

Digital Products Overview

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October 22, 2007

Digital Products: Introduction

- New technologies have constantly challenged state sales tax laws. One recent challenge to these outdated laws derives from the substantial popularity of “Digital Products.”
- What is and is not a “Digital Product”?
 - Downloadable items, such as music, movies, books, and other products delivered, transferred or accessed electronically.
 - Blockbuster rental vs. Netflix rental vs. Downloaded movie vs. Pay-Per-View vs. On-Demand vs. Streaming Major League Baseball game

Example Technology's Impact (Music Concert)

- Customer buys a DVD of Rolling Stones Concert (subject to sales tax in WA and CA)
- Customer buys an electronic download of same DVD (subject to sales tax in WA but not CA)
- Customer buys a subscription to access a digital library of 20 concerts (taxable??)
- Customer pays a fee to view an archived web cast of a Rolling Stones concert (taxable??)
- Customer pays a fee to view a live streaming web cast (taxable??)
- Customer buys a ticket to a Rolling Stones Concert (not subject to sales tax in WA or CA)

Progression of Digital Products Tax Debate

- Taxation of Internet Access
 - In the mid 1990's, state tax administrators, without specific legislative authority, were construing their decades old telecommunications taxes as applying to internet access services
 - Companies were hit with assessments for failing to collect the tax from their customers
 - In 1998, Congress intervenes and passes the Internet Tax Freedom Act which bars state taxes on Internet access (several states grandfathered)
- Taxation of downloaded software
 - Some states treated downloaded software as TPP and taxed it, others treated it as an intangible or a service and exempted it
 - In 2001, software industry advocated uniform treatment of software as TPP along with definitions allowing states to continue to exempt transactions based on method of delivery

Digital Products Debate

- Taxation of Digital Products
 - In early 21st century, bandwidth increases allowing convenient delivery of large file movies and music
 - States move to try to exert their sales taxes on “digital products” without any uniform definition
 - Disparate practice amongst the states leads to confusion over what is taxable and not taxable
 - SSTP begins work on uniform definition of “digital products”
 - Process proves arduous and contentious as states strive for broad definition that would result in expansion of tax base
 - Business argues for narrow definition that focuses on current business models

Digital Products: Impact of Convergence

- Historically, telecommunications, cable, media and the tech industries were in separate “silos” subject to separate tax and regulatory systems
- Broadband is the great equalizer – digital products and services are sold by everyone
- What are these digital products and services and should they be taxed and if so how should they be taxed?

Digital Products: Classification Issues

- Downloaded digital products that are similar to products sold as tangible personal property (e.g., movies, music)
- Downloaded digital services that are similar to “taxable services” services (e.g., telecom, cable)
- How to distinguish these services, digital products, Internet access, etc.

Current Approaches to Sales Taxation of Digital Products

- Why do transfers of Digital Products create sales tax problems?
 - Generally, many states impose sales tax on all retail sales of “tangible personal property” and specifically enumerated services
 - Because “Digital Product” does not fit within most states’ existing definitions of tangible personal property and many states do not statutorily define Digital Products, states do not uniformly tax (or exempt) Digital Products
 - This non-uniform treatment often leads to sales tax compliance problems for sellers and purchasers of Digital Products

VAT on Electronically Supplied Services (“ESS”)

Sales by Non-EU Companies to EU B2C customers

- **Effective 7/1/03, EU VAT applies to sales of electronically supplied services (“ESS”) by non-EU companies to EU resident B2C customers.**
- **The applicable VAT jurisdiction will be based on where the customer is RESIDENT.**
- **Example: An ebook sold by a US based “selling company” to a person RESIDENT in Greece will be subject to Greek VAT.**
- **Example: SDP fees charged by a US based “selling company” to a person RESIDENT in the UK will be subject to UK VAT.**

VAT on Electronically Supplied Services (ESS) -Sales by Non-EU Companies to EU B2B customers

- **ESS sold by non-EU companies to EU B2B customers are “zero-rated”. This means that the seller doesn’t have to charge VAT – rather the buyer “self-assesses” the VAT.**
- **Zero-rating is ONLY allowed if the seller VERIFIES the B2B customer’s VAT registration number. Verification requires collecting customer’s tax id number and validating the number. Most US based websites do NOT currently have this functionality.**
- **Example: A US based internet seller that sells down loaded software to a UK company does not have to charge UK VAT on the sale provided that US Company verifies the customer’s UK VAT registration number. Rather, the customer is required to self-assess the UK VAT.**

Scope of EU Directive on ESS

- **There is no formal definition of ESS**
- **Directive provides illustrative list of ESS examples:**
 - **Website supply, web-hosting, distance maintenance of programmes & equipment**
 - **Supply of software & updating thereof;**
 - **Supply of images, text & information and making databases available**
 - **Supply of music, films & games and of political, cultural artistic, sporting, scientific & entertainment broadcasts and events.**
 - **Supply of distance teaching.**

Other services that the EU is currently reviewing . . .

Fun	Media	E-commerce (cont'd)	Miscellaneous (cont'd)
Bellogos & ringtones	· Read newspapers & magazines online	· Toplists, hotlinks lists	· Navigation help in car
Desktop themes	· Sites of TV series	· Tutorials	· Psychological tests
E-cards	· Teletext online	· General excerpts	· Recipes (diner)
Funstuff (e.g. jokes, cartoons)	· TV guide online	· Excerpts from databases (KvK, CBS etc)	· Reminder services
Gambling (casino, bingo)	Safety	· Excerpts of professional literature	· Job vacancies departments
Horoscope	· Make online backups	· Dictionaries, translation programs	· Webcam on day care center, child's bedroom
Online photo album	· Filters on websites	· Search engines specialized on products	
Screensavers	· Firewalls	· Search engines specialized on regional\local level	OTHER:
	· Virusscan, -warnings and -updates	· General search engines	Online banner advertising
Games	Software	Unified messaging	Associates programmes
Cheats for games	· Bannerblockers	· E-mail notification	Person to Person Payment Services
Download games	· Download drivers	· Mobile receiving and replying e-mail	Digital libraries
Play online games	· Download software	· Fax notification	Website hosting
Traditional games online	· Software updates administration	· Send fax	Fixed price Marketplace
Audio & video	Homepage & network	· SMS	
Covers for CDs, DVDs, PSx	· Administration tools	· Voicemail in e-mail	
Internet TV	· Domain registration and -guarding	Communication	
Internet radio	· Online calendar	· Safe, encrypted e-mail	
Download MP3/music	· Remote disc space	· Chat in secure surroundings	
Radio broadcast (streaming audio)	· Remote system administration	· Dating, partnermediation	
Watch movies online	· Webspaces	· Forums	
TV-broadcast (streaming media)	· Website statistics	· Instant messaging	
Webcam-images	· Webtools	· Open Chat	
News	E-commerce	Professional/financial services	
General news	· Online order tracking	· Internet banking	
Economic news	· Online auction	· Legal advice	
e-zines	· Comparison sites	· Online notary	
Mailinglists, newsletters	Reference guides	· Online tax advice	
News archives	· Reviews of books, movies, concerts in archive	Miscellaneous	
Sportnews	· Encyclopedia / atlas	· Online courses	
Traffic information	· Year reports	· e-Books	
Weblogs	· Telephone guides, zip code guides, Yellow Pages	· Entrance tickets	
Weather reports	· Public transportation planner	· Calendar of events, festivals	
	· Routeplanner	· Helpdesk (in general)	

Current vs. Future rules

CUSTOMER TYPE

SELLER TYPE	OLD RULES	EU B2C	EU Country A B2B	EU Country B B2B
	Country A EU Seller	Seller Country A VAT applies regardless of where customer is resident	Seller Country A VAT applies	Customer self-assesses VAT
	Non-EU Seller	No VAT	No VAT	Customer self-assesses VAT

CUSTOMER TYPE

SELLER TYPE	NEW RULES	EU B2C	EU Country A B2B	EU Country B B2B
	Country A EU Seller	Seller Country A VAT applies regardless of where customer is resident	Seller Country A VAT applies	Customer self-assesses VAT
	Non-EU Seller	Customer country VAT applies (15 countries)	Seller has no liability for VAT AS LONG AS Seller verifies that Customer is VAT registered.	Seller has no liability for VAT AS LONG AS Seller verifies that Customer is VAT registered.

NEW RULES: EU SELLERS SUBJECT TO 1 COUNTRY VAT vs. NON-EU SELLERS SUBJECT TO VAT REGIMES OF ALL 27 EU COUNTRIES