaming Video Services*, TENNESSEE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS (Sept. 2019), at 2, 32, and 59, https://www.tn.gov/content/dam/tn/tacir/2019publications/2019CordCutting.pdf. The report recognized that local revenue from cable franchise fees would decrease if consumers continued to "cut the cord" on cable services. *Id.*

[91] *See infra* Parts III.C.1, 2, and 3.

[92] Creve Cour first filed its complaint against Netflix in 2018. Petition for Declaratory Judgment and Other Relief, City of Creve Coeur v. DIRECTV, LLC, (E.D. Mo. July 19, 2018), 2018 WL 4006896.

[93] See Rene Blocker & David Epstein, *Analysis: Netflix, Hulu Streaming Battle Localities Over Revenue*, BLOOMBERG LAW (Feb. 28, 2023), https://news.bloombergtax.com/daily-tax-report/analysis-netflix-hulu-streaming-battle-localities-over-revenue (mentioning lawsuits filed on behalf of cities in Arkansas, Illinois, Nevada, Indiana, Texas, California, Ohio, and Tennessee).

[94] *See* City of Lancaster v. Netflix, 2022 WL 1744233 (Cal. Super. Ct. 2022) (discussed infra Part III.C.1) and City of Reno v. Netflix, Inc., 52 F.4th 874 (9th Cir. 2022) (discussed infra Part III.C.2). Other cases where the cities lost include City of Ashdown, Ark. v. Netflix, Inc., 52 F.4th 1025 (8th Cir. 2022); Gwinnett County v. Netflix, Inc., 885 S.E.2d 177 (Ga. App. Ct. 2023); City of Knoxville v. Netflix, Inc., 656 S.W.3d 106 (Tenn. 2022); *City of Fort Scott v. Netflix, Inc.*, 2022 WL 16946889 (Kan. Dist. Ct. July 21, 2022); City of Maple Heights v. Netflix, Inc., 215 N.E.3d 500 (Oh. Sup. Ct. 2022). A few cases are still on appeal, including City of Creve Coeur v. Netflix. It is discussed further, *infra*.

[95] This is not the first-time courts have struggled with technology in the state and local arena. Sales and use taxes as applied to software has been a challenge for many years. *See supra* footnotes 29 and 54.

that these limitations have caused cities in these states to bring lawsuits against Netflix and Hulu in an attempt to tax streaming services under these VSP statutes.

1. California

The California Digital Infrastructure and Video Competition Act of 2006 (DIVCA) imposes a fee on video service providers equal to five percent of gross revenue derived from providing video services using facilities located at least in part in public rights of way.[96]

In 2021, the City of Lancaster, California filed a class action lawsuit[97] against Netflix and Hulu alleging that Netflix and Hulu must pay the video service provider fee under DIVCA because they "provide[d] video services throughout California using broadband wireline facilities located at least in part in public rights-of-way."[98] The court dismissed the case on two main grounds.[99]

First, the court found that DIVCA did not give the city a private right of action to bring the lawsuit against Netflix and Hulu because they were not franchise holders.[100] As drafted, the statute specifically gave local governments a limited right to bring an action against a franchise-holder over underpayment of franchise fees but was silent as to whether local governments had the right to bring an action against non-franchise holders for the nonpayment of franchise fees.[101]

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[96] CAL. PUB. UTIL. CODE § 5860(a) (imposes the fee); CAL. PUB. UTIL. CODE § 5860(d) (defines gross revenue); CAL. PUB. UTIL. CODE § 5830 (contains definitions of video programming and video service and video service provider).

[97] The class action was brought on behalf of "All California cities, counties, cities and counties and/or joint powers authorities in which one or more of the Defendants has provided video service (the "Class")." Amended Class Action Compliant, City of Lancaster v. Netflix, No. 21STCV01881 (Cal. Super. Ct. Oct. 20, 2021), 2021 WL 8651676.

[98] City of Lancaster v. Netflix, 2022 WL 1744233, 1 (Cal. Super. Ct. 2022).

[99] *Id.* at 1–13.

[100] *Id.* at 1–5 (the court held "local entities such as Plaintiff and the putative class members may not compel Defendants to obtain a DIVCA franchise or comply with DIVCA – only the [Public Utilities Commission] has authority to determine whether to issue, suspend, or revoke franchises and or to compel nonfranchise holders to comply with DIVCA.").

[101] *Id.* at 1–5; CAL. PUB. UTIL. CODE § 5860(i) provides that "[e]ither a local entity or the holder may, in the event of a dispute concerning compensation under this section, bring an action in a court of competent jurisdiction." The court interpreted this language to mean that a local entity has a private right of action "with respect to disputes with a franchise holder over underpayment of franchise fees." City of Lancaster, 2022 WL 1744233 at 2. The court found that there was no similar language in the statute regarding disputes with nonfranchise holders, such as Netflix and Hulu. The court also found that the DIVCA did not provide for an implied private right of action against nonfranchise holders. *Id.* at 5. Rather, under CAL. PUB. UTIL. CODE § 444 (a provision that was not directed solely at franchise holders (like section 5860) but rather more generally at "video service providers") the California Public Utilities Commission could bring a lawsuit against nonfranchise holders to enforce DIVCA. *Id.* at 3.

Second, the court held that DIVCA did not apply to Netflix or Hulu because they were not "video service providers" as that term was defined under the statute.[102] Under DIVCA, a video service provider is an entity that provides "video programming services, cable service, or [open-video system] service . . . through facilities located at least in part in public rights-of-way without regard to delivery technology, including Internet protocol or other technology."[103] The court found that Netflix and Hulu did not meet the definition of video service provider because their use of Internet service provider networks to provide streaming services to customers did not constitute "use" of the public right-of-way under DIVCA.[104] In addition, the court found that Netflix and Hulu did not provide "video programming" because the on-demand programming that customers streamed was not similar to the programming provided by a television broadcast station.[105]

2. Nevada

In 2020, the City of Reno, Nevada brought a class action lawsuit against Netflix and Hulu in district court alleging that the defendants failed to pay franchise fees pursuant to Nevada's Video Services Law (VSL).[106] Similar to California's DIVCA, Nevada's VSL permits local governments to impose a franchise fee equal to five percent of a video service provider's gross revenues from subscribers within the local government's jurisdiction.[107]

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[102] City of Lancaster, 2022 WL 1744233 at 10–12.

[103] CAL. PUB. UTIL. CODE § 5830(t); CAL. PUB. UTIL. CODE § 5830(s).

[104] The court determined that "the Legislature clearly intended DIVCA to apply primarily to video service providers who build their own facilities and networks in the rights-of-way." *City of Lancaster*, 2022 WL 1744233 at 9. As such, DIVCA did not apply to either Netflix or Hulu since neither constructed the Internet service provider networks through which their streaming services were provided, nor did they control where the Internet service providers' (ISPs) network cable lines would be constructed. *Id.* at 8.

[105] Video programming is defined as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station, as set forth in section 522(20) of Title 47 of the United States Code." CAL. PUB. UTIL. CODE § 5830(r). In finding that the definition of video programming did not include Netflix's or Hulu's on-demand services, the court focused on the word "programming" which was not specifically defined in DIVCA. While the court looked to the Oxford English dictionary definition of "programming" and other case law interpreting the meaning of "programming" in similar statutory language, the Court's ruling seemed to hinge on two definitions in the federal cable communications law, specifically, "multichannel video programming distributor" under 47 U.S.C. § 522(13) and "interactive on-demand services" under 47 U.S.C. §522(12). The court reasoned that since the definition of "interactive on-demand services" expressly excluded "services providing prescheduled video programming, such as television broadcast stations" that Congress intended "to state that interactive on-demand services without prescheduled video programming are not generally considered comparable to programming provided by. . .a television broadcast station.'" City of Lancaster, 2022 WL 1744233, 11-12.

[106] City of Reno, Nevada v. Netflix, Inc., 558 F.Supp.3d 991 (D. Nev. 2021). The VSL is in NEV. REV. STAT. § 711.020 *et seq.*

[107] NEV. REV. STAT. § 711.670(1), (3).

The district court dismissed the case on two grounds. First, the court found that Netflix and Hulu were not required to pay the franchise fee because they did not provide "video services" as defined by the VSL.[108] While the *City of Lancaster* court found that Netflix and Hulu were not video service providers because they did not "use" the public right-of-way, and in the alternative, they did not provide "video programming,[109] the *City of Reno* court determined that the defendants were not video service providers because their services fell within a public Internet exception.[110] Under the VSL, the term "video service" did not include "[a]ny video content provided solely as part of, and through, a service which enables users to access content, information, electronic mail or other services that are offered via the public Internet."[111] Because the streaming services were provided over the Internet, the court determined that the public Internet exception applied to Netflix and Hulu such that neither was considered a video service provider.[112]

Second, the district court dismissed the case because it found that Reno did not have a private right of action under the VSL.[113] While the statute was silent on who could bring an action for nonpayment by a purported video service provider, the district court held that the Nevada legislature intended that only the State of Nevada through the Nevada Attorney General could file a claim for unpaid franchise fees on behalf of a local government.[114] Like the *City of Lancaster* court, the *City of Reno* court was hesitant to allow a local government to bring a lawsuit against streaming service providers under the VSL.

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[108] City of Reno, 558 F.Supp.3d at 997. Under the VSL, only a "video service provider" is subject to the franchise fee.NEV. REV. STAT. § 711.670(1). A video service provider is "any person that provides or offers to provide video services over a video service network to subscribers in [Nevada]." NEV. REV. STAT. §711.151(1).

[109] *See supra* Part III.C.1.

[110] City of Reno, 558 F.Supp.3d at 997.

[111] NEV. REV. STAT. § 711.141(3)(a).

> "'Video service' means the provisions of multichannel video programming generally considered comparable to video programming delivered by a television broadcast station, cable service or other digital television service, whether provided as part of a tier, on-demand or on a per-channel basis, without regard to the technology used to deliver the video service, including, without limitation, Internet protocol technology or any successor technology."

NEV. REV. STAT. § 711.141(1). The court found persuasive the defendants' arguments that their business provides more than just video streaming services and that paying a fee does not render the Internet not public. *City of Reno*, 558 F.Supp.3d at 996.

[112] *City of Reno*, 558 F.Supp.3d at 997.

[113] *Id.* at 997–98.

[114] *Id.* at 999–1000. See also NEV. REV. STAT. § 711.680(4) stating that "[a]ny action to recover a disputed underpayment of a franchise fee. . . must be commenced and prosecuted by the Attorney General on behalf of the affected local governments."

The City of Reno appealed the case to the U.S. Court of Appeals for the Ninth Circuit, which affirmed the lower court's holding that Reno did not have a cause of action under the VSL.[115] In so holding, the court did not even address the disputed definition of "video service provider."[116] Perhaps the court did not want to struggle through analyzing whether streaming services would fit within a definition that was drafted years before streaming services even existed. However, the definitional issue is now mute since the Nevada legislature amended the definition of "video service" to specifically exclude video streaming services.[117]

3. Missouri

In 2018, the City of Creve Coeur, Missouri brought a class action lawsuit[118] against Netflix and Hulu alleging that the defendants owed the five percent fee under Missouri's Video Services Providers Act (VSPA).[119] While the case has yet to be finally decided,[120] Creve Coeur had an early victory when the state court denied defendants' motion to dismiss.[121] The victory may have spurred the other VSP lawsuits, but as mentioned above, many of these lawsuits were dismissed and none of these lawsuits have resulted in a verdict for the local municipality.[122] Thus, it is worth taking a closer look to understand why *City of Creve Coeur* was not initially dismissed. First, though, this article will provide a brief overview of the VSPA and state legislative response to the *City of Creve Coeur* ruling.

In Missouri the VSPA allows local governments to impose fees on video service providers.[123] The VSPA fee was originally five percent of gross revenues charged to customers in the local government's jurisdiction, however the state legislature amended the VSPA statute in 2021, after the city of Creve

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[115] *City of Reno v. Netflix, Inc.,* 52 F.4th 874 (9th Cir. 2022).

[116] *City of Reno,* 52 F.4th at 877.

[117] NEV. REV. STAT. § 711.141. The new definition was effective as of July 1, 2023. The legislative history indicates that the amendment was intended to clarify that streaming service providers would not be subject to the VSL.

[118] The case was brought on behalf of Missouri's other municipalities, on the basis that many of these small municipalities do not have the resources to bring a case like this. *See* Creve Coeur's initial Petition for Declaratory Judgment and Other Relief, 2018 WL 4006896 (July 19, 2018).

[119] *Id.*

[120] The last court order was in July 2022 when the circuit court affirmed the class certification. *City of Creve Coeur v. Netflix, Inc.*, 2022 WL 2987799 (Mo. Cir. Ct. 2022).

[121] *City of Creve Coeur v. Netflix, Inc.*, 2020 WL 13120428 (Mo. Cir. Ct. 2020). About a year later, the circuit court denied the city of Creve Coeur's motion to dismiss Netflix's counterclaim. *City of Creve Coeur v. Netflix, Inc.*, 2021 WL 9169798 (Mo. Cir. Ct. 2021).

[122] *See City of Lancaster* and *City of Reno*, discussed *supra* in Part III.C.1 and Part III.C.2.

[123] MO. REV. STAT. §§ 67.2675 – 67.2714; 67.2689.

Coeur's early victory, to gradually reduce the fee to 2.5 percent.[124] Not knowing how the *City of Creve Coeur* court would finally rule, the state legislature also enacted a law prohibiting the imposition of any new tax upon the provision of video streaming service[125] and set up a task force to study "best methods for right-of-way management, taxation of video services, and the future revenue needs of municipalities and political subdivisions as such revenue relates to video services."[126] In addition, legislation proposed in 2023 would have specifically excluded video streaming providers from the VSPA.[127] These legislative actions show a divide between the local jurisdictions that want to tax streaming service providers and the state legislature which does not want to tax streaming services.

As discussed above, Creve Coeur's early victory spurred both state legislative action and the other VSP lawsuits. This article proceeds to analyze why Creve Coeur had an early victory as compared with Lancaster and Reno, and how Creve Coeur survived an ITFA challenge.

One reason that Creve Coeur's lawsuit survived the initial motion to dismiss is that Missouri's definition of video service provider specifically includes video service provided "on-demand."[128] Comparatively, California's definition of video service provider does not include on-demand video service.[129]

While Missouri's VSPA contains a public Internet exception that is very similar to Nevada's VSL, the *City of Creve Coeur* court determined that the plaintiffs had alleged sufficient facts that Netflix's and Hulu's provision of video programming (via their content-delivery systems) bypassed the public Internet, such that their video programming did not necessarily fall within the public Internet exception.[130]

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[124] MO. REV. STAT. § 67.2689. Beginning August 28, 2023, the maximum fee is 4.5 percent. In each of the subsequent four years, the maximum fee is reduced by another .5 percent, such that beginning August 28, 2027, the maximum fee is 2.5 percent. Legislators may be second guessing this decision to reduce the VSPA fee, as recent proposed legislation would have pushed back the dates for the reduction in the video service provider fee. *See* H.R. 928, 102d Gen. Assemb., Reg. Sess. (Mo. 2023).

[125] MO. REV. STAT. § 67.2680.

[126] MO. REV. STAT. § 67.2720.1 (expired Dec. 31, 2023). As of this writing, the task force has yet to produce any publicly available reports.

[127] S.B. No. 152, 102d Gen. Assemb., Reg. Sess. (Mo. 2023).

[128] *City of Creve Coeur v. Netflix, Inc. 2020 WL 13120428* at 4; MO. REV. STAT. § 67.2677 (14).

[129] CAL. PUB. UTIL. CODE § 5830(t), (s), (q). *City of Lancaster*, at 11–12.

[130] *City of Creve Coeur*, 2020 WL 13120428, at 4. While the court noted the plaintiffs' and defendants' arguments regarding Netflix's and Hulu's use of ISP networks, the court did not get into the factual details to explain this technology since it was ruling on a motion to dismiss. In the future, the court may need to work through and try to apply the VSPA to a technology (e.g., Netflix's and Hulu's use of ISP networks) that did not exist at the time the VSPA was enacted. *Id.*

Notably absent from the motion to dismiss ruling was any discussion of whether Creve Coeur had a private right of action to bring the lawsuit.[131] In both *City of Lancaster* and *City of Reno*, the courts based their dismissal rulings in part on the fact that the city did not have a right under the statute to bring a lawsuit for unpaid fees. Creve Coeur appeared to survive the motion to dismiss because the VSPA specifically provides the local government with the right to bring a cause of action to recover any unpaid fees.[132]

As discussed above in connection with *Labell v. City of Chicago*, the ITFA bars discriminatory taxes on electronic commerce.[133] In *City of Creve Coeur*, Netflix and Hulu argued that the VSPA fee was discriminatory because television broadcast stations were not required to pay the fee.[134] The court determined that it was the services provided by both television broadcast stations and video streaming services providers, and not the programming, that had to be comparable for ITFA to apply. [135] Since the services were not comparable, taxing the video services providers (and not the television broadcast stations) under the VSPA did not violate the ITFA. [136]

D. Why Are Cities Trying to Tax Video Streaming Services under VSP Statutes?

Cities have yet to win a case against and collect VSP franchise fees from Hulu or Netflix. The courts' reasoning in the VSP cases has varied, but there are two common themes in the courts' holdings and analyses. First, the city did not have a cause of action to enforce the franchise fee.[137] Second, the video streaming providers did not meet the definition of "video service provider" (which was drafted before video streaming became a widely used technology).[138] Netflix and Hulu have also challenged the VSP fee as being a

[131] *See* MO. REV. STAT. § 67.2691(4) providing the local government with the right to bring a cause of action to recover any unpaid VSP fees.

[132] MO. REV. STAT. § 67.2691(4).

[133] The ITFA provides that a tax discriminates against electronic commerce if the tax "is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information. . . ". Pub. L. No. 105-277, § 1100, 112 Stat. 2681-719 (1998) (codified at 47 U.S.C. § 151).

[134] *City of Creve Coeur*, 2020 WL 13120428, at 5. See also Netflix's Motion to Dismiss Petition and Memorandum in Support, 2019 WL 13200796 (Nov. 25, 2019).

[135] *City of Creve Coeur*, 2020 WL 13120428, at 5–6.

[136] The court based its ruling on the technology neutral wording of the VSPA, that the fee applies no matter what technology is used to deliver the video services, so long as the provider uses the public right-of-way. *Id.* at 5–6.

[137] *See supra* notes 100 and 113.

[138] *See supra* notes 102 and 108.

violation of ITFA, but of the three cases discussed above, only the *City of Creve Coeur* court ruled on this issue.[139]

Since most of the courts found that a streaming service provider is not subject to a state's VSP statute, why were cities trying to impose the franchise fee on the streaming service providers as opposed to taxing the streaming providers under a sales tax or amusement tax law?

As discussed supra, consumer demand for cable services has decreased while consumer demand for streaming services has increased.[140] As a result, the VSP "tax base" (that is, the total revenues subject to the VSP franchise fee) has decreased and presumably the amount of VSP franchise fees being paid to local governments has decreased. Arguably, cities sought to impose VSP franchise fees on video streaming services to replace the lost VSP fees from cable services.

In addition to increasing the future VSP franchise fee "tax base," there are significant, immediate dollars at stake in these VSP lawsuits. If a city were to win one of these lawsuits against Netflix or Hulu, the streaming service provider would not only have to start paying the franchise fee on a go-forward basis, but could also owe the franchise fee on past gross revenues.[141] The franchise fee on past gross revenues would be a large, current windfall for the city (and potentially their attorneys, depending on the fee arrangement).

Assuming a city or state has the requisite authority,[142] a city or state could enact an amusement tax or a state could update its sales tax laws to tax streaming services.[143] However, a new amusement tax or sales tax would be prospective, bringing in only one year's worth of revenue at a time. In addition, the economic burden for such prospective tax falls immediately on the state's residents as this tax would be an additional amount added to the customer's bill and then remitted by the video service provider to the applicable local government. As a result, there is an economic incentive for a city to pursue a claim under a VSP statute to collect a large, immediate amount of fees that would economically be borne by the video service provider.

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[139] *City of Lancaster*, 2022 WL 1744233, at 14 (court did not address whether DIVCA violates the ITFA because the court ruled that DIVCA did not apply to the defendants). There was no mention of any violation of ITFA in the *City of Reno*. *See generally City of Reno, Nev.*, 558 F.Supp.3d 991 (D. Nev. 2021).

[140] *See supra*, Part II.A.

[141] The historic liability would generally be limited by the applicable statute of limitations. Further, while the streaming service provider is likely to pass future franchise fees along to customers, the franchise fee on past gross revenues would likely be borne by the streaming service provider.

[142] As discussed supra Part III.B., a city would need specific authority to enact its own amusement tax, and cities can generally only impose sales tax on transactions that have first been authorized at the state level.

[143] *See supra*, Parts III.A and B.

While economics are likely a reason for these video streaming lawsuits, this article argues that state constitutional tax limitations are the underlying cause of these lawsuits. Cities in states with constitutional constraints that limit the state's ability to update its sales tax laws are trying (albeit so far unsuccessfully) to tax these streaming service providers under VSP laws. Part IV of this article analyzes the constitutional tax limitations in each of Missouri, California, and Nevada that make it difficult for these states to adapt their tax laws to align with the digital economy.

IV. State Constitutional Tax Limitations Analysis

This article first analyzes Missouri's constitutional tax limitations because these limitations are more restrictive than both California's restrictions and Nevada's restrictions when it comes to taxing the digital economy. The article then proceeds to analyze California's constitutional tax limitations and compares California's public vote requirement to Missouri's public vote requirement.[144] Lastly, the article analyzes the Nevada constitutional tax limitations in relation to both Missouri's public vote requirement and California's supermajority legislative voting requirement.

A. Missouri

1. Prohibition on Sales Tax Base Expansion

Missouri's prohibition on sales tax base expansion is an example of one of the most restrictive constitutional limitations on taxing the digital economy.[145] Of the constitutional limitations discussed in this article, it is also the most recently adopted provision.

In November 2016, Missouri voters approved a new provision in the Missouri Constitution that prohibits state and local governments from

[144] Mo. Const. art. X, § 22 (known as the Hancock Amendment); Ca. Const. art. XIIIA, XIIIC. Both of these provisions are discussed in more detail below. Missouri's constitution also contains a provision that requires voter approval for new state taxes and fees that produce significant new revenues (i.e. lesser of $50 million or one percent of the total state revenues). Mo. Const. art. X, § 18(e). This article does not analyze this provision under the assumption that any new Missouri tax on streaming services or other digital products would not produce enough revenues to trigger this provision.

[145] Mo. Const. art. X, § 26. Missouri appears to be the first state with such a provision. *See* The Associated Press, *Missouri Voters to Weigh Ban on Expanding Sales Tax to Services*, N.Y. Times (Oct. 29, 2016), https://www.nytimes.com/2016/10/30/us/politics/missouri-voters-to-weigh-ban-on-expanding-sales-tax-to-services.html. Arizona's constitution also has a provision that is very similar to Missouri's prohibition against any new sales or similar transaction-based tax. *See* Az Const. art. IX, § 25. While Arizona's constitutional amendment was enacted after Missouri's, it does not stop Arizona from taxing streaming services such as Netflix and Hulu because those services were subject to Arizona's sales tax prior to the enactment of the constitutional amendment. However, this provision may prevent Arizona from adopting a digital services tax.

increasing existing sales taxes or imposing new sales taxes.[146] Specifically, the new article 10, section 26 provides: "[S]tate and local sales and use taxes (or any similar transaction-based tax) shall not be expanded to impose taxes on any service or transaction that was not subject to sales, use or similar transaction-based tax on January 1, 2015."[147] This amendment came on the heels of a wave of nationwide proposed state legislation seeking to expand sales and use tax to various services.[148]

This prohibition on sales tax base expansion would need to be repealed or amended[149] for Missouri or its local governments to impose a sales tax on streaming services. A repeal or amendment would require a vote of approval from the people of Missouri.[150] Such vote could occur as a result of either a

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[146] MO. CONST. art. X, § 26; Mo. Sec'y of State, *2016 Ballot Measures*, https://www.sos.mo.gov/petitions/2016BallotMeasures (last visited Jan. 11, 2024). This provision (referred to as "Constitutional Amendment 4" on the ballot) passed with a fifty-seven percent vote. Mo. Sec'y of State, *Election Results*, https://www.sos.mo.gov/CMSImages/ElectionResultsStatistics/2016GeneralElection.pdf (last visited Jan. 11, 2024).

[147] MO. CONST. art. X, § 26. The initiative to get this new constitutional provision on the ballot was "spearheaded" by a nonprofit organization called Missourians for Fair Taxation. Lincoln Strategy, *Congratulations to our Client, Missourians for Fair Taxation* (Aug. 10, 2016) https://lincoln-strategy.com/congratulations-client-missourians-fair-taxation/?doing_wp_cron=1686857238.5309369564056396484375 (last visited Jan. 11, 2024). According to the organization's 2016 IRS Form 990, Missourians for Fair Taxation was formed "to prevent the imposition of a sales tax on services and/or a sales tax on real property, leaseholds, or the sale or transfer of any interest in real property in the state of Missouri by supporting or opposing a ballot issues." Guidestar.com. While few Missourians were considering the future ramifications such a provision would have on taxing the digital economy, a representative from the Missouri Budget Project explained that "[t]his amendment would make it impossible for a sales tax to be added to online transactions or music downloads, which have replaced in-store purchases that could formerly be taxed." Kelly Moffit, *Election 2016: Pros and cons of Missouri's Amendment 4, covering new taxes on services, transactions*, STLPR (Nov. 2, 2016), https://www.stlpr.org/show/st-louis-on-the-air/2016-11-02/election-2016-pros-and-cons-of-missouris-amendment-4-covering-new-taxes-on-services-transactions.

[148] In 2015, the Missouri legislature proposed a constitutional amendment that would have "phase[d] out the individual income tax and replace[d] it with an expanded sales tax." S.J. Res. 11, 98th Gen. Assemb., Reg. Sess. (Mo. 2015), https://www.senate.mo.gov/15info/bts_web/Bill.aspx?SessionType=R&BillID=1090991 (last visited Jan. 11, 2024). *See also* The Associated Press, *Missouri Voters to Weigh Ban on Expanding Sales Tax to Services*, N.Y. TIMES (Oct. 29, 2016), https://www.nytimes.com/2016/10/30/us/politics/missouri-voters-to-weigh-ban-on-expanding-sales-tax-to-services.html. For a more general discussion of this waive of nationwide legislation, *see* David Gamage et al., *Weathering State and Local Budget Storms: Fiscal Federalism With an Uncooperative Congress,* 55 U. MICH. J.L. REFORM 309 (2022).

[149] In 2023, the Missouri Senate proposed an amendment to Missouri Constitution article X, § 26 that would have carved out from the general prohibition on new sales taxes "subscriptions, licenses for digital products, and online purchases of tangible personal property." However, the amendment never made its way to the voters because it was not approved by a majority of the members of the Missouri House of Representatives. S.J. Res. 3, 102nd Gen. Assemb., Reg. Sess. (Mo. 2023).

[150] Currently, any such vote to pass a constitutional amendment must be a simple majority. MO. CONST. art. XII, § 2(b). However, there is a risk that such approval threshold will increase. During the Missouri Legislature's 2023 legislative session, the Missouri House passed a resolution raising the voting threshold to pass constitutional amendments to fifty-

direct citizen ballot initiative (like the initiative whereby this amendment was initially adopted) or a proposal passed by the Missouri legislature (a legislatively referred constitutional amendment).[151]

This constitutional tax limitation is the strictest of the limitations discussed in this article. The provision prohibits any new sales tax or similar transaction-based tax, such that the state legislature is not able to expand the tax base to tax the digital economy. Even if the people of Missouri voted to repeal this limitation, Missouri has another constitutional tax limitation that makes it difficult for Missouri to tax the digital economy.

2. Public Vote for New State and Local Taxes

Not quite as restrictive as an outright prohibition on sales tax base expansion, but still a significant impediment to imposing a tax on streaming services, are citizen voting requirements included in a state constitution.

In Missouri new "taxes" must be approved by a public vote while "user fees" can be imposed by a local government without such a vote.[152] Article X, section 22 of the Missouri Constitution (customarily known as the "Hancock Amendment"[153]) prohibits local governments from

> "levying any tax, license or fees, not authorized by law, charter or self-enforcing provisions of the constitution . . . or from increasing the current levy of an existing tax, license or fees, above that current levy authorized by law . . . without the approval of the required majority of the qualified voters of that county or other political subdivision voting thereon."[154]

Since the initial passage of the Hancock Amendment, there has been a significant amount of litigation alleging that various "charges" were unconstitutional under the Hancock Amendment because they were taxes enacted

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seven percent, but the Missouri Senate failed to pass the resolution before the legislative session ended. H.J. Res. 43, 102nd Gen. Assemb., Reg. Sess. (Mo. 2023). *See also* Caroline Sullivan, *Missouri House Passes Bill Making It Harder for Voters to Amend State Constitution*, DEMOCRACY DOCKET (May 15, 2023), https://www.democracydocket.com/news-alerts/missouri-house-passes-bill-making-it-harder-for-voters-to-amend-state-constitution.

[151] MO. CONST. art. XII § 2. Constitutional amendments can also go on the ballot through constitutional conventions. *Id.* art. XII, § 3.

[152] MO. CONST. art. X, § 22. *See also* Zweig v. Metro. St. Louis Sewer Dist., 412 S.W.3d 223 (Mo. 2013) (en banc).

[153] Melton "Mel" Hancock was a public proponent of the amendment. He founded the Taxpayer Survival Association, an organization which was "created to educate the public on the merits of constitutional tax limitations." *Melton "Mel" Hancock (1929-2011)*, MO. HOUSE OF REPRESENTATIVES, https://house.mo.gov/FamousInductee.aspx?id=1070 (last visited Dec. 14, 2023); *Representative Mel Hancock*, CONGRESS.GOV, https://www.congress.gov/member/melton-hancock/H000151 (last visited Dec. 14, 2023).

[154] MO. CONST. art. X, § 22.

without a public vote.[155] Litigation is costly, and even when the taxpayers have been victorious in a Hancock Amendment challenge, they often indirectly bear the entire cost of the litigation. For example, in *Zweig*, the Missouri Supreme Court held that a stormwater charge imposed by the Metropolitan St. Louis Sewer District (MSD) was unconstitutional under the Hancock Amendment because the "charge" was a tax enacted without a public vote.[156] The court ordered MSD to pay the plaintiffs' (i.e., MSD ratepayers) attorneys' fees and costs.[157] Because MSD is funded through a combination of taxes and fees paid by St. Louis area residents, the taxpayers indirectly funded plaintiff's fees as well as MSD's litigation fees.[158] Litigation over whether a particular charge or tax is subject to a constitutional tax limitation is a common theme, and is discussed further below with respect to California's and Nevada's constitutional tax limitations.

B. California

While Missouri's Hancock Amendment applies to both state and local taxes, California's constitution has separate limitations for state taxes and local taxes. The limitation on state taxes (Proposition 13) was approved by voters in 1978[159] and the limitation on local taxes (Proposition 218) was approved in 1996.[160] Proposition 13 was part of a nationwide wave of broad tax supermajority requirements at the state level.[161] California's constitution

[155] As a result, the Missouri Supreme Court has had numerous opportunities to weigh in on what constitutes the "levying [of] any tax, license or fees." *See*, *e.g.*, *Zweig*,412 S.W.3d); *Arbor Inv. Co., LLC v. City of Hermann*, 341 S.W.3d 673 (Mo. 2011) (en banc) (increase in city's utility rates was not subject to Hancock Amendment); *Keller v. Marion Cnty. Ambulance Dist.*, 820 S.W.2d 301 (Mo. 1991) (en banc); *Zahner v. City of Perryville,* 813 S.W.2d 855 (Mo. 1991) (en banc) ("special assessment" for street work not subject to Hancock Amendment); *Oswald v. City of Blue Springs,* 635 S.W.2d 332 (Mo. 1982) (en banc) (utility charges for operation and maintenance of sewer plant not subject to Hancock Amendment). In *Zweig*, the court clarified the five factors that should be considered in classifying a particular charge as a tax or user fee for purposes of the Hancock Amendment in hopes that this clarification would minimize future Hancock Amendment litigation. *Zweig*, 412 S.W.3d at 233–42.

[156] *Zweig*, 412 S.W.3d at 244.

[157] *Id.*

[158] *Id.* at 251. According to the Charter Plan of the Metropolitan St. Louis Sewer District, the Metropolitan St. Louis Sewer District is a metropolitan district established under the Missouri constitution for the "functional administration of services common" to the St. Louis region. It is funded through a combination of user charges and taxes, both of which are paid by the people in the St. Louis region. *See generally Charter Information*, MSD PROJECT CLEAR, https://msdprojectclear.org/about/our-organization/charter/ (last visited Dec. 13, 2023).

[159] *See* Mark Baldassare et al., *Proposition 13: 40 Years Later*, PUB. POL'Y INST. OF CAL., (2018) https://www.ppic.org/publication/proposition-13-40-years-later/.

[160] Cal. Sec'y of State, *Supplement to the Statement of Vote – November 5, 1996 General Election Statewide Summary by County*, (1996), https://elections.cdn.sos.ca.gov/sov/1996-general/ssov/measures-statewide.pdf.

[161] For a discussion of the nationwide wave of broad tax supermajority requirements, *see* Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959

was subsequently amended in 2010 to make the state tax limitation even broader[162] and to add a definition of "taxes" that applies to both the state tax limitation and local tax limitation.[163]

1. Supermajority Legislative Vote for State Taxes

California's state tax limitation provides that any "state statute which results in any taxpayer paying a higher tax" must be approved by two-thirds of the California legislature.[164] For example, a new law that would result in most taxpayers paying a lower tax, but at least one taxpayer paying a higher tax, would be subject to the supermajority voting requirement.

Like Missouri, California had years of litigation over whether an alleged "fee" was actually a tax subject to the supermajority voting requirement.[165] As a result, voters added a new definition of "tax" to the constitution in 2010.[166] The definition of tax now includes "any levy, charge, or exaction of any kind imposed by a local government" and excludes a list of specific charges that are not taxes.[167]

(2021); Ariel Jurow Kleiman, *Tax Limits and the Future of Local Democracy*, 133 HARV. L. REV. 1884 (2020).

162 The original language of California Constitution article XIII A, section 3provided that a two-thirds legislative vote was required to approve "any changes in State taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation." As discussed below, the language currently provides that a two-thirds vote is required for "[a]ny change in state statute which results in any taxpayer paying a higher tax." For a discussion as to how this language helped stop legislatures from evading the tax limitation language, *see* David Gamage & Darien Shanske, *On Tax Increase Limitations: Part II – Evasion and Transcendence*, TAX NOTES STATE (April 23, 2012), https://www.taxnotes.com/tax-notes-state/tax-policy-issues/tax-increase-limitations-part-ii-evasion-and-transcendence/2012/04/23/b2dc?highlight=On%20Tax%20Increase%20Limitations.

163 Cal. Proposition 26 (2010). Voters approved the amendment as part of Proposition 26. Cal. Sec'y of State, *Supplement to the State of Vote Statewide Summary by County for State Ballot Measures*, (2010), https://elections.cdn.sos.ca.gov/sov/2010-general/ssov/ballot-measures-summary.pdf.

164 The limitation also provides "that no new ad valorem taxes on real property, or sales or transaction taxes on the sales of real property may be imposed." CAL. CONST. art. 13A, § 3(a).

165 The concern was that the legislature and local governments were "disguis[ing] new taxes as 'fees' in order to extract even more revenue from California taxpayers without having to abide by these voting requirements." 2010 Cal. Legis. Serv. Prop. 26, § 1.

166 Voters approved the new definition as part of Proposition 26. See CA. CONST. art. 13A, § 3(b) (state tax limitation) and CA. CONST. art. 13C, § 1 (local tax limitation).

167 CA. CONST. art. 13A, § 3(b) (state tax limitation); CA. CONST. art. 13C, § 1(e) (local tax limitation).

2. Public Vote for Local Taxes

While new state taxes must be approved by two-thirds of the California state legislature, new local taxes must be approved by the voters in the applicable local jurisdiction.[168] The voter approval threshold for local taxes depends on whether the local tax is a general tax or a special tax. "General taxes" must be approved by a majority of the voters and "special taxes" must be approved by two-thirds of the voters.[169] A general tax is "any tax imposed for general governmental purposes"[170] and a special tax is "any tax imposed for specific purposes, including a tax imposed for specific purposes, which is placed into a general fund."[171]

The supermajority voting requirements at both the state level (legislature voting) and the local level (public vote for special taxes) continues to generate a fair amount of litigation. As to the state limitation, taxpayers continue to challenge "fees" alleging that they are taxes that should have been passed with a two-thirds legislative vote.[172] At the local level there is litigation alleging that new taxes are "special taxes" that should have been approved by two-thirds of the voters.[173]

C. Nevada

1. Supermajority Legislative Vote for State Taxes or Majority Legislative Vote Along with a Public Vote

Like California, Nevada has a supermajority voting requirement for state taxes; however, Nevada's supermajority voting requirement was added long after the nationwide wave of broad tax supermajority requirements at the

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168 CA. CONST. art. 13C, § 2.

169 CA. CONST. art. 13C, § 2; CA. CONST. art. 13A, § 4. Section 4 also provides that local governments may not impose any "ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property" within the local government's jurisdiction. *Id.*

170 CA. CONST. art. 13C, § 1(a).

171 CA. CONST. art. 13C, § 1(d).

172 *See, e.g.*, Cal. Chamber of Com. v. State Air Res. Bd., 216 Cal. Rptr. 3d 694, 700 (Cal. Ct. App. 2017) (holding that revenue generated by the state from the sale of greenhouse gas emissions allowances did not amount to a tax subject to the two-thirds supermajority vote requirement); Howard Jarvis Taxpayers Ass'n v. Bay Area Toll Auth., 265 Cal. Rptr. 3d 235, 250–51 (Cal. Ct. App. 2020) (determining that a bridge toll imposed for the entrance to or use of state property was not a tax subject to supermajority approval).

173 *See, e.g.*, Howard Jarvis Taxpayers Ass'n v. City & Cnty. of San Francisco, 274 Cal. Rptr. 3d 432, 444 (Cal. Ct. App. 2021), *petition for rev. denied*, No. S267516, 2021 Cal. LEXIS 2860, at *1 (Cal. 2021) (holding that additional tax on commercial rents to fund early childhood and education was valid after being approved by a simple majority citizen vote); City of Fresno v. Fresno Bldg. Healthy Cmtys., 273 Cal. Rptr. 3d 144, 146–47 (Cal. Ct. App. 2020), *petition for rev.denied*, No. S266846, 2021 Cal. LEXIS 2282, at 1 (Cal. 2021) (Measure P, a voter initiative measure entitled the "Fresno Clean and Safe Neighborhood Parks Tax Ordinance" was not a special tax subject to the two-thirds voting requirement).

state level.[174] In 1996, the people of Nevada approved a constitutional amendment providing that a two-thirds vote of both houses of the Nevada legislature would be required to pass a state law that generates or increases a tax, fee, assessment, rate, or any other form of public revenue.[175] The constitutional provision also provides that if the legislature cannot obtain a two-thirds vote to approve such a law, then by a simple majority vote of both houses of the legislature they could refer the proposed law to the people of Nevada to approve by majority vote.[176] This public vote requirement is very similar to Missouri's Hancock Amendment.

Unlike California's legislative supermajority voting requirement that applies only to state "taxes," Nevada's legislative supermajority voting requirement applies to "fees, assessments and rates, or changes in the computation bases for taxes, fees, assessments and rates"[177] Scholars have noted that this supermajority voting requirement language is very broad, which of course invites litigation as to whether a particular fee or rate change is unconstitutional because it was not approved by a supermajority legislative vote.[178]

2. Public Vote to Amend State Sales Tax Laws

In addition to the legislative supermajority voting requirement, Nevada's original sales and use tax laws are protected as if they were provisions of the Nevada constitution because they were approved by the people as a constitutional referendum.[179] In Nevada, a constitutional referendum functions in a manner similar to a constitutional amendment.[180] Consequently, the original

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[174] *See* Appleby *supra* note 161, at 966.

[175] Dean Heller, STATE OF NEVADA BALLOT QUESTIONS Question 11(1996), https://www.leg.state.nv.us/Division/Research/VoteNV/BallotQuestions/1996.pdf; NEV. CONST. art. 4, § 18(2).

[176] NEV. CONST. art. 4, § 18(3). The people would need to approve such tax law with a majority vote. *Id.*

[177] NEV. CONST. art. 4, § 18(2).

[178] *See* Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959, 985 (2021).

[179] A little background is helpful to explain this unique constitutional protection that resulted from a constitutional referendum. Most states enacted sales taxes in the 1930s as revenue raisers during the Great Depression. *See* Liz Emanuel, *When Did Your State Adopt Its Sales Tax?*, TAX FOUNDATION TAX POL'Y BLOG (July 11, 2014), http://taxfoundation.org/blog/when-did-your-state-adopt-its-sales-tax. Nevada, however, did not enact its two percent state sales tax until 1954, when the state needed to dramatically increase funding for its public schools. Supporters of the new sales tax felt so strongly about the need to protect public school funding, that they submitted the law to the people of Nevada to approve as a constitutional referendum. *See* Liz Malm, Joseph Henchman, Jared Walczak, & Scott Drenkard, *Nevada Simplifying Nevada's Taxes: A Framework for the Future*, TAX FOUNDATION 29 (2014) https://files.taxfoundation.org/legacy/docs/NV_TaxFoundation.pdf. *See also* Nev. Att'y Gen. Op. No. 56-228 (Dec. 10, 1956).

[180] Under Nevada Constitution article 19, section 1, an act passed by the legislature may be submitted to the voters for approval. If the people approve the law (by a simple majority

two percent Nevada state sales tax law[181] cannot be changed or repealed unless the people vote to approve such change or repeal.[182] This constitutional limitation functions similarly to both Missouri's Hancock Amendment (which requires a public vote for new or increased taxes) and Missouri's prohibition on expanding the sales tax base. However, Nevada's constitutional tax limitation is even broader than Missouri's limitations because it would also apply to proposed sales tax exemptions[183] and proposed sales tax rate reductions. Missouri's constitutional tax limitations would not prohibit exempting certain transactions from sales tax or reducing the sales tax rate.

A quick search shows that the Nevada sales tax rate is no longer two percent.[184] The Nevada legislature has been able to "evade" this constitutional tax limitation and increase the sales tax rate by creating three new "sales taxes": Local School Support Tax, Basic City-County Relief Tax, and Supplemental City-County Relief Tax.[185] Each of these sales tax laws was separately enacted outside of the original state sales tax statutory construct, and so is technically a separate tax.[186] However, all four of these sales taxes are essentially combined to operate as a single sales tax administratively and are applied to an identical tax base (e.g., sales of tangible personal property).[187]

While Nevada may have been able to successfully "evade" the public vote requirement to change the state sales tax rate, these new sales taxes were

vote) the law ends up being protected like a constitutional amendment. In other words, the law cannot be changed or repealed unless the people vote to approve such change or repeal. NEV. CONST. art. 19, § 2(4).

181 NEV. REV. STAT. tit. 32, §§ 372.105 to 372.180.

182 Citizens must approve the amendment with a simple majority vote. NEV. CONST. art. 19, § 2(4).

183 For example, see Question 13, asking the voters to approve an amendment to the sales and use tax to exempt orthotic appliances and ambulator casts if prescribed by a licensed healthcare provider. Dean Heller, STATE OF NEVADA BALLOT QUESTIONS 1996 (1996), https://www.leg.state.nv.us/Division/Research/VoteNV/BallotQuestions/1996.pdf.

184 NEV. REV. STAT. tit. 32, § 372.105.

185 NEV. REV. STAT. tit. 32, § 374.110 (Local School Support Tax); NEV. REV. STAT. tit. 32, § 377.040 (City-County Relief Tax). Local governments can impose an additional local sales tax on the transaction. Nev. Rev. Stat. tit. 32, § 374.110. *See also* Liz Malm, Joseph Henchman, Jared Walczak, & Scott Drenkard, *Nevada Simplifying Nevada's Taxes: A Framework for the Future*, TAX FOUNDATION (2014), https://files.taxfoundation.org/legacy/docs/NV_TaxFoundation.pdf; Charlie Kearns, Maria Todorova & Justin Stone, *Ladders out of Chaos: State Constitutional Limitations on State and Local Taxes*, J. 29 MULTISTATE TAX'N AND INCENTIVES 4 (July 2019).

186 Liz Malm, Joseph Henchman, Jared Walczak, & Scott Drenkard, *Nevada Simplifying Nevada's Taxes: A Framework for the Future*, TAX FOUNDATION, 3 (2014), https://files.taxfoundation.org/legacy/docs/NV_TaxFoundation.pdf.

187 *Id*. The administrative provisions relating to the regulation and collection of the state sales tax were originally protected by the constitutional referendum, but they were removed from such constitutional protection by a vote of the people in 1983. The effect of this vote was to grant the legislature the power to make administrative changes related to the state sales tax without having to obtain voter approval. *Id*. at 29–30.

all enacted before the Nevada constitution was amended to require a supermajority legislative vote for new taxes.[188] As a result, Nevada has struggled to pass new laws that would impose a sales tax on digital products.[189]

V. PROPOSAL

A. Existing Constitutional Limitations Impede the Taxation of the Digital Economy

There is a significant body of scholarly research on constitutional tax limitations, with a particular focus on tax increase limitation (TIL) provisions.[190] The original policy behind TIL provisions was to control government spending and reduce personal tax burdens.[191] Some scholars have performed empirical research analyzing whether the original policy holds true to this day.[192] While many scholars have critiqued TIL provisions, most scholars concede that there are some benefits to having such limitations in place.[193]

However, constitutional tax limitations are problematic when the economy changes and local governments need to find new sources of tax revenue because old sources no longer exist in the new economy. Further, local governments want to tax new sources of revenue, such as video streaming services, as evidenced by the VSP lawsuits. If TIL provisions remain in place, it is very difficult for states like Nevada and California[194] to impose a tax on

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[188] In addition, these new sales taxes were enacted before the Nevada constitution was amended to require the legislative supermajority approval for any new taxes. *Id.* at 3. Thus, a simple majority legislative vote was all that was needed to enact these new taxes.

[189] Most recently, a proposed Senate bill would have broadened Nevada's sales tax base to include digital products such as streaming services. S.B. 396, 82nd Reg. Sess. (N.V. 2023). Similar bills were proposed in 2021 and 2019. April Corbin Girnus, *State Senator Continues Push To Expand Sales Tax Base To Include Digital Products*, NEV. CURRENT (Apr. 5, 2023) https://www.nevadacurrent.com/2023/04/05/state-senator-continues-push-to-expand-sales-tax-base-to-include-digital-products/.

[190] *See* Ariel Jurow Kleiman, *Tax Limits and the Future of Local Democracy*, 133 HARV. L. REV. 1884 (2020); Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959, 966–67 (2021); David Gamage & Darien Shanske, *The Trouble with Tax Increase Limitations*, 6 ALB. GOV'T L. REV. 50 (2013).

[191] Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959, 966–67 (2021).

[192] *See* Colin H. McCubbins & Mathew D. McCubbins, *Cheating on Their Taxes: When are Tax Limitations Effective at Limiting State Taxes, Expenditures, and Budgets?*, 67 TAX. L. REV. 507 (2014).

[193] *See* Ariel Jurow Kleiman, *Tax Limits and the Future of Local Democracy*, 133 HARV. L. REV. 1884 (2020); Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959, 966–67 (2021); David Gamage & Darien Shanske, *The Trouble with Tax Increase Limitations*, 6 ALB. GOV'T L. REV. 50 (2013).

[194] To tax streaming services, Nevada would need a supermajority legislative vote, or a simple majority legislative vote along with a citizen vote. California would need a

streaming services. It is even more difficult for a state like Missouri to tax streaming services because the state has a constitutional provision that completely prohibits any new sales or similar transaction-based tax.[195]

Assuming states like California and Nevada cannot add streaming services to their state sales tax base because of the constitutional TIL provisions, there are a couple of alternative methods to taxing streaming service revenues.

First, the state legislature could amend the applicable VSP statute to include streaming service providers, such as Netflix and Hulu, in the definition of video service provider. While that would allow local governments to tax five percent of the streaming service revenue, this is not an ideal solution from a tax policy perspective. VSP statutes were not intended to act as sales tax statutes. Rather, these statutes impose a fee for a cable company's right to use the public way in laying cables that bring television to people's homes.[196] Further, despite local government support for taxing streaming services under the VSP statutes, ever since the VSP lawsuits began state legislators have proposed or enacted legislation to exclude streaming services from the VSP statutes.[197]

Another alternative under the status quo (that is, under the current constitutional limitations) is to tax streaming service revenue under an amusement tax. This alternative proposal assumes that either the legislature would amend an existing amusement tax law,[198] or the legislature would enact a new amusement tax.[199] However, any amendment or new amusement tax

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supermajority legislative vote to tax streaming services at the state level and a public vote to tax streaming services at the local level. *See supra* Part IV.B. and Part IV.C.

[195] The citizen of Missouri would have to vote to amend the constitution before the legislature could enact a law taxing streaming services. *See supra* Part IV.A.

[196] *See supra* Part III.C.

[197] Jared Walczak, *Cities Want to Tax Streaming Video Services, But They're Not Sure Why*, TAX FOUNDATION, (Mar. 1, 2023) https://taxfoundation.org/tax-streaming-services/; *see* Illinois H.B. 3808 enacted July 28, 2023 (providing that for purposes of Illinois's video service provider statute that the definition of "video service" does not include Internet streaming services); MO. REV. STAT. § 67.2680 enacted in 2021 under Missouri's VSPA (providing that no new tax shall be imposed upon the provision of streaming video service); S.B. No. 152, 102nd Gen. Assemb., Reg. Sess. (Mo. 2023) (proposing legislation that would exclude streaming service from the definition of "video service" under the VSPA); NEV. REV. STAT. § 711.141 (providing that effective July 1, 2023, the definition of "video service" specifically excludes video streaming services).

[198] *See supra* Part III.B., discussing how Chicago and Evanston amended their existing amusement tax laws to include digital entertainment such as streaming services.

[199] To the extent a local government enacts an amusement tax, this would require the local government to have the authority to enact such a statute. For a discussion on powers granted to local governments over taxing authority, *see* Erin Adele Scharff, *Powerful Cities?: Limits on Municipal Taxing Authority and What to do About Them*, 91 N.Y.U. L. REV. 292 (2016).

would likely be subject to the constitutional limitations discussed in this article.[200]

Even if an amusement tax could bypass any constitutional limitations, it would not be good tax policy to subject streaming services to such a tax.[201] Amusement taxes are levied on big events in order to financially support the additional city services needed to handle these crowds of people.[202] Streaming services do not strain city resources in the same way as large, in-person amusement events. As discussed in Part II, tax policy supports taxing streaming services under a state's sales tax law. Since this article argues that constitutional limitations make it very difficult to tax streaming services under a sales tax law, one could propose that states remove these TIL provisions from their constitutions.

B. Constitutional Tax Increase Limitations Should Not, and Politically Probably Cannot, Be Eliminated

The removal of TIL provisions from the constitutions of states such as Nevada and California would make it much easier for the state and local governments to tax streaming services. Politically, it would be a difficult task to remove these TIL provisions from state constitutions as removal would generally require a vote of the people to amend the constitution.[203] In addition, many states are attempting to make it more difficult for citizens to approve constitutional amendments by raising the voting approval threshold.[204]

States would be able to tax the digital economy if their citizens would approve the removal of TIL provisions from their states' constitutions, but that is not the only justification for eliminating these limitations. Arguably, these tax limitations should be removed if they are not having their intended effect of controlling government spending and reducing the personal tax burden. Some scholars' analyses have concluded that TIL provisions do not

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200 For example, California's TIL provision applies if a state law increases the tax burden on any taxpayer. *See supra* Part IV.B.

201 Richard C. Auxier, *Chicago's Streaming Tax is a Bad Tax But It's Not a "Netflix Tax",* TAX POL'Y CENTER (June 11, 2019), https://www.taxpolicycenter.org/taxvox/chicagos-streaming-tax-bad-tax-its-not-netflix-tax.

202 *Id.*

203 For example, Nevada citizens would have to approve the amendment with a majority vote. NEV. CONST. art. 19, § 2(4).

204 States are attempting to pass resolutions that would raise the threshold to pass constitutional amendments from a simple majority vote to a supermajority vote. For example, in 2023 the Missouri House passed a resolution raising the threshold to pass constitutional amendments to a sixty percent citizen vote. These efforts are coming after the people of Missouri passed a constitutional amendment legalizing marijuana with a fifty-three percent vote. Caroline Sullivan, *Missouri House Passes Bill Making It Harder for Voters To Amend State Constitution*, DEMOCRACY DOCKET (Mary 15, 2023) https://www.democracydocket.com/news-alerts/missouri-house-passes-bill-making-it-harder-for-voters-to-amend-state-constitution/.

change the behavior of the state legislature, nor do they decrease government spending or reduce government debt.[205] Other scholars have argued that there are ways for a state legislature to evade these TIL provisions when the legislature wants to increase its spending.[206]

On the one hand, if these limitations are not actually controlling government spending or reducing taxes, as the original policy intended, perhaps the limitations should be eliminated in their entirety. On the other, a TIL provision may have a modern-day purpose that was not contemplated when these limitations were first enacted: advertising a state's low tax business environment.[207] States often compete with one another when it comes to attracting new business to the state. One scholar has argued that a properly designed supermajority requirement in a tax increase limitation provision can achieve a "strong low tax signaling function."[208] Such low tax signaling could help incentivize businesses to relocate to a particular state.[209]

Because states could use TIL provisions to attract new businesses, and practically, it would be very difficult to eliminate TIL provisions from a state's constitution, TIL provisions should not be removed entirely from state constitutions.

C. Proposal: No Constitutional Tax Limitations on Sales or Similar Transaction-Based Taxes

This article makes a two-part proposal with respect to constitutional tax limitations that would enable state and local governments to tax streaming services and the broader digital economy.

First, this article proposes that state constitutions should not include provisions, such as Missouri's article 10 10, section 26, that would prohibit expanding the tax base of either an existing sales or similar transaction-based tax or enacting a new sales or similar transaction-based tax.

Second, this article proposes that tax increase limitation provisions, whether they require a super majority vote by the state legislature or a vote of the people, exclude sales and use taxes as well as similar transaction-based

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[205] Colin H. McCubbins & Mathew D. McCubbins, *Cheating on Their Taxes: When are Tax Limitations Effective at Limiting State Taxes, Expenditures, and Budgets?*, 67 TAX. L. REV. 507, 542 (2014).

[206] David Gamage & Darien Shanske, *On Tax Increase Limitations: Part II – Evasion and Transcendence*, STATE TAX NOTES, Apr. 23, 2012.

[207] Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959, 967 (2021).

[208] *Id.* at 959.

[209] *Id.* at 1007–12.

taxes. As discussed in Part IV above, Missouri,[210] California,[211] and Nevada[212] all have variations of TIL provisions in their respective constitutions. By excluding sales and use taxes and similar transaction-based taxes from these TIL provisions as suggested by this proposal, these TIL provisions would not apply to new taxes on streaming services. Thus, a state could add streaming services to an existing sales tax base with a simple majority vote of the state legislature. Alternatively, if a local government otherwise has the authority to enact its own sales or similar transaction-based tax, it could follow its own legislative procedures to enact such a tax on streaming services.

D. Evaluating the Proposal

As discussed above, the proposal to eliminate constitutional limitations on sales and similar transaction-based taxes would allow states to more easily tax revenues from streaming services; however, the implications of this proposal extend far beyond taxing streaming service providers. This article argues that there are other policy reasons supporting the proposal. Scholars have brought forth versions of these policy considerations in other articles. This article adds to the literature by evaluating these policy considerations as they relate to constitutional tax limitations on sales taxes and the digital economy.

1. Adapt to New Technologies and Tax the Digital Economy

States need the flexibility to adapt to new technologies and tax the digital economy. The proposal to eliminate constitutional limitations on sales and similar transaction-based taxes would allow a state to impose taxes on new sources of revenues from the digital economy. This would include streaming services, but also other digital products such as books, music, and software, which if purchased in tangible form would likely be subject to sales tax in most states.

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210 Missouri's Hancock Amendment requires a majority public vote to enact a new tax. MO. CONST. art. 10, § 22.

211 California's constitution requires a supermajority legislative vote for state taxes, a majority public vote for general local taxes and a two-thirds public for special local taxes. CAL. CONST. art. 13A, § 3(a); CAL. CONST. art. 13C, § 2; CAL. CONST. art. 13A, § 4.

212 Nevada's TIL provision requires a two-thirds vote of the Nevada legislature to increase an existing tax or implement a new tax. NEV. CONST. art. 4, § 18(2). The constitutional provision also provides that if the legislature is not able to obtain a two-thirds vote to approve such tax, that by a simple majority vote of both houses of the legislature, the legislature could refer such proposal to the people of Nevada who would need to approve the tax with a majority vote. NEV. CONST art. 4, § 18(3).

The proposal would also allow states to respond to changes in technology and possibly tax digital businesses such as Google, Meta, and Amazon through a digital services tax.[213]

2. Increasing the Sales Tax Base Can Lessen the Regressivity of Sales Tax

As discussed in Part II, sales tax is a regressive tax meaning that people with lower incomes generally spend more of their incomes on items subject to sales tax. The proposal would allow states to increase their sales tax base by adding streaming service revenues, as well as revenues from other services and digital products, neither of which were included in states' original sales tax statutes.

When a state increases the sales tax base, it may also be able to lower the sales tax rate and keep the same amount of tax revenue.[214] Lowering the sales tax rate and expanding the sales tax base to include services and digital products could help shift the sales tax burden to those who can better afford to pay the sales tax. Services and digital products can be viewed as discretionary consumption spending, as compared with spending on necessities like groceries, menstrual products, and family products including diapers and wipes. Lowering the sales tax rate on necessities, or even providing a sales tax exemption for necessities, can help reduce the regressive nature of sales tax. Further, a state can financially afford to exempt necessities from sales tax when it expands the tax base to include discretionary spending on services and digital products.

3. Signal a Favorable Business Environment

Increasing the sales tax base could also allow a state to keep other tax rates low. For example, a state that increases its sales tax revenues by expanding the tax base could afford to keep its income tax rates low. A low income tax rate can signal a favorable business environment which could help attract new business to the state and grow the economy.[215]

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213 *See* Young Ran (Christine) Kim & David Shanske, *State Digital Services Taxes: A Good and Permissible Idea (Despite What You Might Have Heard)*, 98 NOTRE DAME L. REV. 741 (2022); Andrew Appleby, *Subnational Digital Services Taxation*, 81 MD. L. REV. 1 (2022); Orly Mazur & Adam Thimmesch, *Closing the Digital Divide in State Taxation: A Consumption Tax Agenda*, 98 TAX NOTES STATE 961 (2020); Young Ran (Christine) Kim, *Taxing the Metaverse*, 112 GEO. L. J. 1 (2024, forthcoming).

214 For example, a five percent sales tax rate imposed on $10,000,000 of sales would result in $500,000 of tax revenue. If the sales tax base was expanded so that it captured $100,000,000 of sales, a state could lower the sales tax rate to .5 percent and maintain its $500,000 tax revenue stream. Alternatively, a state could lower the sales tax rate to one percent and increase its tax revenue stream to $1,000,000.

215 *See* Appleby, *supra* note 207, at 959.

Further, while a typical TIL provision may perform a low-tax environment signaling function, scholars have argued that TIL provisions should exclude transaction taxes.[216] Individuals are generally less concerned with transaction taxes as they are with income and property taxes, and thus a limit on transaction taxes is not likely to signal a favorable business environment.[217] Accordingly, neither a prohibition on any new sales or similar-transaction based taxes nor a TIL provision that applies to such taxes is likely to encourage new business investment and stimulate the economy.

As discussed in Part V.B above, it may be difficult politically to pass a proposal removing the constitutional limitations on sales taxes. Such a proposal may be more palatable to the voters if it is combined with a proposal to lower or limit income tax rates.[218]

4. Local Government Authority to Increase Sales Tax Base May Result in Less Fines and Fees

As discussed above, one policy reason for eliminating TIL provisions is that governments can find ways to circumvent these limits. Scholars have argued that local municipalities have circumvented constitutional taxing limitations by raising revenue through fines and fees on misdemeanors, such as traffic violations.[219] This use of police power to raise revenue is especially prevalent in nonaffluent municipalities that struggle to raise revenue from property and sales taxes due to lower property values and the relocation of large retail establishments to more affluent municipalities.[220]

This proposal would give local municipalities more authority to use their taxing power, as opposed to police power, to raise revenue through

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216 *Id.* at 959.

217 *Id.* at 1010.

218 The Missouri Senate recently passed a joint resolution that combined two such proposals. The resolution would have submitted to the people of Missouri two constitution amendments. First, there was an amendment limiting the state income tax rate to no more than 5.5 percent. Second, there was an amendment to the constitutional prohibition on expanding the sales tax base that would have excepted from such prohibition "subscriptions, licenses for digital products, and online purchases of tangible personal property." This resolution passed in the Missouri Senate, but was not approved by the Missouri House before the end of the 2023 legislative session. S.J. Res. 3 (Mo. 2023).

219 Henry Ordower, J.S. Onésimo Sandoval, & Kenneth Warren, *Out of Ferguson: Misdemeanors, Municipal Courts, Tax Distribution, and Constitutional Limitations*, 61 HOW. L. J. 113, 117 (2017). *See also* Ariel Jurow Kleiman, *Tax Limits and the Future of Local Democracy*, 133 HARV. L. REV. 1884, n.66 (2020) (referencing studies that find tax limits increase reliance on user fees).

220 When property values decrease, property tax revenues generally decrease as well, unless the property tax rate is increased. In addition, retail stores have an incentive to be located close to affluent communities to increase sales revenue. A municipality generally loses out on sales tax revenue when retail stores move out of the municipality's jurisdiction into another municipality. *See* Ordower, Sandoval, & Warren, *supra* note 219, at 117, 129.

expanding the sales tax base or increasing the sales tax rate. While sales taxes are regressive taxes that have a greater impact on low-income communities, as discussed above, local governments can curb the regressive nature by exempting necessities from sales tax or by taxing them at a lower rate.

5. More Local Control to Better Adapt to Economic Changes and Respond to Emergencies

There is a need to quickly amend tax laws to capture lost tax revenue when the economy undergoes significant changes. Some economic changes occur over several years, such as the evolution from renting movies in a VHS format to streaming movies over the Internet.[221] Other economic changes might occur over a matter of months or weeks, such as the shutdown of restaurants and retail shopping due to the COVID-19 pandemic. In both of these situations revenue streams that were subject to sales tax dropped significantly and so did the local tax revenues.[222]

State and local governments need the flexibility to adapt their sales tax laws when there are changes in the economy. Further, this flexibility would allow state and local governments to propose tax reform to respond to emergencies such as the COVID-19 pandemic and to do so without the costs of electoral approval.[223] The costs of electoral approval can be a significant impediment when the projected increase in tax revenues are not much more than the costs of electoral approval.[224] Yet, with a relatively small budget, the increased tax revenues can let a local government continue to provide services to those most in need during such a community emergency.[225]

VI. CONCLUSION

Constitutional tax limitations are an impediment to states taxing streaming services and the broader digital economy. This article argues that local governments in states with constitutional tax limitations have sued Netflix

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[221] *See, e.g.*, *supra* note 33 for a discussion of Netflix's decline in DVD rental revenue and an increase in streaming services revenue.

[222] Lucy Dadayn, *The COVID-19 Effect: State Sales Tax Receipts Shrank $6 Billion in May*, TAX POL'Y CTR. (July 14, 2020), https://www.taxpolicycenter.org/taxvox/covid-19-effect-state-sales-tax-receipts-shrank-6-billion-may.

[223] *See* David Gamage, Darien Shanske, Gladriel Shobe, & Adam Thimmesch, *Weathering State and Local Budget Storms: Fiscal Federalism with an Uncooperative Congress*, 55 U. MICH. J. L. REFORM 309, 343, 349–50 (2022).

[224] Ariel Jurow Kleiman, *Tax Limits and the Future of Local Democracy*, 133 HARV. L. REV. 1884, 1938 (2020).

[225] Gladriel Shobe, Grace Stephenson Nielsen, Darien Shanske, & David Gamage, *Why States Should Consider Expanding Sales Taxes to Services, Part I*, 98 TAX NOTES STATE 1349, 1350–51 (2020), https://www.taxnotes.com/tax-notes-state/budgets/why-states-should-consider-expanding-sales-taxes-services-part-1/2020/12/21/2d9dx.

and Hulu under video service provider statutes instead of enacting a sales tax on streaming services because the constitutional tax limitations prevented the state or local government from expanding the sales tax base to include streaming services.

As discussed in Part II, tax policy supports taxing streaming services under a state's sales tax law even if there challenges to implementing such tax. When the economy changes and local governments need to find new sources of tax revenue because old sources no longer exist in the new economy, state and local governments need the flexibility to impose taxes on new sources of revenue. Constitutional tax limitations are problematic in this regard. On the other hand, constitutional tax limitations can help control government spending or attract new businesses to a low tax environment.

Because there are benefits to constitutional tax limitations and practically it would be very difficult to eliminate tax limitation provisions in their entirety from a state's constitution, this article proposes that constitutional tax limitations should not apply to sales or similar transaction-based taxes. While the proposal would allow states to more easily tax revenues from streaming services, the implications of this proposal extend far beyond taxing streaming service providers.

The proposal would allow states to respond to changes in technology and possibly tax digital businesses such as Google, Meta, and Amazon through a digital services tax. Further, by increasing the sales tax base to include revenues from the digital economy, states would be able to lessen the regressivity of sales tax by lowering the sales tax rate or excluding necessities from the sales tax base. In addition, the proposal would give local municipalities more authority to use their taxing power, as opposed to police power, to raise revenue through expanding the sales tax base or increasing the sales tax rate. These broader policy considerations support the proposal that constitutional tax limitations should not apply to sales or similar transaction-based taxes.

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