

The Committee approved the minutes from the September 25, 2008 meeting during the October 30, 2008 meeting. There were no amendments.

Study of the Taxation of Electronically Delivered Products
Committee Meeting Minutes
September 25, 2008

1. Welcome

- Chair Hunter opened the meeting.
- Present: Chair Hunter, Rep. Kilmer, Rep. Orcutt, Cindi Holmstrom, Rich Prem, Jim Justin, and Julie Murray.
- Teleconferencing: Steve Collier, Ron Bueing.
- Absent: Vice-Chair Zarelli, Bruce Reid, Victor Moore, Greg Silverman, Dr. Ben Kim, Paula Borhauer, and Chuck Robinson.

2. Review and Approve August 12, 2008 Meeting Minutes

- Motion to adopt the August 12, 2008 meeting minutes approved.

3. Presentation of Chair Hunter's Proposed Language by Drew Shirk, Project Counsel, and Mark Mullin, Legislative Counsel, Department of Revenue (01:50)

- Chair Hunter explained his:
 - Proposal was sent to committee members last week. Some changes have since been made and the committee will work from the latest draft.¹
 - Desire for a free flowing discussion to examine if the proposal will work, potential changes, costs associated with potential changes, and whether the proposal can be administered; and
 - Expectation that the proposed language will be a “moving target.”
- Mr. Shirk explained that the draft language is one possible way to capture the intent of Chair Hunter's proposal. At the August 12th meeting, the committee asked Chair Hunter for draft language. Mr. Shirk explained that the language is not an actual bill draft, but contains key elements that can be used for legislation.
- Mr. Shirk explained that there are three parts to the proposal:
 - **Key definitions.**
 - A new section in chapter 82.04 RCW, the business and occupation (B&O) tax chapter, would provide definitions for “digital code,” “digital automated service,” “digital goods” and “electronically transferred.” Definitions established in chapter 82.04 RCW would also apply to the retail sales and use statutes (chapters 82.08 and 82.12 RCW, respectively).
 - “Digital code” – the definition is from the Streamlined Sales & Use Tax Agreement (SSUTA). The definition is intended to define what digital code entails for access to a digital good.

¹ The proposal discussed during the meeting appears on the Department of Revenue's Internet site. Edits made to the draft proposal sent to committee members appear in the legislative strikeout and underline format.

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- “Digital automated service” – is intended to define web-based services, such as search engines, genealogical search sites, and web dating.
 - The definition of digital automated service excludes certain activities:
 - Services primarily provided by human effort.
 - Distinguishes between on-line services and services that are primarily provided by humans.
 - There may be a digital component, but the services need to be primarily provided by human involvement.
 - On-line loan services.
 - Automated teller machine transactions and other machines dispensing physical items.
 - Payment processing.
 - Lottery games administered by the Lottery Commission was included in the draft sent to committee members but has been eliminated in the corrected version provided at the beginning of the meeting. The Lottery Commission does not currently administer any games that would fall under the definition of a digital good or digital automated service.
 - Rep. Hunter explained that if there were, the Lottery Commission would need to come before the Finance Committee to remove the sales tax.
 - Pari-mutuel wagering.
 - Telecommunications and ancillary services –defined in RCW 82.04.065.
 - Internet and Internet services –defined in RCW 82.04.297.
 - Consumer access to prewritten computer software – defined in RCW 82.04.050.²
- “Digital goods” – are sounds, images, data, facts, or information, or any combination thereof in an electronic format made available for the use or enjoyment of consumers. Whether a consumer receives possession or merely has access rights is immaterial.
 - Includes audio or video programming on a pay-per-program basis (streamed or on-demand).
 - Excludes:
 - Broadcast cable or satellite television.
 - Radio broadcasting.

² RCW 82.04.050(6) defines the sale of standard prewritten software as a retail sale, regardless of the method of delivery. RCW 82.04.215(6) defines the term “prewritten computer software.” RCW 82.08.010(7) defines the term “tangible personal property,” which includes prewritten computer software.

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- Sounds, images, data, facts, or information, or any combination thereof in an electronic format made available via tangible media storage.
- Telecommunications services and ancillary services –defined in RCW 82.04.065.
- Computer software – defined in RCW 82.04.215.
- Internet services – defined in RCW 82.04.297.
- The representation of a professional service in an electronic format, such as an engineering report prepared by an engineer.
- Digital automated services and services that are excluded from the definition of digital automated services.
- “Electronically transferred” or “transferred electronically” – Mark Mullin explained that these two terms include digital goods that are delivered to the customer (i.e. download) and goods where the customer’s rights are limited to access (i.e. streaming).
- **General imposition language for inclusion in the retail sales tax, use tax, and B&O tax statutes.**
 - Definitions to be amended include:
 - Chapter 82.04 RCW – Retail sale – to include:
 - The sale of digital goods, digital codes, and digital automated services to consumers who are end users regardless of the rights received or the method of payment.
 - The provision of access to prewritten computer software (on-demand software services), which includes remote access software and application service providers (ASP).
 - Chapter 82.08 – the retail sales tax statutes would not need to be amended.
 - Chapter 82.12 – the use tax statutes would need to be amended to specifically impose use tax on the use of digital goods, digital code, digital automated services, and on-demand software.
 - The SSUTA requires specific imposition if various elements are taxed:
 - Sales to end users.
 - Sales where the user is granted permanent use.
 - Sales where the user is granted temporary or less than permanent use.
 - Sales where continued payment is not a condition of sale.
 - Sales where continued payment is a condition of sale (subscriptions).
- **Potential business input sales and use tax exemptions as proposed by Chair Hunter during the August 12th meeting.**
 - Sales for resale.
 - Ingredients or components.
 - Digital goods, codes, etc. to be given away by an Internet site generating advertising revenue.

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- Certain digital goods for which no charge is made, such as personal e-mail communications.
- Digital automated services for which no charge is made.
- Chair Hunter asked Mr. Shirk to explain the proposed Ron Bueing exemption.³
 - Business data sales and use tax exemptions for inclusion in chapters 82.08 and 82.12 RCW.
 - Exempts the sale to and the use by a business of digital data purchased solely for business purposes.
 - Digital data is data that consists primarily of statistical data, quantitative data, demographic data, or similar data, or any combination thereof, including any associated analysis or discussion of the data.
- Mr. Collier asked if this was Mr. Bueing's amendment.
 - Cindi Holmstrom clarified that the language was drafted to capture Mr. Bueing's comments from the August 12th meeting. The language was sent the night before and she was unaware if Mr. Bueing had reviewed the language.
- Chair Hunter explained that this expands the exemption for standard financial data given⁴ to all data purchased by businesses for use in their business.
 - Mr. Shirk clarified the exemption is limited to digital data as defined.
 - Jim Justin asked if there is an existing definition of "business purposes," to which Mr. Mullin replied that he was unaware of any such definition.

4. Discussion of Proposal Language (25:58)

- **Discussion of digital code definition. (26:44)**
 - Chair Hunter noted that the definition of "digital code" is from the SSUTA. He also questioned the definition's usefulness because of its narrowness. Chair Hunter confirmed that the purchase of a plastic card that has a code that is used to purchase downloaded music or a cup of coffee would not be a digital code. He also confirmed that it would not be a purchase of digital code if the card was used to purchase downloaded goods, some of which are taxable in one area and some of which are taxable in another area. Chair Hunter used the example of purchasing downloaded music and the use of on-line software. Both items have the same rate but not the same tax treatment.
 - Rich Prem used the example of Pepsi purchasing a million song codes to explain the reason behind the SSUTA definition of "digital code." Pepsi places the codes under bottle caps that Pepsi's customers use to obtain music. The code is a prepaid purchase. The definition was included to determine where the point of taxation would occur to avoid each individual customer

³ The proposed exemption language was e-mailed the previous night to Committee members.

⁴ ESHB 1981 (chapter 182, Laws of 2007), codified as RCW 82.08.705 and 82.12.705, provides sales and use tax exemptions for the purchase of electronically delivered standard financial information by an investment management company or financial institution.

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paying a negligible amount of tax. Pepsi is the consumer of the codes it uses as a give away promotion. Mr. Prem explained that such transactions are common and occur in bulk. The intent is to distinguish between a stored value/gift card and a unique digital code that is one-to-one.

- Chair Hunter and Mr. Prem concluded that the definition is useful. Mr. Prem commented that Amazon.com would lobby hard to keep the definition.
- Mr. Shirk noted that the imposition language includes digital code and an inputs exemption would be necessary to exclude the purchase from retail sales and use tax.
- Mr. Bueing asked if the definition is intended to include “keys” that turn products on (i.e., software that is downloaded for free for use for 30 days).
 - Mr. Shirk commented that this includes whatever method is used for access. He clarified that the word “code” is not about software. It’s about keys and access. Software has its own imposition that is separate from digital goods.
 - Mr. Prem agreed with Mr. Shirk and noted the importance of distinguishing between the two. He further explained that there was a decision to define prewritten software as tangible personal property under the SSUTA.
 - Mr. Prem asked if the drafting included the SSUTA definitions for the specified items of books, music, and video.⁵
 - Mr. Mullin explained that the language does not include the term “specified digital products” or any of the specific components because the term “digital goods” is broadly defined to encompass the specified items.
 - Mr. Prem recommended further thought because there is a debate that states must do both. He explained that it’s important relative to sourcing and bundling issues.
 - There was further discussion about the need to do so for SSUTA purposes and an agreement to revisit the issue.
- **Discussion of digital automated services definition.** (40:12)
 - Mr. Prem asked about payment processing services. He explained that Amazon.com runs websites for other people. The customer uses Amazon.com’s software to run the website. Amazon.com offers various services that can be bundled together for one charge, which includes payment processing. He asked if there would be a primary purpose or true object test for purposes of the payment processing service.
 - Chair Hunter paraphrased Mr. Prem’s question as what would be the tax treatment of a bundled transaction where one element is taxable (web hosting) and another is not (payment processing).

⁵ For discussion about the SSUTA requirements for “specified digital items,” please refer to the minutes from the October 7, 2007, and November 15, 2007, meetings.

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- Mr. Shirk replied that the general language was intended to capture Chair Hunter's wish to exclude financial transactions from tax and that further clarification is necessary for bundled transactions.
- Chair Hunter asked Mr. Prem what would occur today if Amazon.com was to sell an on-line service, such as an exchange hosting service, and the customer received a copy of Outlook.
 - Mr. Prem replied that, absent a separate charge, most states would apply a true object or preponderance test. He used the example of a \$1 million charge for the service and the customer receives a \$39 copy of Outlook, the true object would be the hosting service. There would also be the question of whether Amazon.com would be the consumer and subject to use tax for the software.
 - Director Holmstrom asked if the SSUTA bundling rules should be reviewed.
 - Mr. Prem replied yes. He also noted the evolving nature of the SSUTA's bundling rules and that SSUTA has pushed the bundling rules to the side.
- Chair Hunter asked about distinguishing between automated web service and a professional service (i.e. engineering services) as related to the term "primarily."
 - Mr. Shirk responded that "primarily" means 51 percent – more than half.
 - Chair Hunter asked how it would be measured.
 - Mr. Shirk explained that it would be necessary to look at the activities and what's being provided. He further explained that there's a chicken and egg distinction in that you have to determine if the human element initiated the service or was it as a response to the service request.
 - Chair Hunter used the example of on-line fortune telling. Technology is used to link up to a live medium. How is the technology measured?
 - Mr. Shirk explained that the purpose of the language is to clarify that the presence of a human element doesn't exclude an activity from being a digital good. The focus must be the human element rather than an ancillary element. He noted that many activities will require a true object test.
- Mr. Prem questioned asked where the lines will be drawn given the federal Internet Tax Freedom Act (IFTA) restrictions. He used two examples to illustrate: on-line auctions without human intervention vs. physical auctions and stock brokerage trades. He asked if the on-line auction would be taxed as a digital good while the physical auction would not.
 - Chair Hunter and Mr. Shirk noted that the stock brokerage trades are exempt as financial services and that the auction issue requires further thought.
- Steve Collier asked if (2)(b)(i) under digital automated services is where the battle about standard information occurs.⁶

⁶ Over time, the Committee has discussed standard financial information at length. To review these discussions, please refer the minutes from previous meetings.

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- Chair Hunter replied no, it appears in the Department’s interpretation of Ron Bueing’s August 30th comments⁷ or another specific exemption.
- Mr. Bueing noted that RCW 82.04.297 defines “internet services” to include the hosting of information for retrieval over the Internet. He noted an apparent a conflict between the taxing of information under the RCW definition of Internet service and digital automated service.
 - Chair Hunter noted that under the proposal’s definition, Internet hosting is not a digital automated service (largely because ITFA says Internet access can’t be taxed). The sale of data via the Internet is a different transaction. Under the proposal, it would be a digital good and not a digital automated service.
 - Mr. Shirk acknowledged that additional work may be necessary to avoid a conflict.
- Chair Hunter asked Mr. Shirk to outline the items identified as requiring additional work:
 - ITFA issue (auctions).
 - Clarification of Internet service (as related to digital automated services and digital goods).
 - SSUTA issue with respect to specific imposition of tax on specified goods – digital books, music, and video.
- **Discussion of digital goods definition.** (01:06:08)
 - Chair Hunter noted that this definition has the same specificity problem (as previously pointed out by Mr. Prem).
 - Jim Justin asked if the exclusion from digital goods for “The representation of a professional service in electronic form, such as an electronic copy of an engineering report prepared by an engineer” is intended for customized products.
 - Mr. Shirk responded no and explained the intent to clarify that simply e-mailing a report containing the results of a professional service does not make the service taxable. He used the example of an architect who prepares plans and then e-mails those plans to the client.
 - Mr. Collier asked if the definitions for “digital automated services” or “digital goods, reverses the exemption for standard financial information.
 - Chair Hunter explained that he asked the Department to prepare language to provide a broad imposition of tax with a set of exemptions. The language prepared does not include the exemption for standard financial information because of needing to first determine the broad statute. Noting that Mr. Collier’s proposal included an exemption for standard financial information, Chair Hunter explained the specific set of exemptions can be determined after the broad language is in place. He further explained that the exemptions are simply policy calls. He wants the Committee to define what the exemptions could be and then to recommend exemptions to the Legislature.

⁷ See page 4 for the overview about business data sales and use tax exemptions.

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- **Discussion of “electronically transferred” definition.** (01:12:07)
 - Mr. Bueing commented that the language does not address “place of transaction” issues, which he believes is a problem with existing law. He used the example of credit reports, which are retail sales, to illustrate his point. The transaction is taxed where the retail service occurs, which is outside the state. This is a “dumb rule” because it ensures that no one operates a credit bureau service in the state.
 - Chair Hunter commented that the language doesn’t address destination sourcing issues. The Committee is interested in the issue. There was a proposal to use the IP address for sourcing purposes when no customer address information is available, such as with PayPal.⁸ He explained that the interpretation would be addressed by rule rather than by legislative action. Chair Hunter also noted that destination sourcing should resolve most of the sourcing concerns.
 - Mr. Bueing also noted concern with respect to lump sum purchases of services when the service will be used in more than one place.⁹
 - Mr. Shirk commented that this issue needs to be addressed.
 - Chair Hunter asked when the issue would be addressed. He would like a proposal from Mr. Bueing for at the next meeting. Mr. Bueing agreed.
- **Discussion about retail sales and use tax imposition statutes.** (01:15:55)
 - Mr. Justin asked why the phrase “service of providing consumers with access to prewritten computer software” is referred to as “on-demand software services” throughout the remainder of the document.
 - Mr. Mullin replied that it was for the sake of brevity.
 - Mr. Justin asked if “prewritten computer software” is currently a term of art that was being changed throughout.
 - Mr. Prem explained the need distinguish between prewritten software and access to prewritten software. Currently, the purchase of software (i.e., Tax Cut) in the store is a purchase of tangible personal property. It’s still a purchase of tangible personal property if you download prewritten software.¹⁰ This (“service of providing consumers with access to prewritten computer software” or “on-demand software services”) is meant to capture the electronic access to prewritten software where the software is not downloaded. Currently, this falls into the “service” bucket rather than the tangible personal property bucket.
 - Chair Hunter explained that because prewritten computer software was pulled out by the SSUTA, it’s necessary to pull it out in the proposal.

⁸ For previous discussion about sourcing issues and blind payment provisions, such as PayPal, please refer to minutes from the May 29, 2008, and August 12, 2008, meetings.

⁹ For previous discussion about the purchase of information that is accessed from multiple locations, please refer to the minutes from the August 12, 2008, meeting.

¹⁰ RCW 82.08.010(7) defines the term “tangible personal property.”

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- Mr. Mullin explained that “on-demand software services” would not be used as statutory language.
- Mr. Bueing asked if, for use tax purposes, changes to the definition of “value of the article used” are necessary.
 - Mr. Shirk agreed that determining value is an important element.
 - Chair Hunter asked the Department and Mr. Bueing to spend some time discussing the issue to provide clarity for the Committee.
- **Discussion about business inputs and other exemptions.**
 - Mr. Prem asked why on-demand software isn’t included in the exclusion from the definition of “consumer” as an ingredient or component or provided free of charge when the website generates advertising revenue (proposal to amend RCW 82.04.190(11)(b) and (c)).
 - Chair Hunter and Mr. Prem discussed the question as an attempt to clarify when on-demand software is used to produce a product vs. on-demand software that is used in the business.
 - Director Holmstrom commented that the ingredients and components exemption is only for when there is a new product.
 - Mr. Prem noted that it could involve digital automated services, not just a digital product.
 - Mr. Shirk said that examples would help to clarify how on-demand software may become an ingredient or component.
 - Mr. Bueing agreed with Mr. Prem. He explained that he didn’t think including on-demand software would be broadening the exemption.
 - Rep. Orcutt explained that he is supportive of giving business the deduction, but wondered if it would work in practice. He used the example of a business ordering something that is exempt but would be taxable for other purchases. Would the business receive the exemption or would it have to apply for the credit to use against its liability.
 - Mr. Shirk explained that the business would give a resale certificate, which is current practice.
 - Mr. Prem clarified that if it went under the resale certificate that all of the SSUTA provisions, such as the hold harmless provisions, would apply.
 - Mr. Prem asked if the exemption under (11)(c) for digital goods or automated services available free of charge when the website generates advertising revenue was intended to be narrow. He suggested broadening it to include listing fees, commissions, or other revenue sources.
 - Mr. Shirk commented that he didn’t think it was broad enough to include the other types of revenue.
 - Mr. Bueing agreed with Mr. Prem.
 - Chair Hunter said he tended to concur, but wants to see the implications before he does.

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- **Discussion about use tax exemptions for certain digital goods/digital automated services for which no charge is made. (01:39:41)**
 - Mr. Collier and Chair Hunter asked for clarification about the discussion statement that retail sales tax would not apply because there was no charge, however use tax would apply absent an exemption.
 - Mr. Mullin explained that the term “digital goods” is defined so broadly that, as an example, it literally includes internal e-mails. Sales tax does not apply because there’s no sale of the e-mail. Use tax, however, would arguably be due.
 - Mr. Bueing commented that, in the real world, auditors narrowly apply exemptions to the point where the exemption disappears. He suggested that when the language isn’t clear, incorporating language to broadly construe the exemptions in connection with the spirit of the language.
 - Chair Hunter stated his preference “just get the language right.” He noted that incorporating such language makes him nervous.
 - Mr. Bueing commented that the broad imposition taxes everything and then cuts out some things. From a legal interpretation perspective, the one question that is in the taxpayer’s favor (the initial taxation) is covered by the broad imposition. The part that’s in favor of the taxpayer (the exemption) is going to be narrowed. Mr. Bueing further commented that this is a crucial element of achieving the right result.
 - Ms. Murray explained her belief that the general rules have severed them well. Digital goods exemptions shouldn’t be treated differently.
 - Chair Hunter and Mr. Bueing further discussed the issue.
 - Mr. Collier commented that the premise is there’s no intent to tax what’s currently not taxed. He suggested adding bridge language to that intent.
 - Chair Hunter paraphrased Mr. Collier’s comment as suggesting that language should be added to clarify that they’re not trying to tax tangible personal property that was not previously taxed. Chair Hunter stated he’s not sure why they would do so.
 - Mr. Collier replied that there is an established sales and use tax code regarding tangible items. He questioned that with moving into the digital world, does that mean that they’ll have to battle all of the items from the past or can they include bridge language to make it clear they don’t intend to redo that battle.
 - Chair Hunter commented that the proposal’s language does not address the tangible world.
 - Ms. Murray commented that Mr. Collier is asking to include a digital equivalent test. She believes the Committee rejected that principle early on because there will be products that have no digital equivalent. She believes to provide such a test is a slippery slope.

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- Mr. Prem suggested that the use tax exemption for digital services for which no charge is made include on-demand software. He used the current day example of spreadsheets given away by Google.
 - Mr. Mullin explained that the language before the Committee was cut and pasted from a larger document, which did have the exclusion.
- Mr. Bueing asked why the exemption for personal e-mail communications didn't include business e-mail communications.
 - Mr. Mullin commented that the language could be further clarified to include business e-mail communications. He noted that it would also be excluded as digital goods created solely for an internal audience.
- **Business data sales and use tax exemptions.** (01:53:49)
 - Mr. Mullin explained the thought process that went into drafting sales and use tax exemptions for data sold to a business for business purposes based on Mr. Bueing's comments during the previous committee meeting.
 - Mr. Bueing replied to a question by Chair Hunter that the language was precisely what he had in mind. He noted his assumption that this includes the financial data exemption¹¹ and standard financial information used in a business context.
 - Mr. Collier also replied that he believes this covers what his business deals with, but may not include all types of information that others may purchase. As examples, Mr. Collier used a hospital accessing non-statistical dynamic information data (remedies, drugs, etc.) and genealogical information.¹² He noted that neither of these examples has been taxed in the past.
 - Ms. Murray commented that Mr. Collier's examples seemed to be fixed data rather than dynamic data that change. If it's all data, it should be called data. Ms. Murray asked if a magazine would then be considered data.
 - Chair Hunter noted that everything is data, including the music on a CD.
 - Mr. Mullin explained the concern that data could be construed "extremely broadly," which is why the terms "statistical," "quantitative," and "demographic" were included.
 - Ms. Murray noted that from a business directory, she can look up all oil refiners or she can buy it as a book. She asked if it's statistical data because she's "sliced and diced" a little, or something else.
 - Mr. Mullin replied that it could be depending on what's included.
 - Ms. Murray asked if this is making an exception for between the physical and the non-physical world.
 - Chair Hunter commented that it exempts some things in the digital world that are taxable in the physical world. Their existence is rapidly

¹¹ See ESHB 1981 (chapter 182, Laws of 2007), codified as RCW 82.08.705 and 82.12.705.

¹² Mr. Collier's proposal presented during the May 29, 2008, introduced the term "dynamic information." For more information, refer to the minutes for the May 29, 2008, and the August 12, 2008, meetings.

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diminishing from the physical world. Chair Hunter explained that he isn't saying this fits in the final bill, but he wants everyone to understand the draft. The language is more extensive than current exemptions for business inputs in the physical world. He wants to make sure it works for the intention of the language.

5. Updated Data Presentation by Stephen Smith, PhD, Tax Policy Specialist, Department of Revenue ¹³ (02:01:29)

- Dr. Stephen Smith directed the Committee's attention to a two-page handout.¹⁴
- Page one, a summary titled "Digital Goods State Fiscal Estimate – Cash Basis," is an estimate based on Chair Hunter's proposal language.
 - Chair Hunter confirmed that the estimate is for the base language without Mr. Bueing's proposal to exempt business data. He also noted that for a first cut, the estimate is pretty close to being revenue neutral.
- Dr. Smith walked the Committee through the estimates on page one. He explained that page two provides a breakdown of the estimates.
 - Chair Hunter asked Dr. Smith to walk everyone through his assumptions.
 - Dr. Smith explained that while there is some data available, it's not as high quality as the Department usually prefers to work with.
 - There is some data available for games, on-line activities, etc.
 - Remote access prewritten software (however characterized) begins small but grows over time because it's a more rapidly growing component.
 - Data is also available for streaming, audio-visual, pay-per-program, etc.
 - Chair Hunter asked about the assumption for the "pick-up" period – the time it takes for people to understand they owe the tax and to start reporting.
 - Dr. Smith explained that people tend to comply with new exemptions quicker than with the imposition of a new tax. Compliance for a new tax that requires education takes longer.
 - Dr. Smith also explained the 75 percent compliance rate for use tax from the Compliance Study¹⁵ was used for the estimate.
 - Dr. Smith explained that the data available for the exemption components in number one is skimpy. Using the data presented during the April 2008 meeting, he identified potential exemptions that were and were not included in the proposal and carved the data into segments. He talked with auditors, looked at 10-K

¹³ The Committee broke for lunch after the Discussion of the Proposal Language. Before the Updated Data Presentation, Chair Hunter asked those Committee members participating via phone to identify themselves for the record. Steve Collier identified himself at that time. Ron Bueing later joined the conversation.

¹⁴ Dr. Smith's handout is available on the Department of Revenue's Internet site.

¹⁵ The Department of Revenue's Compliance Study, completed every two years, focuses on taxpayers registered with the Department and uses the results of stratified random sample of audits. The most recent study was released July 10, 2008. The 2008 Compliance Study and earlier studies are available on the Department's Internet site.

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statements, and any other information he could find to come up with the best estimates for all of the components.

- Dr. Smith invited any data that people may have to help with the estimates.
- Chair Hunter asked about the margin of error.
 - Dr. Smith replied that the margin of error is high – probably 50 percent. He clarified, however, that the issue is “sliding” things between categories. He started with a pool of dollars and then cut it up.
- Mr. Justin asked if there is an estimate for the proposed business data exemption.
 - Dr. Smith responded yes and noted that the first year estimate was \$1 million, and growth rates were assumed to be the same as the other growth rates.
- Ms. Murray asked if the estimate for the ingredients/components business inputs exemption was limited to ingredients or components of goods or if it also included ingredients or components of services.¹⁶
 - Dr. Smith confirmed that it was for goods.
- Ms. Murray also asked if the use tax exemption for consumers, such as free software, was assumed to be zero.
 - Dr. Smith explained that the fiscal note is based on current law and it is assumed that the taxes due are paid.
 - Ms. Murray believes the Department’s Compliance Study says otherwise.
 - Mr. Collier commented that he thinks this is very important.
 - Dr. Smith explained that while a fiscal note estimate is current law as compared to proposed law and assumes the tax is paid, comments about noncompliance and potential ranges are addressed in the fiscal note’s text.
 - Ms. Murray believes there should be another component because the use tax exemptions for consumers and businesses could be large, particularly on the business side.
 - Chair Hunter commented that if you don’t provide the exemption there won’t be any tax collected because no one would locate a server farm in the state.
 - Ms. Murray commented that what she’s hearing is that it’s irrelevant and the number should be larger.
- Ms. Murray asked what the amount of the B&O tax reduction is that’s offset by the sales tax gains in number two.
 - Dr. Smith replied that in the first year it would be \$12 million sales tax one way and \$2 million the other way. The sales tax is 6.5 percent and the difference in the B&O tax rate is about one percent.

¹⁶ Ms. Murray’s question was due to the difference between the initial proposal language provided to Committee members on September 19 via e-mail and the edited draft distributed during the meeting. The proposal distributed during the meeting, the phrase “new product or service” used in the definition of “consumer” in RCW 82.04.190 was edited to read “new product.” For more information, please refer to footnote number one on page 1.

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- Referring to Ms. Murray's comment, Mr. Collier commented that the proposal estimate should go down instead of up if the numbers were modified for the tax that's not currently collected.
 - Dr. Smith cautioned that fiscal notes are sometimes counter-intuitive and that he would need to think about it.
 - Mr. Collier replied that the estimate includes as going away tax that the Department has argued is taxable that practitioners haven't treated as taxable.
 - Chair Hunter responded that it is tax that would be collected in the future that the proposal wouldn't collect. He noted that this the unsolvable argument from the committee's first two meetings – whether the Department or the practitioners are correct about the taxability of certain transactions under current law. Instead of having that argument, Chair Hunter would rather decide what to do in the future. He commented that the numbers need further explanation, preferably written definitions to have closer to an actual fiscal note. Chair Hunter also explained reasons why the Department must follow when preparing fiscal notes.
 - Ms. Murray explained her point that there are three categories based on business purchases and that the bill has components related to consumer purchases. She wanted to know if the Department had negated that piece and further commented it sounds like that piece just wasn't considered.
 - Dr. Smith commented that he hadn't worked it through that carefully.
 - Chair Hunter would like it worked out because it may significantly affect the numbers. He suspects the numbers in the outer years are random. In the long run, he's nervous. In the short run, Chair Hunter wants to:
 - Have Ms. Murray's and Mr. Collier's questions answered.
 - Know the error bounds to handicap the numbers as high or low.
 - Know how much more analysis would be done if the proposal was a bill.
 - If the numbers would be more accurate if a fiscal note were generated.
 - To the last point, Dr. Smith noted that it's hard to tell. He explained that fiscal notes are sometimes a public process and the Department receives good data from interested parties that helps to significantly refine the numbers.
- Mr. Prem asked if the retail sales tax numbers were derived from the side of Washington sellers or from the side of consumer purchases. He also asked about the assumptions made for nexus.
 - To Mr. Prem's first question, Dr. Smith replied that he did some of both, but primarily from the consumer side. He explained that he found information from both angles. To the nexus question, Dr. Smith replied that he did not assume that Congress passes legislation that changes nexus standards.

6. Discuss Future Meetings (02:26:40)

- Chair Hunter noted that two more meetings are scheduled for Thursday, October 30th, and Tuesday, November 18th.

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- On October 30th, the Committee is to review the updated bill draft, hear public reaction, and decide what the final report should contain.
- On November 18th, the Committee is to approve recommendations (possibly including a bill draft if there is consensus).
- Chair Hunter commented that it appears he needs to generate a bill draft, but would like to know more about the numbers. He also noted that there is a lot of bill language to complete based on a review of the proposed language. Chair Hunter would like to receive feedback concerning the language, which may affect the numbers. Chair Hunter asked how much time was necessary to review a draft and to get back with substantive comment.
 - Mr. Bueing responded that he generally needs a couple of weeks to receive feedback back from AWB. He wants to discuss the proposal with the organization's Tax & Fiscal Committee, which will meet on October 8th.
- Director Holmstrom committed the Department to getting a concept draft bill to Mr. Bueing for AWB's meeting. The draft will not be final because some of the concepts discussed require additional research and analysis. The Department needs to work with Mr. Prem and others to further clarify the issues raised.
 - Mr. Bueing felt that even if it wasn't the full draft, it would be useful to get feedback on some of the broader concepts. Mr. Bueing will provide comments after the meeting.
- Mr. Prem believes two issues are still "hanging out" there - sourcing and nexus. Is nexus established if people merely store things on a Washington server?
- The October 30th meeting will be used to address these two issues. The Department will have some language ready for the Committee members to review for the meeting.
- Chair Hunter confirmed for Mr. Justin that the draft language will be sent out the first week of November for member to "chew on" before the November 18th meeting.
- Mr. Collier asked if there was a deadline to provide feedback to staff. Mr. Hunter responded that he would get back on that after he confirms dates with staff.
 - Director Holmstrom clarified Mr. Collier's question. He replied that he believes that others will have many thoughts on this draft. Mr. Hunter asked Mr. Collier to provide feedback to the Committee as soon as possible. He explained that he's not sure about the Open Public Meetings aspects, but he's not interested in hiding any of it. Chair Hunter said to send comments and they will be posted somehow.
 - Mr. Collier commented that he expects more proposals for exemptions.

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7. Public Comment (02:37:00)¹⁷

- Ralph Amon (Boeing) presented additional draft language with respect to exempting from retail sales and use tax products delivered in digital form if the tangible form of the product is exempt.¹⁸
- Mr. Amon noted his concern that the SSUTA says that digital goods are not tangible personal property and can't be treated as if they are. He commented that current law provides exemptions that address certain types of and uses of tangible personal property. He is concerned the proposal may result in losing exemptions because the Department will not consider as tangible items that were previously considered to be tangible.
- Chair Hunter asked Mr. Amon to provide an example.
 - Mr. Amon used the example of an electronic flight bag. Mr. Amon explained that instead of the pilot carrying the maps on board the aircraft, the maps are downloaded onto the aircraft's computer system. He's not sure if this is currently considered maps or software, but it's exempt as a component of aircraft used in interstate or foreign commerce.
 - Chair Hunter asked if this was business use – Mr. Amon replied yes.
- Mr. Amon explained that flight bags are currently considered tangible personal property, but that it wouldn't be under the proposal.
- Mr. Amon further explained that his proposal is to cure the unintended consequences that may result. His language would exempt all sales of products that are delivered in digital form that are currently exempt if they were delivered in a tangible form.
- Mr. Amon also noted his agreement with Mr. Prem's comments about the desirability of adopting the SSUTA definitions of specified digital products and then treating everything else in addition to specified digital products. He commented his belief that there would be less resistance to specified digital products than for taxing all other services.

8. Final Comments

- Rep. Orcutt requested that persons submitting future documents to the Committee include their name, affiliation, and contact information on the document.
 - Chair Hunter agreed.

9. Meeting Adjourned.

¹⁷ Although Chair Hunter typically identifies persons who sign the attendance sheets at committee meetings, he did not do so for the September 25th meeting. For the record, the following persons signed the attendance roster: Lew McMurrin (Washington Technology Industry Association), Julie Ewald (KPMG LLP), Terry Byington (AeA – Washington Council), and Michael Transue (Intelius).

¹⁸ Mr. Amon's additional draft language appears on the Department of Revenue's Internet site.

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