

Digital Products

Presented by:

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Agenda

- Background SSUTA
- Other States & Federal
- Background Washington Digital Product Law
- Washington States' broad administration/taxation of digital products
- Washington State digital products rulemaking
- Tax Department Considerations
- Digital Products Case Studies

Streamlined Sales and Use Tax Agreement (SSUTA) Background

- The “Streamline” process started in 2000 as an effort to simplify and modernize the country’s sales/use tax system
- Simplification & Uniformity
 - Simplification is achieved by creating simpler forms, administration exemptions, and a simple rate structure
 - Uniformity is achieved by similar definitions, tax bases, and rate structure
- Digital Equivalent: Early efforts to tax certain digital items as part of the SSUTA focused on attempting to define the “digital equivalent” of tangible personal property
- Digital Products: This evolved into the taxation of digital products
- Digital Services: This should be distinguished from taxation of automated services

Streamlined Sales and Use Tax Agreement (SSUTA)

Conforming Legislation at State Level

- Preserve authority of states to tax online transactions
- Neutrality between “brick and mortar” and online business
- Effort to minimize differences between state sales tax policies (collection and administration)
- Broad variance in how states tax digital products
 - 24 member states
 - 19 Non-conforming advisory states
 - 2 Project states
 - 1 Not participating
 - 5 states with no sales tax
- Does not dictate taxability of good or service
- Requires states to adhere to definitional provisions only

Digital Products Overview

➤ **What is a digital product?**

- TPP, data processing, information services, cloud computing, telecommunications, or software?

➤ **Definition varies**

- States define digital products differently, but many analogize to TPP as basis for tax
- Others define digital products as a taxable service

➤ **True Object Test**

- Some states use a “true object” or “facts and circumstances” or “bundled transaction test” test to characterize transactions

➤ **Sourcing**

- User location, server location, order location, billing address

Digital Products

States Rely on General Tax Statutes

- **Texas** (TX Tax Code § 151.010)
 - ❑ "Taxable item" means tangible personal property and taxable services (i.e., ***data processing, information services***)
 - ❑ Sale or use of a taxable item in electronic form instead of on physical media does not alter the item's tax status

- **New York** (TSB-A-10(60)S, New York Commissioner of Taxation and Finance (11-24-10))
 - ❑ Accessing software on provider's server to classify and organize legal documents constitutes a "right to use" or license of TPP
 - ❑ Not an exempt "service" activity (Tax Law §1105(a))

Digital Products

States Enact Specific Digital Products Legislation

- **New Jersey** (N.J.S.A. 54:32B-8.56)
 - ❑ "**Digital property**" means electronically delivered music, ringtones, movies, books, audio and video works and similar products, where the customer is granted a right or license to use, retain or make a copy of such item
 - ❑ Digital property does not include video programming services, including video on demand television services, and broadcasting services, including content to provide such services
- **Washington** (ESHB 2075 (2009); SHB 2620 (2010); WAC-458-20-15503 (Pending))
 - ❑ Digital Products and Digital Codes are retail sales
 - ❑ Washington is at forefront of taxing digital services (DAS)

Digital Goods and Services Tax Fairness Act of 2011

Federal Legislation (H.R. 1860/S. 971)

- Seeks to establish a national framework for state & local taxation of digital goods and services (apps, cloud services, etc.)
- “To promote neutrality, simplicity, and fairness in the taxation of digital goods and digital services”
- Establish a uniform, nationwide rule governing which state and locality may tax the sale of a digital good or service when the transaction crosses state borders
- “Sourcing rules” specifying which jurisdiction(s) can tax the interstate sale of a digital good or service
- Pre-empts state and local taxation of certain digital goods and services
- State and local taxing jurisdictions express concerns and oppose legislation in current form

Washington Digital Products Law Background

- Legislation first passed in 2009 (ESHB 2075) Sought to tax “Digital Products” – Effective **July 26, 2009**
 - ❑ Similar Other States: Washington sought to tax Digital Goods like many other states
 - ❑ Unique: Washington went further by taxing **Digital Automated Services** (“DAS”)
- Clarifying: Legislature passed clarifying legislation in 2010 (SHB 2620)
 - ❑ Clarification: Remote access of prewritten software is retail sale
 - ❑ Clarification: DAS changed exclude live presentations, digital goods, storage of digital products and data processing services
 - ❑ Clarification: Nexus safe harbor provides that storage of computer software on servers in Washington does not create nexus
 - ❑ Clarification: Exemption for standard digital information broadened to include all digital goods for business purpose

Washington Digital Products

Digital Automated Service (DAS)

- ❑ A **DAS** is defined as any service transferred electronically that uses one or more software applications. (RCW 82.04.192(3)(a))
- ❑ A **DG** is defined, in part, as sounds, images, data, facts, or information, or any combination thereof transferred electronically. (RCW 82.04.192(6)(a))
- ❑ **OSD Special Notice (Nov. 2, 2010)**
 - ❑ Online Searchable Database (OSD), such as online legal research services, are DAS because they are transferred electronically and use one or more software applications. While these services provide “data, facts, or information” similar to a DG, they also provide additional functions, such as search, retrieve, and storage capabilities (software applications).”
 - ❑ 2009 – OSD is DG (standard information) and exempt from sales tax
 - ❑ 2010 – New law “broadened” exemption for digital good used for business
 - ❑ 2010 – DOR “**has determined**” that OSD is now DAS and subject to sales tax
 - ❑ 2012 – Draft Rule 15503 maintains broad DAS category

Washington Digital Products Exemptions & Exclusions

➤ **Digital Good**

- Solely for Business Purpose (*does not apply to DAS*)
- MPU – concurrently available

➤ **Digital Automated Service**

- Primarily human effort >50%
- Payment processing
- Advertising
- Online education
- Live presentations
- Online marketplace
- Data processing
- Hosting, storage, back-up

Digital Products Sourcing

- Sales of digital products are sourced under the same hierarchical rules that apply to other retail sales, as provided in RCW 82.32.730.
 1. Business location of seller (i.e. downloads music at the store)
 2. Place of receipt (first use, access, or possession)
 3. Buyer address in records (“reasonably estimates receipt location”)
 4. Buyer address obtained during sale (e.g. credit card address, I.P. address)
 5. Origin of seller

- **Proper documentation (P.O., Invoice, I.T. data, etc.) is critical to audit support**

Washington Digital Products

WAC 458-20-15503 (Rule 15503 – Pending Adoption)

➤ Digital goods, digital automated services, digital codes, remote accessed software (i.e., SaaS or “cloud”) are retail sales

- ❑ Effective July 26, 2009 - Limited amnesty/phased

- ❑ Changes in 2010 session – retroactive and prospective

- ❑ Digital goods, DAS defined (RCW 82.04.192)

- ❑ Exemption for concurrent use (RCW 82.08.02088)

- ❑ Use tax applies to amount used in WA

 - *Exemption also applies to pre-written software*

- ❑ Digital goods used for business purpose are not taxable

- ❑ Supersedes the standard information exemption allowed in 2009 (RCW 82.08.02087)

Digital Products Dilemma

Tax Department Considerations

- Suspension of un-named taxpayer rulings
- How do taxpayers receive clear guidance/instructions
- FAS 5 (ASC 450) contingent liabilities
- No adoption of Rule since July 2009
- Is DAS broader than intended by the Legislature (OSD)
- Setting policy through examples (41 examples in 15503)
- What if my business situation is not covered by example
- “True object” depends on who you ask
- Disparate treatment during audit and among auditors, examiners, discovery agents
- “...if you disagree, you have the right to appeal this...”
- **Planning and documenting is essential**

Digital Products Dilemma

Application of Digital Products

➤ **Digital Good**

- Many examples of digital goods (*iTunes*)
- No change in taxation - Same Past Treatment
- Taxed as tangible personal property

➤ **Digital Automated Service**

- Many examples of digital automated services (*Web Platform*)
- Change in taxation - Change Past Treatment
- Separate Stating v. True Object
- Documentation: Contract v. Invoice
- Expanding Category

Digital Products Dilemma

Application of Digital Products

➤ **Case Study 1**

- Seattle, Washington company providing SaaS, PaaS
- Separately charge installation and/or professional services
- Customers in WA and outside WA
- Reporting under service classification State/City Seattle

➤ **Considerations**

- Is this DAS? Is it entirely DAS or should prof. serv./install serv.?
- Is WA state/local sales tax due/collected?
- Is there an applicable exemption?
- Do you have documentation (Contract , invoice, etc.)?
- Do you have nexus in other states?

Digital Products Dilemma

Application of Digital Products

➤ **Case Study 2**

- California based company providing SaaS, PaaS
- Separately charge installation and/or professional services
- Customers in Seattle, WA and outside WA
- Reporting nothing to Washington/Seattle

➤ **Considerations**

- Do you have nexus in WA?
- Is this DAS? Is it entirely DAS or should prof. serv./install serv.?
- Is WA state/local sales tax due/collected?
- Is there an applicable exemption?
- Do you have documentation (Contract , invoice, etc.)?

Digital Products Dilemma

Application of Digital Products

➤ Case Study 3

- Non-WA company with no physical presence in WA.
- Industry membership organization that funds itself with memberships
- Members have access to blog pages, links to related to industry issues and searchable database related to discrete items for sale.
- Company developed software to gather data from public sources, updates from members and search capabilities

➤ Considerations

- Is membership fee or any part of it taxable as DAS?
- Is there any exclusion or exemption?

Digital Products Dilemma

Application of Digital Products

➤ Case Study 4

- WA banking company buys from a “Chinese Menu” of internet banking services from service provider that interacts with Bank-maintained customer database of financial information.
- Bank select programs that allow bank customers access to secure email, live links to related bank products, searchable database related to customer’s bank accounts; and payment or fund transfer features.
- Internet banking provided free to customers.

➤ Considerations

- Did bank buy DAS?
- Is there any exclusion or exemption?

Questions?

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