

# FINAL BILL REPORT

## ESHB 2075

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**C 535 L 09**  
Synopsis as Enacted

**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).

**House Committee on Finance**  
**Senate Committee on Ways & Means**

### **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. Downloaded 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. 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 legislation 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

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issues surrounding the taxation of digital products, the committee was not able to reach consensus on a specific tax policy proposal. However, the committee agreed 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) provided sales and use tax amnesty to taxpayers who failed to collect tax on digital products for prior periods; (3) maintained conformity with the SSUTA; and (4) protected and promoted 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.

#### **Summary:**

##### 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 a 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.

**Votes on Final Passage:**

House	52	46
Senate	28	20

**Effective:** July 26, 2009