Study of the Taxation of Electronically Delivered Products

Meeting Minutes
October 2, 2007
1:30 p.m. – 3:30 p.m.

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1. Welcome and Introductions

Department of Revenue Director Cindi Holmstrom opened the meeting by explaining the committee’s purpose and composition.

- Committee members introduced themselves and identified who they represent.
  - Members physically present were Senator Derek Kilmer, Senator Joseph Zarelli, Representative Ross Hunter, Representative Ed Orcutt, Cindy Holmstrom, Ben Kim, Greg Silverman, Julie Murray, Steve Collier, and Ron Bueing.
  - Members present via teleconferencing were Rich Prem, Chuck Robinson, and Paula Borhauer.
  - Members absent were Victor Moore, Bruce Reid, and Jim Justin.

2. Election of Chair and Vice Chair

Election for Committee chair and vice chair was held:

- Senator Kilmer nominated Representative Hunter to serve as the committee chairperson. The nomination was seconded and then approved by the committee.
- Senator Kilmer nominated Senator Zarelli to serve as the committee vice-chairperson. The nomination was seconded and then approved by the committee.
- Chair Hunter noted the importance of the committee’s work stressing that Washington State is well positioned to study the taxation of electronically delivered products because the “leading lights of industry” are located in the state. He also identified the importance of fairness, consistency, and clarity.
- Vice-Chair Zarelli spoke about the importance and need for clarity.

3. Review of Enabling Statute and Committee Role

Gil Brewer from the Department of Revenue reviewed the enabling statute and committee role contained within Substitute House Bill 1128 of the 2007 Washington State Legislature. A copy was provided to members in their notebooks and was made available to the public in attendance.

4. Legal Requirements of Members and Committee

JoAnne Gordon from the Department of Revenue addressed the committee about the Open Public Meetings Act, Public Records Act, RCW 82.32.330 and the prohibition concerning the disclosure of tax returns and tax information, and the retention of public records.

- Handouts were included in committee members’ notebooks and made available to the public.
Representative Hunter requested that the Joint Legislative Audit and Review Committee template for committee member responsibilities be obtained for the committee’s legislative members.

5. Review of Timelines

Gil Brewer provided a review of committee timelines.

- A preliminary report is due to the Legislature by November 30, 2007.
- No committee meetings will be held during the 2008 legislative session.
- Committee meetings will resume in April 2008.
- A final report is due to the legislature by September 1, 2008.

6. Overview of Digital Products Issues and Background

Mark Mullin with Jan Bianchi and Gil Brewer from the Department of Revenue provided an overview of Digital Products issues. Mark Mullin’s prepared remarks are as follows:

- Good afternoon Chair Hunter, members of the Committee. My name is Mark Mullin, and I’m the Department’s Legislative Counsel. I’m pleased to provide the Committee a brief overview of the Department’s position on the tax treatment of digital goods.

- Digital goods includes such items as music, movies, books, newspapers, periodicals, ring tones, pictures, and other content or information that can be sent electronically from computer to computer.

- The taxability of digital goods is not expressly addressed in our tax statutes. The administrative rule that the Department uses to determine the tax treatment of digital goods has been in place since 1985. While it does not specifically address the taxability of digital goods, it does provide a framework and principles that the Department follows in resolving questions relating to the taxability of electronically delivered content or information.

- In applying the rule to the taxation of digital goods, the agency applies a true object test to determine whether a transaction is the retail sale of a product or the sale of a service that is not subject to retail sales tax.

- The agency’s position is that retail sales tax and retailing B&O tax applies to the sale of an item delivered electronically to consumers, if the item is generally available to any number of customers.

  - For example, if I make an on-line purchase of music or a movie, which I download to my computer, RST applies to my purchase. The seller is subject to B&O tax under the retailing classification.

  - Similarly, a photographer takes my picture as I cross the finish line of a 12-K road race. Subsequently, I purchase one of the pictures which are delivered to me electronically via e-mail. The sale is subject to RST and retailing B&O tax.

  - Suppose a business purchases a subscription to an industry newsletter delivered electronically by e-mail each month. Because the newsletter is generally available,
business is subject to RST. The seller is subject to B&O tax under the retailing classification.

- All of my examples presume that Washington has jurisdiction to impose a tax collection and payment responsibility on the seller.

- Where electronically delivered data or information is created to meet the particular needs of a specific customer, sales of such data or information are not retail sales. These sales are sales of services. Income received from these sales is subject to the service and other activities classification of the B&O tax.

  - For example, a business hires a person to write a safety manual that is tailored to meet the specific needs of the customer and which will not be made available for sale to other potential customers. This is not a retail sale but, rather, the sale of a service.

- A sale of merely the right to access content electronically without the ability to download the content is not subject to RST. Income derived from these sales is subject to B&O tax under the service and other activities classification.

  - For example, I subscribe to a service that allows me to listen to an unlimited amount of music during the term of my subscription. I cannot download any music. I am purchasing a service, which is not subject to retail sales or use tax. The sale is subject to B&O tax under the service and other activities classification.

- During the 2007 legislative session the Legislature passed ESHB 1981. This legislation provides RST and use tax exemptions for the sale and use of electronically delivered standard financial information by investment management companies and financial institutions.

  - Thus, if a bank purchases and downloads reports containing financial market data not compiled for the specific needs of a single customer, these purchases are exempt from RST effective 8/1/07. The seller is subject to retailing B&O tax on such sales.

  - If the buyer in the previous example was an insurance company rather than a bank, the purchases are subject to RST, even after 8/1/07. The exemption for sales of standard financial information is only available to investment management companies and financial institutions.

- This concludes my overview. I’d be happy to take any questions.

### 7. Other comments and follow-up questions

Committee members asked a number of questions during the presentation. Members were interested in the following:

- What other states are doing in this area? It was noted that 15 states currently tax digital products in some form. The department is undertaking a review of how other states, Canada and the European Union tax electronically delivered products.

- A discussion of the True Object Test was initiated and a request was made that the department prepare a decision tree for the next meeting to explain how interpretations of taxability are determined.
8. Streamlined Sales Tax status report

Greg Potegal from the Department of Revenue presented a current status report of the Streamline Sales Tax Initiative’s recent digital goods amendments. Mr. Potegal’s prepared remarks are included below;

- SST is a project of 44 states to make more uniform the sales tax structure across the country. Uniformity requirements are set forth in the Streamlined Sales and Use Tax Agreement (SSUTA). Fifteen states are full members. Washington will be a full member on 7-1-08. Over 1,000 businesses voluntarily registered to collect tax in all full member states.

- If a state doesn’t comply with the SSUTA requirements, it risks sanctions, including expulsion.

- Product definitions are part of the requirements. States can tax or not tax, but they must use the common definitions. Digital product definitions have been a struggle since 2000. Agreement was finally reached last week.

- On September 20, 2007, the Governing Board of the SSUTA made changes to the Agreement regarding digital products.

- The Governing Board provided definitions of three kinds of "specified digital products."
  - "Digital Audio-Visual Works"--movies;
  - "Digital Audio Works"--music; and
  - "Digital Books".

- By the end of 2009, member states that want to impose sales tax on the sale of any or all of these three defined products must do so specifically by statute. The imposition must be separate from the imposition of sales tax on the sale of tangible personal property.

- By the end of 2011, member states that want to impose sales tax on any other item transferred electronically must do so specifically by statute. The imposition must be separate from the imposition of sales tax on the sale of tangible personal property.

- Discussion ensued by the committee covering destination sourcing and comments were made that the European Union had gone to a destination sourcing for digital goods.

9. Future Meetings/Schedule

Future meetings were discussed with October 22, 2008 and November 15, 2008 set as tentative meeting dates. It was determined that these meetings will be held in Olympia on the Capitol Campus. It was suggested to move the meetings to a legislative hearing room as those rooms have video conferencing capability if needed.

- The agenda for the October 22 meeting was discussed and the Department of Revenue was asked to prepare a Problem Statement for the Study Committee with members requested to provide suggestions to the Department. Also a draft set of committee goals was requested. The Department will also provide a decision tree flow chart for the committee at the next meeting. It
was also requested that committee members may present at the next meeting a discussion of the future of technology.

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*Preliminary drafts to be sent to committee members and interested members of the public with next agenda in advance of the October 22 meeting.

- Discussion ensued regarding potential legislation in 2008. Cindi Holmstrom indicated that no request legislation would be pursued by the Department. Chair Ross Hunter indicated that if some clarity were achieved by the time the 2008 Legislature were to meet, legislation may be possible.

- Other discussion followed regarding technological neutrality and tax treatment, assumptions of taxability and second life/virtual reality.

10. Public Comment

Public comment was taken:

- Kim Risenmay of Risenmay Law asked how public comment would be handled and that he would like to present his written testimony to the committee. The Chair asked that a sign in sheet be prepared at the next meeting allowing the public to request to testify and that time be made on the agenda for public testimony.

- Lew McMurran representing WSA asked that future meetings be longer since it was a major time commitment to attend and that way time could be allowed for full public testimony.

Signed in attendance were:

Amber Carter AWB  Ryan Moore Senate caucus staff
Chris Laine Moss Adams LLP  Jay Balasbas House caucus staff
Kim Risenmay Risenmay Law  Bob Heller Ernst and Young
Jeff Mitchell House Finance Staff  Lew McMurran WSA
Robert Lanoman  Dean Carlson Senate Ways and Means Staff

Committee Members

Senator Derek Kilmer  Cindi Holmstrom  Victor Moore  Jim Justin
Senator Joseph Zarelli  Ben Kim  Rich Prem  Ron Bueing
Representative Ross Hunter  Greg Silverman  Bruce Reid  Chuck Robinson
Representative Ed Orcutt  Julie Murray  Steve Collier  Paula Borhauer

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