

# HOUSE BILL REPORT

## ESHB 2075

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### As Passed House:

April 13, 2009

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

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

**Sponsors:** House Committee on Finance (originally sponsored by Representative Hunter).

### Brief History:

#### Committee Activity:

Finance: 2/19/09, 3/2/09 [DPS].

#### Floor Activity

Passed House: 4/13/09, 52-46.

### Brief Summary of Engrossed Substitute Bill

- Conforms the sales and use taxation of downloaded digital goods to the streamlined sales and use tax agreement.
- Imposes sales and use taxes on certain streamed or remotely accessed digital services, goods, and prewritten computer software.
- Provides certain exemptions for electronically transferred digital goods and digital services.
- Applies the traditional retailing and wholesaling business and occupation tax rates to electronically transferred digital goods and digital services.
- Prohibits the state from extending its taxing authority to a business by considering a business's use of Washington based servers to store digital goods.
- Makes a number of technical amendments.

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## HOUSE COMMITTEE ON FINANCE

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 6 members: Representatives Hunter, Chair; Hasegawa, Vice Chair; Conway, Ericks, Santos and Springer.

**Minority Report:** Do not pass. Signed by 3 members: Representatives Orcutt, Ranking Minority Member; Parker, Assistant Ranking Minority Member; Condotta.

**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 (TPP) and some services. If retail sales taxes were not collected when the property or services were acquired by the user, then use taxes are applied to the value of most TPP and some services when used in this state. Use tax rates are the same as retail sales tax rates. Prewritten computer software is included within the definition of TPP and is therefore subject to sales or use tax, but downloaded products such as digital music, movies, and books, are not specifically included within the definition of TPP. Currently, the Department of Revenue (DOR) treats downloaded music, videos, and books as TPP, subjecting these products to retail sales and use taxes. However, if these same products are streamed to the customer, then sales and use taxes do not apply because the customer is not considered to have taken possession of the product.

In 2007 the Washington Legislature directed the DOR to "conduct a study of the taxation of electronically delivered products" and to prepare a final report for the Legislature by September 1, 2008. The legislation required the DOR to conduct the study in consultation with a committee consisting of four legislative members, as well as additional members representing the industry and government. The committee consisted of 16 members in total. In December 2008 the DOR completed its study. The final report included a discussion of a number of issues related to the taxation of digital products, including compliance with the streamlined sales and use tax agreement (SSUTA), sourcing, bundled digital products, and methods of obtaining digital products. The report's conclusion stated that legislation implementing tax policy on digital products is necessary in 2009 to: (1) protect the sales and use tax base; (2) establish certainty in the tax code; (3) maintain conformity with the SSUTA; and (4) encourage economic development. Because of the differing views on certain fundamental issues surrounding the taxation of digital products, the committee was not able to reach consensus on a specific tax policy proposal. However, the committee did agree that legislation adopting a broad, general imposition approach for digital products would be possible only if the legislation: (1) contains meaningful and easily administered broad-based exemptions for business inputs; (2) provides sales and use tax amnesty to taxpayers who failed to collect tax on digital products for prior periods; (3) maintains conformity with the SSUTA; and (4) protects and promotes the location of server farms and data centers in Washington.

On September 20, 2007, the SSUTA was amended to define three specified digital goods (digital audio-visual, digital audio, and digital books) as not being TPP. To remain compliant with the SSUTA, Washington has to enact a separate provision by January 1,

2010, to continue imposing sales and use tax on these three products. As of January 1, 2012, a separate tax imposition provision will be required to impose sales and use tax on all other electronically delivered products.

"Substantial nexus" is the connection required to exist between a state and a potential taxpayer, such that the state has the constitutional right to impose tax obligations on the taxpayer.

Prewritten computer software is subject to sales and use tax if it is sold in tangible form or downloaded. It is included within the definition of TPP.

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

#### Definitions.

**Digital Good:** A digital good is a product that includes sounds, images, data, or facts, which is transferred electronically. Digital good includes electronically delivered music, books, and movies.

**Digital Automated Service (DAS):** A DAS is an electronically delivered service that uses one or more software applications. Examples of DAS include credit reports, online games, and searchable databases. A DAS does not include: the loaning or transferring of money or financial instruments, dispensing cash or other physical items from a machine, payment processing services, telecommunications services, providing Internet access, providing access to prewritten computer software, providing online educational programs including those by private accredited schools, online travel agent services, online auctions, and online classified advertising services.

**Digital Code:** A digital code is an enabling or activation code that gives a purchaser access to a digital good or a DAS. As an example, a soft drink company, as part of a promotion, may purchase digital codes from a music distributor. The soft drink company then gives away the codes to customers who purchase its soft drink products. Those customers use the code to download songs from the music distributor's website.

**Digital Product:** A digital product is a digital good or a DAS.

**End User:** An end user is a person who acquires a digital product or digital code without the right to broadcast, rebroadcast, license, or otherwise distribute the product or code.

#### Imposition of Sales and Use Taxes.

Sales and use taxes are separately imposed on the sale of digital goods to end users.

Sales and use taxes are imposed on the sale of DAS to end users.

Sales and use taxes are imposed on the sale of digital codes to end users. A digital code is taxed the same way as the underlying digital good or DAS to which the code gives the purchaser access.

Sales and use taxes are extended to prewritten computer software accessed remotely.

No distinction is made for sales and use tax purposes between digital codes, goods, or automated services that are downloaded, streamed, or accessed remotely.

Exemptions.

Digital products purchased for resale, and digital products incorporated as an ingredient or component of another product for resale, are exempt from sales and use tax.

Digital products provided free of charge are also exempt.

Sales of radio and television broadcast programming by a radio or television broadcaster are exempted from sales and use tax. This exemption includes broadcasts on a pay-per-program basis if the sale of the programming is subject to a franchise fee.

An exemption is provided for standard digital information purchased solely for business purposes. "Standard digital information" means a digital good consisting primarily of data, facts, or information that is not generated for a specific client or customer.

A partial exemption is provided for businesses that use digital products or prewritten computer software concurrently within and outside Washington. Tax is apportioned based on the number of users within Washington as a percentage of all users of the digital product or software.

A sales and use tax exemption is provided for newspapers transferred electronically as long as the electronic newspaper shares content and the same name as the printed newspaper.

Business and Occupation Taxes.

The standard business and occupation tax rates for wholesale and retail sales (0.484 percent and 0.471 percent) are explicitly imposed on wholesale and retail sales of digital goods, digital automated services, digital codes, and electronically delivered software.

Server Farms and Substantial Nexus.

The DOR is prohibited from considering a business's ownership or rights in digital goods or codes residing on a server located in Washington in determining whether the business has substantial nexus with the state.

Amnesty.

A person may not be held liable for the failure to collect or pay state and local sales and use taxes accrued before the effective date of this act on the sale or use of digital goods.

Technical Changes.

A number of conforming and technical amendments are made.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) None.

(Neutral) This bill meets the requirements of the streamlined sales and use tax agreement. This bill will treat electronically delivered goods consistently. The bill addresses the changing economy by modernizing the tax code to reflect 21st century business practices. This is a big, complicated bill, and also an important one.

(With concerns) The issues relate to clarity, conformity with the streamlined agreement, and certainty in the tax code. If done properly, this bill can promote economic development. The bill does not necessarily reflect the best way to achieve streamlined conformity. A clear statement of intent is needed. Some provisions need clarity such as those pertaining to data centers and apportionment. The business community favored a narrow approach to taxing digital goods. The bill does contain many of the components the business community is looking for. However, because of the broad nature of the bill there are many services that would fall within the provisions of the bill, but would not be taxable outside the digital environment, such as online auctions and travel agent services. Amnesty is a big concern for businesses. A fairly broad level of amnesty is needed. Conformity with the streamlined agreement can be achieved by not taxing digital goods. There is a concern that this bill does not use the streamlined definitions for music, books, and movies, and that digital goods simply stored on servers in Washington could be subject to taxation. There is also an issue with respect to apportionment. The sourcing of digital goods should parallel tangible personal property. There could be some hardship for businesses that have not had to collect tax on these sorts of transactions. There could be a negative impact on economic growth in the state in the high technology industry. Online education is an area of change. There is a date that should be removed in the education exclusion portion of the bill. The bill language does not provide an exemption for all accredited higher education institutions or institutions licensed by the workforce training board.

(Opposed) None.

**Persons Testifying:** (Neutral) Drew Shirk, Department of Revenue.

(With concerns) Amber Carter, Association of Washington Business; Ron Bueings, Deloitte; Lew McMurrin, Washington Technology Industry Association; Tom McBride, Tech America; Carolyn Logue, K-12; Gena Wikstrom, Northwest Career College Federation; and Jean Janes, Kaplan Higher Education Corporation.

**Persons Signed In To Testify But Not Testifying:** (Neutral) Dylan Waits, Department of Revenue.