The Committee amended and approved the May 29, 2008 meeting minutes during the August 12, 2008 meeting.

Study of the Taxation of Electronically Delivered Products
Committee Meeting Minutes
May 29, 2008

1. Welcome
   • Chair Hunter opened the meeting.
   • Present: Chair Ross Hunter, Vice Chair Joseph Zarelli, Representative Derek Kilmer, Representative Ed Orcutt, Department of Revenue Director Cindi Holmstrom, Julie Murray, Ron Bueing, Paula Borhauer, Victor Moore, Rich Prem, Bruce Reid, Jim Justin, Steve Collier, Greg Silverman,
   • Absent: Ben Kim, Chuck Robinson

2. Review and Approve Minutes
   • The April 24, 2008, meeting minutes were approved without amendments.

3. Update Survey of 50 States – Tennessee (03:18)
   • Dylan Waits, Department of Revenue staff, corrected information about Tennessee that was included in the 50 State Survey presented during the April 24th meeting. Tennessee taxes digital goods.
   • Tennessee adopted the specified SSUTA definitions for music, books, and videos and subjected those items to retail sales tax.
   • Tennessee’s tax is imposed regardless of user rights.
   • Mr. Waits advised that the correction and the legal background (statutes, case law, determinations, etc.) will be posted to the Department’s Internet site.

4. Refresher Vision & Goals (07:17)
   • Mr. Waits reviewed the seven goals of the Vision & Goals Statement included in the Committee’s Preliminary Report of November 30, 2007.
   • Bruce Reid commented about goal number three. Discrimination in the case electronic commerce is ok. It’s not necessary that tax policy be neutral. The 2008 advertising income legislation\(^1\) and the limited exemption for standard financial information\(^2\) support his opinion. The Committee should be able to entertain the idea that discrimination in some form is ok if it fits within the overall tax policy.
   • Chair Hunter urged the Committee to consider the vision and goals statement when evaluating proposals.

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\(^1\) SHB 2585 (chapter 273, Laws of 2008) extends the B&O tax rate for publishers of printed newspapers to include the advertising income generated from the electronic version of a printed newspaper.

\(^2\) ESHB 1981 (chapter 182, Laws of 2007), codified as RCW 82.08.705 and 82.12.705, provided sales and use tax exemptions for the purchase of electronically delivered standard financial information by an investment management company or financial institution.
• Mr. Waits clarified that goal number three focuses on technological neutrality and the future rather than on specific tax policy. Goal number four is more in line with Mr. Reid’s comments. Mr. Waits noted that the Legislature has already made decisions that, on some level, impact digital goods.
• Mr. Collier believes that the industry issue was included because the exemption for investment management and financial services is what brought the Committee together.
• Jim Justin asked if the preliminary report’s discussion about the SSUTA is still accurate. He also asked if there are other pertinent SSUTA discussions.
• Mr. Waits noted that the Preliminary Report discussion remains accurate.
• Chair Hunter characterized the SSTUA discussions as that the national group could figure out music, books, and videos without being able to resolve other issues. Chair Hunter expressed his belief that SSUTA will not resolve digital goods issues in the short run. If Washington resolved a few issues, he expressed the opinion that the state wouldn’t be “stepped on” any time soon.
• Greg Potegal, Department of Revenue staff, is unaware of further SSUTA discussion about digital goods. Having adopted the rules concerning music, books, and video, the governing board is leaving “other items” up to the states.

• Julie Murray asked if Washington will follow the SSUTA interpretation that those items (digital goods) that are not tangible personal property.
• Chair Hunter explained that under Washington law and Department of Revenue interpretation, music, books, and videos are taxed as tangible personal property. The SSUTA board does not determine/change Washington law. The state will not comply with the SSUTA if Washington’s laws are not changed. Mr. Potegal agreed with Chair Hunter’s statement.
• Ron Bueing argued that the issue is whether the Department’s interpretation is consistent with current law. Digital goods are not tangible personal property and never have been.
• Chair Hunter noted that this is the Committee’s purpose – to resolve the issue in a thoughtful legislative manner, rather than by an arbitrary court decision.

5. Proposal Presentation – Bruce Reid (24:20)
• Bruce Reid explained that his proposal follows the general concepts put forth by AeA and WITA. Mr. Reid questioned whether taxation of the digital base is the right answer or if there’s a different answer. He acknowledged that his proposal ignores

3 Ibid.
4 Copies of proposals were made available to the audience as handout material and are also posted on the Internet site.
5 The AeA – Washington Council and Washington Technology Industry Association (WTIA) submitted written comment to the Committee during the April 24, 2008, committee meeting.
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revenue consequences. He hopes that while hearing the various proposals, the Committee sorts through what the right policy is to recommend.

- Mr. Reid’s concept focused on the “business inputs” issue. Business inputs are the “whole universe” of items a business would use, including its own intellectual property. Examples include: 1) Microsoft’s internally created map technology, put on a server here in Washington that is used to generate a service that people use on-line; and 2) a game developed by a California company and put on Washington-located servers. Business inputs include anything digital that is used to provide a digital product or service.

- Mr. Reid offered that tax policy should exclude business inputs from the tax base. Taxing inputs goes against the business development and economic incentives concepts expressed by AeA and WITA. If the Committee agrees that the policy should exclude business inputs, it needs to be clearly addressed. First use of digital property and where first use occurs must be addressed.

  - Chair Hunter paraphrased Mr. Reid’s comments as that the product is built here, placed on servers here and world-wide, and that use tax should not apply.
  - Mr. Reid stated that the underlying value of technology should not be subject to sales or use tax.
  - Chair Hunter asked Mr. Reid if his concern is payment of sales tax by the end user or use tax being due the first time the server is turned on.
  - The latter is Mr. Reid’s concern. He said there is also a question as to whether the consumer should pay tax.

- Director Holmstrom asked if Mr. Reid’s concerns could be addressed with a business inputs exemption that covered sale for resale or ingredients and components.

  - Mr. Reid believes it potentially could and that this is a starting point.
  - Director Holmstrom expressed concern that a “right to reproduce” exemption might be hard to administer – for example, defining what is reproduction. She wondered if the current standard exemption – sale for resale and ingredient and component concept (as with manufacturing) – could be applied to digital goods.

  - Mr. Reid wants to stay away from the concept of manufacturing. An exemption shouldn’t depend on if the digital service or good will be sold. An exemption should include anything used to deliver a service or product regardless of whether it’s just available (like going on line to MSN to get a stock quote).

  - Chair Hunter compared such an exemption to the treatment of a tangible community newspaper where the newspaper is not sold but is supported with advertising revenue. There was in-depth discussion about the similarity to the taxation of community newspapers with respect to paper and other items.

  - Ms. Murray compared the situation to a free Google e-mail account where it’s implied exchange and she gets tailored advertising. A comparable situation would be Starbucks might give out free product. That would not be a sale for resale and that Starbucks would have to pay tax on the free product it gave away.

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For Google the software would be subject to sales tax because it’s not a sale for resale but it is comparable to the community newspaper because of the advertising. She questions if the “freebees” should be treated as tangible personal property and taxed or should it be treated different – in some instances it may be free on both ends.

- Mr. Reid explained that the proposal is pretty general without being specific about what would and would not be included. He noted that his thoughts were about the intellectual property and not the software for e-mail account.

- Mr. Bueing noted that the discussion brings in concepts related to tangible personal property but that it’s hard to apply those concepts to the digital world. He used the example of a brochure that is seen in one place as compared to a digital product that is seen all over. He noted that it can be done in Washington or it can be done in Oregon and he asked where the jobs are wanted.

- Mr. Reid and Chair Hunter discussed the aspect of establishing a data center in Washington and the lack of certainty faced with respect to business inputs.

- Chair Hunter noted that a possible test of any proposal would be that no additional tax consequences occur based on where the server is located.

- Director Holmstrom asked if the location of the server farm matters because the consumer’s location (for destination sourcing) determines first use for sales tax.
  - Mr. Reid noted that the SSUTA, Section 3-11, sub. 3, provides for “taking possession or making first use of digital goods, whichever comes first.” Mr. Reid does not believe that the tax consequences are on either the business input or the consumer side. There could be uncertainty whether the destination is the server. Mr. Reid believes the intent is to tax it where the customer is and not the server location.
  - Vice-Chair Zarelli noted that clarifying that would go a long way towards resolving the issue.
  - Greg Silverman asked about the current treatment of Microsoft’s purchase of financial data in digital form for display on the Internet.
    - Mr. Reid believes that based on New York law, delivery occurs in that state. As questioned by Chair Hunter, Mr. Reid does not believe that Microsoft pays sales tax on the stock feed.
    - Mr. Silverman questioned if that was because it’s taxed in New York or because it’s not taxed in Washington.
    - Mr. Waits explained that for the standard financial information, the Department would look to where possession occurs. He noted that it sounds like possession occurs in New York. Under current law, if Microsoft were simply hosting the information at a server farm for third parties, the transaction would be a service rather than a retail sale. A retail sale would occur and sales tax would apply if the third party (assuming nexus) sold the information to a Washington person. It would also not be at retail if it were
- Mr. Reid noted that there are all sorts of scenarios. There was no time to look at the range of scenarios. The next step is to see the Department’s interpretation. If it’s the right answer, in his opinion, it should become a part of the final product. If it’s the wrong answer, it should be fixed. The issue is the sales/use tax side rather than the B&O tax.
- Vice-chair Zarelli and Mr. Reid discussed destination sourcing for consumer purchases. Mr. Reid emphasized that he’s primarily concerned about the value of the property that sits on the server for use tax purposes.
  - Vice-Chair Zarelli noted that value doesn’t accrue until there’s a sale.
  - Mr. Reid introduced the concept that tax applies to self constructed assets – even if the asset isn’t sold. Mr. Reid used the example of use tax applying to a test bed constructed by Boeing for internal use.
  - Director Holmstrom noted that sales/use tax does not apply to ingredients and components that become a part of property that is resold. Tax applies to a tool used to manufacture a product for sale. She explained that sales tax applies if the tool is purchased while use tax applies if you build the tool yourself. (Mr. Reid later clarified that tax would not apply in this specific instance due to the sales and use tax exemption for manufacturing machinery and equipment used directly in a manufacturing operation.6)
  - Chair Hunter explained that this avoids the advantage that a vertically integrated company has over a company that purchases from smaller component manufacturers. The tax implications for vertically integrated businesses are the same as for non-vertically integrated businesses. He used the example of 2008 legislation for grocery distributors.7
  - Director Holmstrom recommended that, before the next meeting, DOR analyze the use tax issue to report back about what is happening now.
  - Chair Hunter paraphrased Mr. Reid’s comments as they’re not paying the tax now and, based on the Department’s interpretation of current law, are concerned about potentially being subject to the tax. Further it would be good to have the issued resolved in statute rather than by interpretation. Mr. Reid agreed.
  - Mr. Reid noted that “they” would provide some scenarios for feedback. He hopes that the Committee can get a consensus about if this is the direction the Committee should head. Director Holmstrom noted the

6 See RCW 82.08.02565 and 82.12.02565.
7 HB 3275 (Chapter 49, Laws of 2008) extends the special B&O tax treatment previously provided to a single “qualified grocery distribution cooperative” (RCW 82.04.298) to a grocery distribution cooperative that acquired substantially all of the assets of the grocery distribution cooperative that qualified for the special tax treatment.
usefulness of the scenarios to understand what Mr. Reid is thinking about and to understand the broader implications.

- Mr. Silverman asked for clarification that people in this position are not currently paying use tax (on self-developed software). Chair Hunter and Mr. Waits noted that they “don’t think they are.” Mr. Silverman commented that they know Boeing is paying tax on machinery they make. This statement was corrected by Mr. Bueing as he noted that the sales and use tax exemption for manufacturing machinery and equipment (M&E) applies. Again, Mr. Silverman clarified that software companies are not currently paying tax on their own software.

- Mr. Reid noted his hesitation to directly discuss about what Microsoft and other software companies, and Boeing are doing. He noted that, conceptually, there is uncertainty as to whether data centers are or are not paying tax and whether they are or are not subject to the tax. He suspects it’s not happening because it hasn’t been contemplated. They’re hoping to forward rather than backwards.

- Chair Hunter noted that perhaps they really don’t want the Department to determine what’s happening in a consistent way until after they’ve had a chance to move legislation.

- Mr. Bueing stated that the general feeling of the business community is that it’s information and not taxable tangible personal property, and have not been paying use tax.

- Mr. Reid explained that he is not advocating a solution for one specific company, but is instead looking for a broader policy resolution.

6. **Proposal Presentation – Steve Collier** (01:04:02)

- Mr. Collier explained that his proposal was not meant to be all encompassing. He noted that the “carve out” of an exemption for one specific industry for financial standard information is what led to the Committee and he wanted to make sure this issue was covered.

- For the first time, the statute created “standard financial information,” which was Department language. The statute infers that you owed tax unless you’re exempted.

- He proposes using the term “dynamic information” rather than “standard financial information.” He believes that it would be discriminatory to leave in “financial.”

- He believes the law does not intend to tax dynamic information.

- Mr. Collier explained that businesses used to access dynamic information by calling a consultant to ask what was new and that this wasn’t subject to tax in the past. He argues that discussion is about access to information that changes periodically or daily. Carving this out would not be change because of delivery.

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8 See RCW 82.08.705 and 82.12.705.
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- Mr. Collier explained that he included some terms from the original statute, added some additional terms and examples from the insurance industry, and added some examples that are not financial services. If the Committee decides it’s appropriate to tax music, books, and videos, those items could be excluded from the definition.
- Mr. Collier analyzed his proposal in the context of the goals and vision statement. He stated that even though the Department says standard financial information is taxable, his company and consultants for other companies have said that tax isn’t being paid on dynamic or financial information. He believes it’s a weak position for the state and across the nation. He thinks the revenue impact would be a “big goose egg.” He noted that standard, prewritten software may be an exception. To the extent that software is updated monthly, the Department may be inadvertently taxing dynamic information. He does not propose that software become a part of the exemption. He believes the proposal would make things more clear. He says that his colleagues in other states are surprised to hear what’s happening in Washington State because other states are not taxing dynamic information. The fact that we’re being clearer in our laws will make it more attractive for companies to locate in Washington. He believes the proposal provides a good framework for consistency, durability, and equity.
- Chair Hunter noted his understanding that no one looks at the paper versions of the Commerce Clearing House books (used by the accounting industry). Sales tax is due if you purchase the books. He asked if Mr. Collier was proposing that no sales tax apply if a person purchases the electronic version of the books or purchases electronic access to the books.
  - Mr. Collier answered affirmatively. He argued that the updating of those books is a service and access to the updated service is a service and not subject to tax.
- Chair Hunter asked if the purchase of access to a “real time” stock quote feed would: 1) be taxable under the proposal; and 2) is it taxable today?
  - Mr. Collier responded “no” to the former question.
  - Mr. Waits responded (to the latter question) that assuming the quotes are streaming rather than downloaded, that the transaction is not taxable today.
  - Mr. Collier argued that downloading shouldn’t be relevant.
- Chair Hunter asked about the taxability if he has the information downloaded into his portfolio spreadsheet on his computer
  - Mr. Waits responded that the key is whether it’s standard information or an information services. He used the analogy of custom vs. canned software to explain that it would be retail if the information is, for example a financial newsletter that includes stock quotes that goes to everyone and a service if it’s a newsletter that contains stock quotes just for him.
- Vice-Chair Zarelli asked if it’s possible to view the transaction in terms of wholesaling or retailing. Such as if a consumer purchases the digital service/product for their own use, it’s a retail sale. It would be wholesale sale if a business purchased the service or product (in whatever form) to use in creating a product or service.
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- Mr. Collier replied that the concept isn’t broad enough to cover other industries. Insurance companies receive accident information to determine whether to insure a person. The information is not built into a product that’s for sale.
- Vice-Chair Zarelli commented that it’s still related to the retail sale and would depend on the drafting. The information is used to maintain or continue the sale of that service or product.
- Ms. Murray argued that the proposal would exempt the sale of the information. She used the example of a boat owner receiving a daily weather report. The information could be sent via fax but is sent electronically to a computer. Ms. Murray positioned that the larger question is whether dynamic information should be exempt regardless of how it’s used. It should be technology neutral regardless of whether the information is received via computer, the mail, or in a book. The proposal would treat electronically-delivered dynamic information different than other forms of dynamic information.
- Vice-Chair Zarelli agreed, but noted that you have to look at how it’s used.
- Mr. Collier agreed that electronic could be struck and that all dynamic information would be treated the same.
- Ms. Murray argued that this would change the current treatment of standard, non-electronic information.
- Mr. Collier noted that it would be a change for a few things. Prewritten software would be one example, along with research services. He said that most dynamic information has been a service and not subject to sales tax in the past.
- Mr. Silverman asked where it says that standard financial information is taxable in the first place. There appears to be a statutory exemption for something that is not in the statute book.
- Chair Hunter expressed a desire to decide what the Committee wants to do rather than to decide what current law actually allows. The Department and others disagree as to the taxability of these things. Rather than to fight it out in a court of law, everyone thinks it would be better to set it out clearly in new law.
- Mr. Silverman asked if there’s a need for an exemption if there is no imposition of the tax in the first place.
- It was pointed out that the Department’s position has never been challenged.
- Mr. Collier commented that certain standard information is legitimately taxed today as tangible personal property, such as books and it is relevant if they provide an exemption for dynamic information. He believes the original argument is that prewritten software was written for the masses. One can argue that software delivered in the form of a disk is tangible personal property. If it’s custom it’s a service. If it’s prewritten, it’s not a service – it’s tangible personal property and taxable. Similarly, the Department has argued that standard information is to the masses. He further commented that it’s necessary to decide this because under the

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SSUTA, it can’t be called tangible personal property and then the whole rational for taxing prewritten software or standard information is blown up.

- Chair Hunter noted that he pays sales tax on his purchase of Office, which is updated more than once a month. He asked if Office is now a dynamic service or is it a packaged software product.
- Vice-Chair Zarelli commented that when you buy it, you’re paying for the updates.
- Mr. Silverman asked Mr. Reid if Microsoft now markets software as a service.
- Director Holmstrom asked Mr. Collier if the proposal would include any consumer. She noted that he would be looking at a very broad exemption that would possibly apply to everything other than music, books, and video.
- Mr. Collier answered yes, if it’s dynamic in nature. He noted that the definition might have to be adjusted to note that updates that had to do with new information as opposed to maintenance or updates of a product. He argued that there is a difference between a database that’s giving data and Office that’s a tool. He doesn’t think there was ever intent to tax the service of dynamic information and that the revenue impact isn’t large. (01:27:00)

7. Proposal Presentation – Ron Bueing (01:34:44)
- Ron Bueing presented an Association of Washington Business (AWB) consensus proposal that was more principles than specific recommendations.
  - Emphasized support of SSUTA with respect to digital goods for uniformity’s sake and maintaining the State’s position at the SSUTA table.
    - Digital goods should not be treated as tangible personal property.
    - Use SSUTA definitions and primary categories for music, books & videos.
    - Significant differences between digital goods and tangible items.
    - Tax policy should be based on the unique characteristics of each category.
    - Concern for rules sourcing to the server location when buyer may not be in the state.
    - There should be a business inputs exemption equivalent to that for tangible personal property. Concepts similar to the manufacturing M&E exemption should be used to keep and attract businesses into the state of Washington.
    - Information services should be exempt from retail sales tax regardless of character. In the business context, information is used all over the world and in on many platforms.
    - For B&O tax purposes, information services should be accorded its own category with its own rate and apportionment/allocation rules. If information services are exempt from sales tax, the service and other classification shouldn’t automatically apply. Washington has a unique foothold with technology businesses and we should give them a reason to move or not locate here.

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- Businesses should not be held accountable for past tax policy inconsistencies. Those businesses that have followed inconsistent tax policy should not be subject to class action lawsuits.
- Decisions made should encourage businesses to locate in the state.
- Director Holmstrom asked about downloading and streaming.
- Mr. Bueing clarified that downloading or streaming should not determine the taxability of information services. Information services are different than the SSUTA categories of books, music, and video.
- Chair Hunter paraphrased Mr. Bueing’s comments as exempting the broad category with taxing certain specified items.
- Mr. Bueing clarified that only items defined and specifically subject to tax should be taxed rather than exempting only those items that are specifically exempt.
  - Vice-Chair Zarelli noted that this results in “federal tax code.” He prefers a tax policy that is long lasting rather than one that requires frequent changes. He would rather enact tax cuts rather than tax increases.
  - Mr. Bueing noted that this approach attempts to tax currently unknown items that have unique characteristics and properties.
  - Vice-Chair Zarelli prefers a global tax policy approach with adjustments as things change. This will provide businesses with more stability.
- Chair Hunter questioned Mr. Bueing’s concern about the SSUTA sourcing provisions. Under blind payment provisions such as PayPal, the destination is unknown (credit card billing information is hidden) and the origin – the server location – controls the imposition of sales tax.
- Mr. Bueing confirmed that this is a problem.
- Chair Hunter asked if the state has the flexibility to resolve this concern.
  - Mr. Potegal believes the sourcing rules are pretty inflexible but will look into an interpretation or a change to the SSUTA.
  - Rep. Orcutt asked if this is specific to this state or all states. Mr. Potegal believes it will be a national issue for those states that tax digital goods.
  - Director Holmstrom asked if it was a problem with the tool (PayPal) rather than an issue with the sourcing methodology. There was further discussion about how PayPal works.
  - Rich Prem expressed the idea that the issue is more how you define the incidence of tax. Such as using a use and enjoyment concept for consumers based on residence. The question would then be what proxies are allowed for determining residence. The goal is to take all of the servers out of the equation.
  - Mr. Silverman asked if, in the event the buyer’s location is unknown, is the default the server’s location or the seller’s location/headquarters.
    - Mr. Waits doesn’t believe that the question has been resolved.

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- Chair Hunter explained that, regardless of the server location, Microsoft shouldn’t have to pay sales tax for customers that are not in the state.
- Mr. Reid asked if a company establishes nexus because they have space on a Washington server.
- Mr. Prem addressed the issue in terms of what’s happening in New York as a result of its legislation. Mr. Prem further noted that the SSUTA didn’t consider how the last sourcing rule applies and that the “movability” of digital goods hasn’t been thought through in terms of the sourcing rules. The sourcing rules were approved in 2000 before all of these issues started arising and no one has gone back look at what it means.
- Director Holmstrom questioned why a large Washington business would choose to use a payment tool that would require them to use origin sourcing instead of a tool that allows for destination sourcing.
- Chair Hunter explained that PayPal is the largest player in the market and customers use PayPal as a way to pay for the service.
- Mr. Prem explained that PayPal isn’t being used because customers want to hide their identities or residence. It’s a convenience for the seller. For numerous small purchases, the use of PayPal avoids credit card processing costs. “Micropayments” drive the use of blind payment vehicles.

8. Proposal Presentation – Paula Borhauer (02:14:38)
- Paula Borhauer noted that most of her concerns were already addressed within the other proposals. Ms. Borhauer noted that her proposal is a framework for considering the taxation of digital products.
- The framework should include:
  - Working within the existing excise tax structure.
  - What should and shouldn’t be taxed is a legislative decision.
  - Reluctant to say that specific items should or shouldn’t be taxed.
  - Need to recognize that technology affects all industries.
  - Narrowly crafted legislation is not always drafted as narrowly as people may think.
  - As a consumer and a seller, Ms. Borhauer noted that her company is looking for certainty.
- Considering what the SSUTA has already done and requires.
  - Digital goods, except prewritten software, are not tangible personal property but for Washington still sits in that category and needs to be addressed.
  - Avoiding tax pyramiding
  - Her concern about information services is whether it’s downloadable or not. She believes that most of the information can be “pulled down” to a certain extent.
   - Julie Murray explained that she tried to focus on the outcome, which she hopes is a bill and making choices as to whether to tax or not to tax.
   - Ms. Murray noted that her proposal can be juxtaposed against Mr. Bueing’s proposal.
     - The tax code has certain presumptions, such as all property is subject to tax unless it’s exempt.
     - Ms. Murray explained that she is not convinced that digital products have characteristics that are so unique that the current presumption should be overturned.
   - We should stay within the presumption of the current tax scheme.
   - Streamlined provides definitions for audio-visual works, digital-audio works, and digital books, which are the digital equivalents of things already subject to tax.
   - We should continue to tax those items to provide parity for business, to maintain revenue streams, and to be consistent within the business community and the tax code.
   - For clarity for business, try to impose the tax at the point of consumers.
     - Regardless of whether the consumer is a business or an individual.
     - Regardless of the medium used. Examples included maps, recipes, etc. The use is the same and the tax should remain the same.
   - Other products should be taxed if they’re used or enjoyed in Washington.
     - Unique characteristics of digitized products can then be argued as exemptions – the Legislature makes these arguments every year regarding income, property.
     - An exemption would be created for products just flowing through the state or residing on servers in the state.
     - Other products should be taxed regardless of property rights. Doing so provides clarity for business – the concept is the same for tangible personal property.
   - Ms. Murray noted that she is sympathetic with business and assumed that many of the issues brought up would be resolved under whether it for a sale for resale.
     - Purchases by business that are to be resold or packaged for resale to a consumer wouldn’t be subject to sales tax.
     - Businesses also make purchases for their own use. There is no compelling reason why businesses should be treated differently with respect to what they use versus what they are packaging and reselling.
     - We should maintain parity – what is done for the tangible is the same as for the digitized.
   - Agrees that issues related to storage in Washington need to be looked at.
   - Ms. Murray analyzed her proposal in the context of the committee’s vision and goals statement.
   - Mr. Prem asked Ms. Murray about her views on delivery into Washington and used and enjoyed in Washington. He used the example of an Oregon resident who is in

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Washington at the time he downloads a digital product onto a device. Mr. Prem mentioned that SSUTA had discussions several years ago about “multiple points of use” where products may be used in a variety of locations. Business has a concern about not paying multiple taxes if states have differing definitions of use and enjoyment, which may result in the imposition of multiple use taxes. He further noted that there is a credit for sales tax paid in another state but not for use tax.

- Ms. Murray noted that she hadn’t thought about that specific issue. Her thoughts were limited to when digital products “floated through the ether.” She noted a similar situation would occur if she came into Washington and took delivery even if she doesn’t actually use it in Washington. There are some similarities and it may just be a consequence. Ms. Murray also explained that she assumed that the SSUTA sourcing system becomes a proxy.

- Ms. Holmstrom asked Mr. Prem if he thought there would be a problem with using the credit card address/billing address as a proxy with a use and enjoyment methodology.
  - Mr. Prem replied that he didn’t think so. He wants to make sure that this state doesn’t go down the same path as the European Union with verification requirements. Business shouldn’t have an undue burden to verify.

- Mr. Collier asked Ms. Murray if the exemption for financial information services for investment companies and financial institutions should be repealed for neutrality with respect to vision and goals statement number three.
  - Ms. Murray responded that she wonders if it shouldn’t be. She acknowledged that this is a choice the Legislature has made. There are plenty of inconsistencies to provide preferential treatment.

- There was further discussion about purchases of standard information in a tangible form before information was transferred electronically. There was also discussion about custom information.
  - Mr. Collier noted 20 years ago, a company called its consultant for current data.
  - Mr. Bueing noted that this is a disputed area – he’s seen it both ways. There is no tried and true distinction that everyone has known for years.
  - Vice-chair Zarelli noted that the group is debating this issue for the first time – they’re establishing a new area.
  - Ms. Murray expressed that there’s always been a question about whether information is standard information or a service. Electronic delivery has made it a more immediate issue.

- Mr. Reid asked Ms. Murray if the presumption to tax and then exempt applied to the business inputs proposal he put forth.
  - Ms. Murray responded that those business inputs that are appropriately exempted are exempted.
  - Mr. Reid expressed concern about the presumption that everything is taxable unless specifically exempt if business inputs are not already considered to be

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exempt. The fiscal note would have to carve out the exempt items and he wondered how that could be done.

- Chair Hunter agreed that this is a problem, but wants to limit the discussion to the tax policy issues rather than the “machinations of numbers.”
- Mr. Collier believes that the Committee should recommend what the tax base should include: digital books, audio visual, and music - period.

- Chair Hunter noted that there are two directions for a proposal:
  - A broad imposition statute and in the same bill, create broad exemptions, which might include a broader business inputs exemption; or
  - A series of narrow imposition statutes.

- Ms. Murray expressed hope that the Committee can remain consistent with the way the tangible world is treated and look at both the tangible and the digital at the same time. Using standard financial information as an example, she pointed out that the legislation considered only standard financial information that is provided electronically without considering the same in a tangible format.

- Mr. Bueing noted that Ms. Murray’s proposal would look at businesses as being consumers. He asked Ms. Murray how her proposal would treat products that are used by a business across the country. He used an example of if the use were taxed in each state, sales tax would apply in the state of the billing address and use tax would apply in every other state where the business used the product – 100 percent to the vendor and 300 percent to the states.

- Chair Hunter agreed with that payment of 100 percent of the tax in every state where the product is used is not desirable and suggested apportionment.

- Mr. Justin noted that when Ms. Murray drafted and presented the proposal, they talked about it. They don’t have all of the answers but felt it better to raise the questions now rather than later. He acknowledged that they are trying to protect the tax base for local government.


- Key points of Mr. Silverman’s proposal
  - A definition is used to identify digital goods that are taxable.
  - Digital goods should be treated as services.
    - Discussion of “sui generis,” for the purposes of taxation. The SSUTA, other digital products, is an example of sui generis.
    - Services are only taxed in Washington if they are specifically enumerated.
    - There is no meaningful distinction between digital goods and digital services.
    - Mr. Silverman believes that it’s all services because it’s all a transfer of data, regardless of how the data is used, such as music, screens, etc.
      - It is not useful to distinguish between streaming, downloading, etc.

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- Definition (D2) would provide that a digital good or service is subject to sales tax only if it meets three conditions:
  1. The digital good or service is marketed to the general public.
  2. The digital good or service is an economic substitute for some type of tangible personal property.
  3. The type of tangible personal property for which the digital good or service is an economic service is subject to the retail sales tax.

- The Committee’s challenge is to come up with a principled middle ground of everything taxed at one end of the spectrum and nothing digital should be taxed at the other end.
  - Ideally, “principled” doesn’t mean a political compromise. It means something that can be defended on sound principle.

- Mr. Silverman stated that the Legislature’s urgency for creating the Committee is sales tax leakage. He believes the Committee’s charge is not to look to the Internet economy as a way to raise new revenue. The question is how to mitigate sales tax leakage and not where are the “buckets” of money in the economy.

- Goals associated with proposal:
  - Address the sales tax leakage problem to be consistent with the SSUTA.
  - Provide technological neutrality to avoid the distortion of purchases through tax avoidance – promote economically efficient decisions
  - Provide consistency with sound tax policy principles as represented in the Gates report, such as fairness, administrative simplicity, etc.,
  - An attempt to plug all leaks is not the best way to address sales tax leakage.
  - Taxing everything doesn’t work because you’ll capture a lot of new revenue.
  - Do not want to identify every item where leakage occurs.
  - There are diminishing returns.
  - Should address only significant sources of leakage.
  - How definition achieves goals of the proposal
    - The digital good or service is marketed to the general public.
      - General public is everyone in Washington – does not distinguish between businesses and consumers.
    - Chair Hunter asked about baseball statistic for which there is limited interest. Mr. Silverman explained that this is still marketed to the general public. There was a discussion about marketing techniques. Business model of the seller and who it targets for sales is the distinguishing factor. Mr. Silverman acknowledged there may be nuances and that judgment will be necessary. It will not be a mechanical judgment and that the DOR may have to look at indicia and apply reasonable judgment.
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- The digital good or service is an economic substitute for some type of tangible personal property.
  - Substitute good is well understood from an economic concept.
  - Product doesn’t have to be an equivalent but may replace need to purchase brick and mortar product.
- The type of tangible personal property for which the digital good or service is an economic service is subject to the retail sales tax.
  - Sales tax leakage will only occur if the tangible personal property being replaced is subject to sales tax.
- As a category, the conditions together delineate mass marketed items, such as books, music, and video already identified by the SSUTA. The conditions allow for the identification of other items that are significant sources of sales tax leakage.
- Under this approach, digital goods and services that are marketed to businesses would not be subject to tax.
  - Would help businesses to thrive and increased B&O tax would help to mitigate sales tax leakage.
  - Internet business models are innovative and are creating new products for which there are no tangible equivalents. Casting a wide net to tax all digital goods and services would result in increased tax revenue when you’re trying to stop sales tax leakage.
  - Server farms would not owe use tax because it would be a business-to-business type service and would not meet the mass-marketed condition.
  - Standard financial information would not be subject to sales tax because it would be marketed to businesses.
  - Mr. Silverman suspects that, likewise, information services would not be subject to sales tax under this approach.
  - Mr. Silverman said that there’s better certainty if what’s subject to sales tax is specifically enumerated.
- Chair Hunter noted that to remain compliant with the SSUTA, we can not continue to consider digital goods as tangible personal property. There is a choice between service and creating a new category (for digital or intangible things).
  - Mr. Prem noted that the SSUTA debated having two buckets of TPP and everything else –like the Europeans, or a bucket that’s intangibles – like the Canadians. Under the SSUTA, it just can’t be called TPP. Other sourcing implications should be considered. How to treat sales that are a mix of tangible and intangible will be a future issue for sourcing. For example, a sale that includes the Kindle and a certain number of e-books.
- Ms. Murray believes that (under this proposal) whether it’s called a digital service is irrelevant because the presumption would be that it’s not taxed unless there’s a tangible equivalent.
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- Mr. Silverman agreed with Ms. Murray about what you call it. The real question is what the default rule will be – the items are not taxed unless specifically enumerated or they are taxed unless specifically exempt.
- Ms. Murray stated that the problem with the proposal is that it is not forward thinking. She further noted her belief that we have to look at our tax structure knowing that we are moving more towards the digital. Ms. Murray used the example that under this proposal ring tones would never be taxed.
- Mr. Silverman noted:
  - The ring tone example, which the proposal currently doesn’t capture, could be used to supplement the approach.
  - His goal was to capture the brick and mortar items as they move on-line and create a space for innovative and evolving business models.
  - Rings tones are an interesting example because it is not a business-to-business service but it does not have an economic substitute in the brick and mortar world. His approach is silent as to how it should be categorized. Mr. Silverman would take a friendly amendment to the approach to say mass marketed digital goods and services could be taxed as they are developed.
  - His approach was designed specifically to avoid having to characterize transactions. Characterizations are too fluid with developing business models. If the aim is to mitigate leakage, Mr. Silverman prefers a more functional approach.
  - Ms. Murray explained that the sales tax is meant to tax consumption rather than the market that is consuming. Mr. Silverman’s approach is to define consumers by the marketing approach.

11. Public Comment
- Chair Hunter identified those persons who signed in for the meeting, but who did not wish to testify: Reid Okimoto (KPMG LLP), Stephanie Anderson (K & L Gates), Lew McMurran (Washington Technology Industry Association), Rob Makin (RMC), Sheila Gall (AWC), Ralph Amons (Boeing), Julie Ewald (KPMG LLP), Mike Kelly (K & L Gates), Greg Pierce (Pierce Consulting), Steve Smith (DOR), Bob Longman (Russell Investments), and Terry Byington (AeA – Washington Council).
- Chair Hunter noted that he would be happy to accept written testimony.
- Ralph Amons (Boeing) provided public comment. He noted that current law taxes the sale of tangible personal property. It does not tax a charge for looking at tangible personal property. In the context of computer access, the charge for just viewing is not subject to sales tax. He noted his nervousness because Tennessee just passed a law in which access is subject to tax. He believes that this has increased the tax burden on business. He would hate to see this state go that direction.

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12. **Summarize Meeting/Discuss Future Agenda**

- Chair Hunter noted that the Committee heard a broad set of proposals and expressed his belief that it would be difficult for the Committee, as a group, to draft a proposal.
- Chair Hunter proposed to work with staff members to pull together a consensus that the Committee can agree on.
- He believes that there is a common desire to:
  - Avoid creating a new sales tax incidence for people who have server farms that are basically redistributing products.
  - Consider a “relatively broad” business input exemption to avoid the pyramiding that is sometimes created within the existing tax—particularly the B&O tax. This includes:
    - Components of a product or business inputs
    - The right set of exemptions.
    - That might cover some of (Collier’s) concerns that would be broader than the standard financial information.
    - The services that are used as part of creating a product for sale.
    - A 21st century definition of rather than a 19th century definition.
  - Resolve the SSUTA default sales tax sourcing rule that affects server farms.
- Chair Hunter also noted the following:
  - He’s not hearing a lot of objection of continuing to tax consumer purchases that are already taxed—the streamlined sales tax categories, book, music, movies—that are aimed at consumers.
  - A relatively broad consensus (that businesses and people are both consumers). He used the example of staplers—individuals and businesses buy staplers. If you take staplers to make and sell pieces of art, you might have a case for resale. Everyone else is paying sales tax regardless how they’re using it because it’s simpler.
  - Chair Hunter asked the Committee if there were other areas of broad consensus or “scary differences.”
    - He noted differences with respect to a broad vs. narrow imposition of tax.
- Chair Hunter proposed that he outline a draft proposal and obtain input from the Committee members.
  - If there is consensus:
    - The Committee can resolve remaining issues at the next meeting.
    - The Committee can then meet again in the fall to review a bill draft.
    - The Committee can act on an agreement of an outline for the fall report without the report being a bill draft.
    - Chair Hunter asked and was advised that the Committee’s work ends in September. He explained that typically a committee doesn’t expire until after the next legislative session. He also explained that the Committee

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could present it’s report in September, which would be heard in the Finance Committee in September.

• Hunter asked the Committee if there is interest in reviewing draft legislation.
  • Mr. Reid clarified that the report would be the recommendation of the Committee and then after that, someone would draft legislation that “in their view” would reflect the report and then the Committee would get together to look at it.

• If there is no consensus, Chair Hunter proposed canceling the June meeting. This is because it would not make sense to meet again until the Committee has consensus or agrees that it can’t reach a consensus.

13. Meeting Adjourned