

# HOUSE BILL REPORT

## SHB 2620

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### As Passed Legislature

**Title:** An act relating to excise taxation of certain products and services provided or furnished electronically.

**Brief Description:** Concerning excise taxation of certain products and services provided or furnished electronically.

**Sponsors:** House Committee on Finance (originally sponsored by Representatives Hunter and Moeller; by request of Department of Revenue).

**Brief History:**

**Committee Activity:**

Finance: 1/22/10, 1/28/10, 1/29/10 [DPS].

**Floor Activity:**

Passed House: 2/11/10, 96-0.

Passed Senate: 3/4/10, 47-0.

Passed Legislature.

**Brief Summary of Substitute Bill**

- Clarifies ambiguities and corrects unintended consequences with respect to the digital products tax legislation adopted in 2009.

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Hunter, Chair; Hasegawa, Vice Chair; Orcutt, Ranking Minority Member; Parker, Assistant Ranking Minority Member; Condotta, Conway, Ericks, Santos and Springer.

**Staff:** Jeffrey Mitchell (786-7139).

**Background:**

Retail sales and use taxes are imposed by the state, most cities, and all counties. Retail sales taxes are imposed on retail sales of most articles of tangible personal property and digital

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products and some services. Generally, a retail sale is the sale of property, products, or services to the final consumer or end user. Sales for resale or for incorporation into other property, goods, or services to be sold are not considered retail sales.

If retail sales taxes were not collected when the property, services, or digital products were acquired by the user and retail sales taxes would have otherwise applied, then use taxes apply to the value of most tangible personal property and digital products and some services used in this state. Use tax rates are the same as retail sales tax rates. The state sales and use tax rate is 6.5 percent. Local sales and use tax rates vary from 0.5 percent to 3.0 percent, depending on the location. The average local tax rate is 2.0 percent, for an average combined state and local tax rate of 8.5 percent.

In 2009 the Legislature adopted comprehensive legislation addressing the sales and use taxation and business and occupation (B&O) taxation of digital products, ranging from downloaded music to streamed video. Engrossed Substitute House Bill 2075 (ESHB 2075) clarifies how taxes apply to products that exist only as computer bits and bytes. Specifically, the bill defines digital products as digital goods and digital automated services transferred electronically, extends sales and use taxes to most resale purchases of these products, provides certain exemptions for businesses and end users, requires sellers of digital products to electronically file their tax returns, and provides amnesty to those who did not collect or pay sales or use tax on digital products that were taxed before July 26, 2009 (the effective date of the ESHB 2075). "Digital automated services" (DAS) are services transferred electronically that use one or more software applications. Examples include: search engine services, online gaming subscription services allowing game playing with other remote players, and online digital photography editing services. Services that are primarily the result of human effort performed in response to a customer request are not considered DAS.

Prior to the adoption of ESHB 2075, the Department of Revenue (DOR) considered downloaded digital goods (books, movies, music, etc.) as tangible personal property that were subject to sales or use tax. Furthermore, at the time ESHB 2075 was adopted, prewritten computer software was already included within the definition of tangible personal property and therefore subject to sales and use tax. The ESHB 2075 applies sales or use tax to all digital products and prewritten computer software, regardless of how the digital products or software are accessed (downloaded, streamed, remotely accessed, etc.).

Digital products that are subject to sales or use tax include: downloaded digital goods (books, music, movies, etc.), streamed digital products, and remotely accessed digital products.

Because ESHB 2075 is complicated legislation, the DOR decided to implement ESHB 2075 in a phased process allowing the DOR to obtain substantial stakeholder input as it developed rules to implement the bill. Through this process, a number of ambiguities and unintended consequences have been discovered.

### **Summary of Substitute Bill:**

The overriding purpose of the bill is to clarify ambiguities and correct unintended consequences related to the passage of ESHB 2075. This is done in a number of ways.

The definition of retail sale is clarified to specifically include remotely accessing prewritten computer software to perform data processing. "Data processing" includes check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities.

A person is not considered a final consumer, and therefore not subject to sales or use tax, if the person purchases a digital product, code, or prewritten computer software for the purpose of incorporating the product, code, or software into a new product, code, or software for sale. This would have no impact for sales and use taxes because an exemption already exists for this type of transaction; however, sales now subject to the B&O wholesaling rate would be subject to the retailing rate.

The definition of DAS is modified to specifically exclude: live presentations, digital goods, the storage of digital products and software, and data processing services. (Data processing services are distinct from accessing prewritten computer software to perform data processing, described earlier.)

Photographs sent electronically by a photographer to the end user are specifically included within the definition of digital good.

Royalty B&O tax is clarified to include licensing of digital products to persons who are not the end users of the products.

Clarification is made that the provision of subscription television services and subscription radio services are subject to the general service B&O tax rate.

For purposes of municipal B&O taxes, the sale of digital products is deemed to occur at the location where delivery occurs. (Rules similar to the destination based sourcing rules for sales taxes are used to help make this determination.)

To simplify administration, the sales and use tax exemption for standard digital information is broadened to include all digital goods used for business purposes.

The nexus safe harbor provision in ESHB 2075 is clarified to include computer software. Therefore, the storage of computer software on servers located in Washington would not establish nexus for the purpose requiring a business to pay state taxes.

The amnesty provision in ESHB 2075 is amended by providing amnesty for sales taxable labor and services rendered with respect to installing, repairing, altering, or improving of digital goods prior to the effective date of ESHB 2075 (June 26, 2009), and requiring taxpayers seeking a refund or credit for overpaid B&O taxes to have first paid all sales tax.

Most provisions of the bill apply retroactively as well as prospectively.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect on July 1, 2010.

**Staff Summary of Public Testimony:**

(In support) This bill is a follow up to last session's digital goods House Bill 2075. House Bill 2075 provided the framework for taxing the digital economy; however, a substantial number of issues arose from it. The DOR during the interim brought together stakeholders to address these issues. This bill clarifies a number of those issues, such as what counts as a taxable digital good. This bill will simplify administration, and it is important for the digital economy and the state tax system. This bill corrects a previous definition of data processing that will help out small businesses. The retroactivity of the bill is also important, so that businesses, acting on previous advice of the DOR, are protected.

(In support with concerns) This bill will clear up some confusion around advertising and data processing services. However, we have some suggested language to add to the definition of data processing. We would also like to see digital images treated as digital goods. Washington is the center of the digital image industry.

(Opposed) None.

**Persons Testifying:** (In support) Drew Shirk, Department of Revenue; Brad Tower, Community Bankers of Washington; Steve Lindstrom, Northwest Career Colleges Federation; and Amber Carter, Association of Washington Business.

(In support with concerns) Lew McMurrin, Washington Technology Industry Association.

**Persons Signed In To Testify But Not Testifying:** None.