

**PRELIMINARY DRAFT—FOR DISCUSSION PURPOSES ONLY. THIS DRAFT IS NOT TO BE CONSIDERED A PROPOSED RULE AND IS ONLY PROVIDED FOR DISCUSSION PURPOSES TO DETERMINE WHAT TOPICS A LATER PROPOSED RULE MIGHT ADDRESS. UNDER NO CIRCUMSTANCES IS THIS DISCUSSION DRAFT TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS**

## **DRAFT RULE 15503 TAXATION OF DIGITAL PRODUCTS**

**Introduction.** Effective July 26, 2009, sales or use tax applies to all digital products and digital codes, regardless of how they are accessed (downloaded, streamed, subscription service, networking, etc.) unless there is an exception or exemption.

Subsection 1 of this section provides definitions and examples of products and services that are transferred electronically:

- Digital goods;
- Digital automated services; and
- Digital codes; and

Also, the definitions include the many exceptions to digital goods, digital automated services, and digital codes, such as telecommunications, internet access, and remote access software. Tax treatment of the products and services that are exceptions to these definitions does not change.

Subsection 2 describes the types of transactions that are exempt from retail sales or use tax, including:

- Purchases to be resold in the regular course of business without intervening use;
- Purchases for use as an ingredient or component of a new product for sale;
- Purchases to be made available at no charge to others;
- Standard digital information purchased solely for a business purpose;
- Purchases for concurrent use by the buyer in and out of Washington State (multiple points of use). Buyer must report use tax for in-state use;
- Radio and television broadcasting; and
- Purchases of newspapers.

Subsection 3 describes miscellaneous provisions, including:

- Sourcing the sale of digital products;
- Royalties;
- Amnesty for past periods; and
- Nexus.

This Section contains examples that identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax status of each situation must be determined after a review of all of the facts and circumstances.

Sellers of digital products must file their taxes electronically.

### **1) Definitions.**

- a) **Digital Products.** “Digital products” means digital goods and digital automated services. Sale of digital goods and digital automated services are retail sales, regardless of whether the purchaser’s right of use is permanent or less than permanent.

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- b) **Digital Goods.** “Digital goods” means sounds, images, data, facts, or information, or any combination, transferred electronically. Digital goods include specified digital products, which are digital audio works, digital audio video works, and digital books. Digital goods also include other products transferred electronically.
- i) Examples of Digital Goods.
- (1) Specified Digital Products. Specified digital products consist of digital audio works, digital audio visual works, and digital books. Each of these terms are addressed below.
- (a) “Digital audio works” means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones.
- (i) “Digital audio works” include recorded or live songs, music, readings of books or other written materials, speeches or ringtones or other sound recordings.
1. A “ringtone” is a digitized sound file that is downloaded onto a device and that may be used to alert the customer with respect to a communication. A “ringtone” does not include “ringback tones” or other digital audio files that are not stored on the purchaser’s communications device.
  2. Ringtone software includes features that permit the user to either mix or compose ringtones, and upload finished ringtones to the user’s cell phone. Ringtone software is software that may support one or more cell phone services and is not a specified digital product.
- (ii) “Digital Audio Works” do not include audio greeting cards sent by electronic mail.
- (iii) Examples:
1. An internet-based business sells music online. For a fixed fee per song, purchasers are authorized to download a song and store it on a portable music playing device and to play the song as many times as they want. It makes no difference whether there is a time restriction with respect to how long the purchaser can keep the song. The downloaded songs are specified digital products because music is specifically included within the definition of “digital audio works.”
  2. A music download service vendor provides a subscriber the right to download a song for a set price and copy that song to a portable music playing device. The subscriber can continue to use that song as long as a monthly fee is paid. If the subscriber fails to pay the required fee, the purchaser is no longer authorized to use or play the song. The sale of the song is subject to tax because the statute specifically imposes and separately enumerates a tax on the sale of specified digital products or digital audio works with less than the right of permanent use or the use of which is conditioned upon the purchaser’s continued payment.

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3. Company F also sells music over the Internet for a fixed fee per song. Purchasers download the songs to their portable electronic recording device. The terms of use that govern the purchaser's use of the songs provide that the purchaser's right to use the song terminates in 99 years. The songs are "specified digital products." The terms of use are part of the Agreement between the seller and the purchaser. This transaction is subject to retail sales tax because both permanent and non-permanent sales to digital goods are subject to retail sales tax unless an exemption applies.

(b) "Digital audio visual works" means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.

(i) Products within the definition of the term "digital audio visual works" include movies, motion pictures, musical videos, news and entertainment programs and live events.

(ii) "Digital Audio Visual Works" does not include video greeting cards or video (or electronic) games.

1. Examples.

a. An internet based business sells music online, including live concerts. The sale of a broadcast of the live performance is the sale of a digital audio video work because the broadcast is a series of related images which, when shown in succession, impart an impression of motion with accompanying sounds.

b. An internet based business sells streamed live sporting events. The sale of a live sports event is also a digital audio visual work because the streamed event is a series of related images which, when shown in succession, impart an impression of motion with accompanying sounds.

c. A satellite television company offers a movie downloading product for all of its subscribers. For an additional fee per movie, paid in addition to the monthly subscription fee, a subscriber can download a movie to a recording device. Once the movie is downloaded, the purchaser is authorized to keep and use the movie permanently. The movie is a specified digital product because a movie falls within the definition of a "digital audio visual work".

d. A cable television service company offers a movie downloading product for all of its subscribers. For an additional fee per movie, paid in addition to the monthly cable television subscription fee, a subscriber can download a movie and save it to a recording device. Once downloaded, the purchaser is only able to watch the movie for 24 hours. After the 24-hour period lapses, even though the copy of the movie remains on the purchaser's device, the purchaser is unable to view it.

i. The purchaser is subject to retail sales tax regardless of whether she downloads, streams, or otherwise accesses the movie. Additionally, the purchaser is subject

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to retail sales tax regardless of whether the movie can be watched for 24 hours, 24 days, or permanently. This is because the statute specifically imposes and separately enumerates a tax on the sale of a specified digital product with less than the right of permanent use.

- ii. Note that in the case of cable television service companies, if the company must pay franchise fees to local jurisdictions on the same income from the fee per movie paid in addition to the monthly cable television subscription fee, then the sale is not subject to retail sales or use tax. See description of the exemption below.
- (c) “Digital books” means works that are generally recognized in the ordinary and usual sense as books.
- (i) This includes any literary work expressed in words, numbers, or other verbal or numerical symbols or indicia so long as the product is generally recognized in the ordinary and usual sense as a “book”. The term includes works of fiction and nonfiction and short stories.
  - (ii) The term does not include periodicals, magazines, newspapers or other news or information products, chat rooms or weblogs.
- (2) **Other products transferred electronically.** This represents a general category designed to capture products that would not qualify as specified digital products, but are still considered digital goods. This category is broad and includes but is not limited to the following items transferred electronically:
- (a) Online newspapers
  - (b) Online periodicals and magazines
  - (c) Car history reports.
  - (d) Online legal research results.
  - (e) Online mapping.
  - (f) Financial information, such as stock quotes and prices streamed to the purchaser’s computer or otherwise transferred electronically.
  - (g) Digital schematics of a lawnmower transferred electronically to a repair shop.
  - (h) Machine readable cataloging (MARC) records transferred electronically for use by libraries.
  - (i) Geographic information system (GIS) data used for mapping purposes by the purchaser.

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- (j) Digital photographs.
  - (k) Database information. For example, ZZ Statistical Data, Inc., allows its customers to perform on-line research of statistical information through its data base. ZZ bills its customers a monthly fee for having on-line access to the data base for research. Its customers do not download any information onto their computers. ZZ's sales are subject to retail sales tax and income from those sales are subject to retailing B&O tax. As long as the purchaser may access the product, it will be considered to have been electronically transferred.
  - (l) Digital mailing lists.
- ii) **Exceptions** to Digital Goods. The following products and services can be transferred electronically, but are not digital goods. Products and services that fall under these exceptions maintain their existing tax treatment.
- (1) Telecommunications and ancillary services. For information about these services see RCW 82.04.065.
  - (2) Computer software as defined in RCW 82.04.215. See the Software Rule (WAC 458-20-15502) for more information on both custom and prewritten computer software.
  - (3) Internet access. "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet and may also include access to proprietary content, information, and other services as part of a package of services offered to consumers. Such term does not include telecommunications services. For information about these services, see RCW 82.04.297.
  - (4) The representation of personal service in electronic form that primarily involves the application of human effort and the human effort originated after the customer requested the service. "Primarily" means greater than fifty percent (50%).
    - (a) For example, an animator creates custom three dimensional still images and three dimensional animations for her customers. Each customer contacts the animator and requests stills or animation, which the animator then creates. The stills and animation would be digital goods, except that they are merely the representation of personal service (creating the still or animation) that primarily involves the application of human effort, which originated after the customer requested the service. The sale of the animation is not subject to retail sales tax and should still be classified under Service and Other Activities for B&O tax.
    - (b) An engineer is hired to write a report on the structural integrity of a bridge. The engineer performs the necessary study and analysis after being hired. After writing the report, the engineer sends the report to the customer via email. The report would be a digital good, except it is the representation of the personal service in electronic form. The service was performed after the customer requested the service.

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Therefore, retail sales or use tax does not apply to the transaction and it should be classified under the Service and Other Activities for B&O tax.

- (c) A digital mailing list can qualify for this exception. If the seller of digital mailing lists provides the ability for purchasers to specify limitations on the mailing list, the true object of the transaction is the purchase of the mailing list. For example, if a purchaser wants a mailing list of all female automobile owners between the ages of 14 and 34 in West Seattle and the seller goes into its database of mailing addresses and demographics to provide such a list, the list is a digital good. If the seller must go out door to door to determine which people on the mailing list are female automobile owners, the resulting list would not be a digital good. Instead, the provision of the list would be taxed as a personal service because it primarily involves the application of human effort and this effort originated after the customer requested the service.
- (d) An attorney drafts a will.
  - (i) The will is drafted for an individual client at the client’s request. If the will is sent to that client electronically, then the transaction is not subject to retail sales tax because the will in electronic form is merely the representation of a personal service performed by the attorney after the service was requested by the client.
  - (ii) The will is sold as a “form” designed for individuals to fill in the blanks. This is not a representation of personal service in electronic form. The “form” will is a digital good and the sale would be subject to retail sales tax unless an exemption applies. Additionally, the income from sales of the “form” will should be subject to Retailing B&O tax.
- c) **Digital Automated Services.** “Digital automated services” (DAS) means any service transferred electronically that uses one or more software applications.
  - i) Examples of DAS include:
    - (1) Search engine services.
    - (2) Online gaming subscription services allowing game playing with other remote players.
    - (3) Online digital photography editing services.
  - ii) **Exceptions** to DAS. The following services can be transferred electronically and performed in part by at least one or more software applications, but are not DAS. Services that fall under these exceptions are taxable under other classifications.
    - (1) Any service that primarily involves the application of human effort, and the human effort originated after the customer requested the service.
      - (a) For example, you can hire an attorney to perform legal research for you on a specific topic. The attorney uses an online legal research tool to perform the research and

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provide a legal brief on the issue. The attorney's work is a service that involves primarily human effort, so it is not a digital automated service even if the legal brief is sent to you electronically. Therefore, the transaction would not be subject to retail sales tax.

- (b) The act of creating a digital layout of advertising for direct mail after the customer requests it, where the purchaser is primarily buying the services of a human creator. If the purchaser can do the online digital layout himself through the tools on the seller's website, then the digital layout of advertising would be a DAS.
- (c) Sales of web site development. Sales of web site development that primarily involve the application of human effort and the human effort originated after the customer requested the service. Gross income received for such development is subject to service and other activities B&O tax.
  - (i) However, if a web site development company provides an online application that offers web site templates to customers, who then pick and choose what color, background, etc. will be on their website, then this service is a DAS subject to RST and retailing B&O tax.
- (d) Sales of on-line advertising services. As a result of the legislative language, it appears some on-line advertising services are subject to tax as digital automated services, however this matter was not discussed during the legislative process. The Department is seeking stakeholder input regarding how to interpret the language as passed and whether any legislative change is advisable.
- (e) Sales of data processing services.
  - (i) "Data processing services" includes, but is not limited to, word processing, data entry, data retrieval, data search, information compilation, payroll processing, business accounts processing, data production, and other computerized data and information storage or manipulation. "Data processing services" also includes the use of a computer or computer time for data processing whether the processing is performed by the provider of the computer or by the purchaser or other beneficiary of the service.
  - (ii) Gross income received for data processing services can be classified under retailing or service and other activities for B&O tax.
    - 1. If the data processing service is performed by an automated process, then it is a digital automated service subject to retail sales tax and retailing B&O tax. If the data processing service is performed primarily by human effort after the request has been received, then it will not be considered a digital automated service and is subject to service and other activities B&O tax.
    - 2. For example, data entry could be DAS or could qualify for an exception. If the purchaser provides a stack of documents with numbers on them which a person

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must “10-key” enter the numerical data into a spreadsheet, then that service would involve primarily human effort and qualify for the exception. If the service provider is able to scan in the stack of documents and use an automated system to read the numerical data into a spread sheet, then the service is DAS.

3. Example. JK Processing, Inc., provides payroll processing services to other businesses. JK is subject to retailing B&O tax for providing data processing services. Could be DAS or RAS depending on the facts.
4. Example. KL Processing, Inc., processes payroll data related to its employees. KL is not subject to manufacturing B&O tax or use tax for the electronic processing of its own data.

(2) The loaning or transferring of money.

(a) Examples:

- (i) Electronic funds transfers are not a DAS. Tax treatment of the income from fees for electronic funds transfers does not change.
- (ii) Credit application processing between a car dealer and a bank. An online form is filled out by the customer, with or without the car dealer. Via the online form, the credit application information is provided to the bank for approval or denial via a series of software applications that compares the application to a matrix of criteria. This is a digital automated service that would not qualify for the loaning or transferring of money exception. Simply processing the application is not loaning or transferring money.

(3) The purchase, sale, or transfer of financial instruments

- (a) Financial instruments include cash, accounts receivable and payable, loans and notes receivable and payable, debt securities, equity securities, as well as derivative contracts such as forward contracts, swap contracts, and options.
- (b) Example. The online service of trading stocks through an online brokerage service is not a DAS. Tax treatment of the fee for online brokerage services does not change.

(4) Dispensing cash or other physical items from a machine.

- (a) Example. A person uses an ATM to get cash from their account. The electronic transfer of data between the ATM and the bank and the one or more software applications used to determine whether to allow or disallow the dispensing of cash is not a digital automated service.

(5) Payment processing services.

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- (a) Example. When a customer purchases an item using a credit card, the vendor will “swipe” the card, which sends the credit card information electronically to the credit card company. The credit card company will charge a fee to process the payment to the seller. That service is not a DAS and the fee charged by the credit card company is not subject to RST. Tax treatment of income from such services remain unchanged.
- (6) Pari-mutuel wagering and handicapping contests as authorized by chapter 67.16 RCW.
- (7) Telecommunications services and ancillary services as defined in RCW 82.04.065. The following examples are not DAS.
  - (a) Sales of Voice over Internet Protocol (VoIP) services. "VoIP service" is a service that enables subscribers to use the internet as the transmission medium for telephone calls by sending voice data in packets in internet protocol. Gross proceeds of sales of VoIP services are sales of telecommunications service defined under RCW 82.04.065 subject to retailing B&O tax and retail sales tax.
  - (b) Sales of intranet services. Gross proceeds of sales of intranet services are sales of telecommunications service defined under RCW 82.04.065 and are subject to retailing B&O tax and retail sales tax.
    - (i) "Intranet service" means the service of providing a private or intracompany network used by a person to facilitate the sharing or accessing of internal information by the person's employees or other authorized parties.
  - (c) For example, VV Telephone, Inc., provides a satellite-based tracking and communications system that includes instant messaging between vehicles in transit and dispatch centers. Both the vehicles and the dispatch centers are operated by its customers, and information is both generated and received by the customers. This is not a sale of digital automated services. The true object of the transaction is the transmission of data between the vehicles and the dispatch centers through VV's communications system. VV is providing telecommunications services subject to retailing B&O tax, and it must collect retail sales tax on the sale of telecommunications services. See RCW [82.32.520](#) for sourcing of telecommunications services.
- (8) Internet access as defined by RCW 82.04.297.
  - (a) The tax treatment of a service that enables users to access content, information, electronic mail, or other services offered over the Internet and may also include access to proprietary content, information, and other services as part of a package of services offered to consumers (such term does not include telecommunications services) does not change.
  - (b) Examples showing internet access, telecommunications, and digital products:

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- (i) ISP, Inc., is an internet service provider that provides customers with access to the internet. ISP does not furnish any telephone lines to its customers in providing this access. ISP maintains its operation in Washington. Amelia is charged a monthly internet access fee from ISP for access to the internet in Washington. ISP is subject to service and other activities B&O tax for the monthly internet access fee charged to Amelia.
  - (ii) Same facts as (c)(iv)(A) of this subsection, except that ISP provides customers with access to the internet along with telephone lines used to provide that access. Amelia is charged a combined monthly fee for access to the internet in Washington using the telephone lines. ISP is subject to service and other activities B&O tax for the combined fee, because the true object of the transaction is to provide access to the internet, rather than to provide telecommunications service.
  - (iii) Telecomm Co. provides customers with telephone lines for telecommunications, including long distance service, and for access to the internet (internet services). Zoe is charged a combined monthly fee for access to the internet and for communication services in Washington using the telephone lines. Telecomm Co. is subject to retailing B&O tax for the combined fee because the primary purpose of the transaction is to provide telecommunications service, rather than to provide access to the internet. However, if Telecomm Co. separately states or can reasonably identify from its books and records the fees for telecommunications service and internet access, then Telecomm Co. will be subject to retail and service classifications respectively
  - (iv) DD Computers, Inc., provides access to information through its web site for which it charges its users a fee. DD charges Stan, a Washington customer, a transaction fee to use DD's web site to search and retrieve real estate appraisal information. DD is not providing internet service because DD is not an ISP and does not provide customers with access to the internet. DD, however, is providing Stan access to its web site for informational search and retrieval which is a digital product subject to retail sales or use tax and classified under retailing for B&O tax.
- (9) Remote access software (RAS) is not DAS. See the definition of RAS in the Software rule (WAC 458-20-15502) for more information. Both RAS and DAS involve software and the electronic transfer of data.
- (a) If the software application only uses the customer's data, then it is remote access software.
  - (b) If the software application uses the seller's data, then it is a digital automated service.
  - (c) Another way to tell if it is DAS or RAS is based on how much functionality remains if the software is unplugged from the network. For example, if the online software application is merely the online version of the desktop version of the prewritten software application, then it is remote access software.

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- (i) For example, tax preparation software can be purchased on tangible storage media (like a CD-ROM), downloaded, or accessed remotely at an Application Service Provider (ASP). The remotely accessed tax preparation software provided by the ASP is remote access software.
- (10) Online educational programs
- (a) Provided by a public and private elementary or secondary school (K-12)
    - (i) Local High offers students an “introduction to Spanish class” online. The lectures and homework are provided online, as is instant message and email services for student to student and student to teacher interaction. The online Spanish class offered by Local High is not a DAS.
  - (b) An institution of higher education as defined in sections 1001 or 1002 of the federal higher education act of 1965 (Title 20 U.S.C. Secs. 1001 and 1002), as existing on July 1, 2009. The online educational program must be encompassed within the institution's accreditation.
    - (i) For example, an accredited university offers online courses in Spanish. The online course includes live broadcast lectures that are then available for students to view again for up to a week after each lecture. The online course includes chat rooms and email between the professor and students. The online course includes homework and online tests using an interactive software program. This online educational program qualifies for the exception because the course is part of the university's accredited class offerings.
    - (ii) If the same type of course is offered by an online education provider that is not accredited under the federal higher education act, the course would be a DAS and sale of the online course would be subject to retail sales tax unless an exemption applies.
    - (iii) The original accredited university offers a community online Spanish course that does not count toward college credit. This online community course would not qualify for the exception and would be a digital automated service.
- (11) Travel agent services, including online travel services, and automated systems used by travel agents to book reservations
- (a) The automated systems used by travel agents are the back end reservation services used by travel agent services. Sales of these reservation services are not DAS and are not subject to retail sales tax.
  - (b) WW Travel, Inc., bills its customers a monthly fee for having access to a travel reservation system that includes a charge for dedicated telephone lines. WW is subject to service and other activities B&O tax because WW is providing online travel agent services which are exceptions to digital automated services and is not

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providing a telecommunications service. WW is consuming the phone lines in providing the services. The provider of dedicated telephone lines to WW must collect retail sales tax from WW on the sale of telecommunications service.

(12) Creation of an online market place

- (a) Store.com owns and operates a website that sells tea pots and coffee mugs. Store.com enters into agreements with Cook's Co to allow Cook's Co. to sell Tea Lover cookbooks on Store.com's website. Store.com charges Cook's Co. a fee on each sale. Store.com is selling a service that allows the person (Cook's Co.) receiving the service (Cook's Co.) to make online sales on Store.com's web site. This service is not a digital automated service and the tax treatment of the income generated by this service does not change.

(13) Online classified advertising

- (a) This exception is limited to online advertising in form of traditional newspaper classified ads, so long as the product is generally recognized in the ordinary and usual sense as "classified advertising."
- d) **Digital Codes.** "Digital codes" means a code that provides a purchaser with the right to obtain one or more digital products, if all of the digital products to be obtained through the use of the code have the same sales and use tax treatment. A digital code may be obtained by any means, including e-mail or by tangible means regardless of its designation as song code, video code, book code, or some other term.
- i) For example, Jack purchases a "digital code" that allows the electronic delivery of a single song (which constitutes a "digital audio work"). The purchase of the "digital code" is subject to retail sales tax because "digital audio works" are subject to tax. However, when Jack takes electronic delivery of the "digital audio work", no taxable event occurs; Jack has already paid the tax due with respect to the sale of the "digital audio work."
- ii) "Digital code" does not include a code that represents a stored monetary value that is deducted from a total as it is used by the purchaser.
- (1) This stored monetary value need not be denominated in cash. It can also be denominated in things like points or "in-game currency."
- (2) The sale of points or in-game currency denominations may be sales of digital products.
- iii) "Digital code" also does not include a code that represents a redeemable card, gift card, or gift certificate that entitles the holder to select digital products of an indicated cash value.
- iv) Digital codes only give access to digital products that are all taxed the same

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- (1) For example, a soft drink bottle cap has a code that when entered online at the soft drink company's web page, provides the customer with:
  - (a) A free music file for download; and
  - (b) The ability to purchase music and movie files at a discounted price.
- v) Codes that give access to a mixture of products and services that receive multiple tax treatments are not digital codes. Codes that provide access to products and services that receive multiple tax treatments are bundled sales.
  - (1) If the code provides the purchaser digital products that do not have the same tax treatment, it is not a digital code. In this case, the entire price of the code is subject to sales or use tax if any of the products to be obtained by the code are subject to sales or use tax.
  - (2) If the seller can identify, by verifiable standards, the portion of the selling price that is not subject to sales tax, then tax applies only to the taxable products. This must be based on the seller's accounting records kept in the regular course of business.
  - (3) See RCW 82.08.190 and 82.08.195 for more information on bundled transactions.
- e) **Electronically transferred.** "Electronically transferred" means obtained by the purchaser by means other than tangible storage media (such as CD-ROM or DVD). It is not necessary that a copy of the product be physically transferred to the purchaser. So long as the purchaser may access the product, it will be considered to have been electronically transferred to the purchaser.
- f) **First use** definitions.
  - i) With respect to a digital good or digital code, the first act within this state by which the taxpayer, as a consumer, views, accesses, downloads, possesses, stores, opens, manipulates, or otherwise uses or enjoys the digital good or digital code;
  - ii) With respect to a digital automated service, the first act within this state by which the taxpayer, as a consumer, uses, enjoys, or otherwise receives the benefit of the service;
  - iii) With respect to a service defined as a retail sale in RCW 14 82.04.050(6)(b), the first act within this state by which the taxpayer, as a consumer, accesses the prewritten computer software; and
  - iv) With respect to a service defined as a retail sale in RCW 82.04.050(2)(g), the first act within this state after the service has been performed by which the taxpayer, as a consumer, views, accesses, downloads, possesses, stores, opens, manipulates, or otherwise uses or enjoys the digital good upon which the service was performed;

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- g) **"End user"** means any taxpayer as defined in RCW 82.12.010 other than a taxpayer who receives by contract a digital product for further commercial broadcast, rebroadcast, transmission, retransmission, licensing, relicensing, distribution, redistribution or exhibition of the product, in whole or in part, to others. A person that purchases digital products or digital codes for the purpose of giving away such products or codes will not be considered to have engaged in the distribution or redistribution of such products or codes and will be treated as an end user;
- i) If a purchaser of a digital code does not receive the contractual right to further redistribute, after the digital code is redeemed, the underlying digital product to which the digital code relates, then the purchaser of the digital code is an end user. If the purchaser of the digital code receives the contractual right to further redistribute, after the digital code is redeemed, the underlying digital product to which the digital code relates, then the purchaser of the digital code is not an end user. A purchaser of a digital code who has the contractual right to further redistribute the digital code is an end user if that purchaser does not have the right to further redistribute, after the digital code is redeemed, the underlying digital product to which the digital code relates.
- (1) SongCo operates a website that maintains a catalog of songs available for customers to download. SongCo uses digital codes to facilitate the download of songs by customers. ColaCo, a soft drink bottling company, purchases from SongCo 10,000 digital codes. The contract between SongCo and ColaCo does not give ColaCo the right to redistribute the songs once they have been downloaded. ColaCo, as part of a promotion, places the digital codes in the bottle caps of some of its soft drink products. Customers who buy ColaCo's products receive the digital codes when they purchase a bottle of one of its soft drinks. The customer uses the digital codes to download songs from SongCo's website. Because ColaCo did not receive any right to redistribute the songs once they were downloaded, ColaCo is an end user of the songs represented by the digital codes. The transaction between SongCo and ColaCo is a sale to an end user. (Note: an exemption may apply to ColaCo's purchase).
- (2) Same facts as the example above, except that ColaCo, instead of using the digital codes as part of a promotion intends to resell the digital codes in several states, some of which impose sales tax on electronically transferred digital audio works and some which do not. ColaCo provides SongCo with a sale for resale exemption certificate. ColaCo charges sales tax on the resale of the digital codes in those states that impose tax on digital audio works. The codes purchased by ColaCo are digital codes because ColaCo did not receive any right to redistribute songs after they are downloaded. The fact that ColaCo resold the codes does not disqualify them from being digital codes.
- 2) **Exemptions.** The following exemptions are exemptions from retail sales and/or use tax. Income from exempt sales of digital products and digital codes are still subject to Wholesaling or Retailing B&O tax. This exemption is only available when the buyer provides the seller with an exemption certificate.

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**a) Purchases for Resale.**

- i) Sales tax does not apply to purchases for resale of digital products and digital codes. The buyer must give the seller a completed resale certificate (or reseller's permit after January 1, 2010) when the sale occurs. The seller must keep the certificate, or a copy of the certificate, in their records for five years. The exemption certificate may be used instead of a resale certificate for purchases of digital products, digital codes, prewritten computer software, and remote access software. Sales tax applies unless the buyer provides this exemption certificate or a resale certificate.
  - (1) For example, statistical data purchased to be resold without additional analysis would qualify as a purchase for resale.
  - (2) Music or a book purchased for resale qualifies for this exemption. See WAC 458-20-102.
- ii) Purchase of a digital product that is then placed on tangible storage media to be sold is not a resale, but would be the purchase of an ingredient or component of a new product.
- iii) As of January 1, 2010, the resale certificate will be replaced by the Reseller's Permit. For information about the Reseller's Permit, visit [dor.wa.gov](http://dor.wa.gov) or statute SB 6173, Chapter 563, Laws of 2009.
- iv) The purchaser may provide either a resale certificate, the Digital Products and Remote Access Software Exemption Certificate, or, after December 31, 2009, the Reseller's Permit. The seller would not collect and remit RST if the purchaser provides the appropriate documentation of the exemption and would report the income under Wholesaling B&O tax. Please note that sales qualifying for the other exemptions listed below are still classified as Retailing for B&O tax but are not subject to retail sales or use tax.

**b) Ingredient or component.**

- i) Digital product for use as an ingredient or component of a new product for sale: To qualify, digital products, digital codes or remote access software purchased must become an ingredient or component of a new product.
- ii) New product means a new tangible personal property, digital good, digital automated service, tangible personal property, or remote access software. If a company purchases a digital automated service and adds its own capabilities to then sell to a third party, the digital automated service purchased by the company is an ingredient or component.
- iii) Examples include:
  - (1) Music file purchased to place on a CD to be sold. The music file is an ingredient or component of the CD.

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- (2) Music used in a training video that will be streamed to customers. The music file is an ingredient or component, the purchase of which is not subject to retail sales tax. If the training video includes other functionalities that would qualify it for an exception, such as the primarily human effort exception to the definition of Digital Goods, then the sale of the training video is classified under Service & Other Activities for B&O tax and the purchase of the music is subject to retail sales or use tax.
- (3) Search engine purchased for use on a business's web page that customers pay a subscription fee to access.
- iv) The seller would not collect and remit RST if the purchaser provides the resale certificate, the Digital Products and Remote Access Software Exemption Certificate, or, after December 31, 2009, the Reseller's Permit, and would report the income under Retailing, not wholesaling, for B&O tax.
- c) **Made available at no charge.**
  - i) Digital products made available at no charge to others: Digital products, digital codes, and remote access software purchased by a business to make available free of charge for others to use or enjoy.
  - ii) The following examples qualify for the exemption because they are digital products made available at no charge.
    - (1) Online mapping service that provides satellite images. Online mapping company does not pay retail sales or use tax on the purchase of the satellite images. End users of the online mapping service do not owe use tax on the use of the online mapping service.
    - (2) Purchases by a parent of a song for use by their children to listen and enjoy does not qualify for this exemption.
    - (3) Purchases of a movie online for the buyer and her date to watch is not exempt.
    - (4) Purchases of a photograph for placement on a webpage for others to view and download would qualify for this exemption.
    - (5) Use of free online search engines qualify for this exemption.
    - (6) Libraries providing ebooks to library patrons are exempt from RST or use tax on the purchase of the ebook. The library patrons are exempt from use tax on the use of the ebook obtained from the library.
    - (7) Purchase of a digital code by a soft drink company to give away the underlying song the digital code provides access to.
    - (8) Lawnmower schematics posted on the manufacturer's website so that anyone can download the schematics to repair their lawnmower.

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**d) Standard digital information.**

- i) Standard digital information purchased solely for a business purpose: Standard digital information consists primarily of data, facts, or information that is not generated for a specific client or customer. Standard digital information does not include sounds or images.
  - (1) “Business purpose” means the information is relevant to the buyer’s business needs. This exemption does not apply to purchases for personal or household purposes or for any activity conducted by a government entity. This exemption also does not apply to purchases of digital automated services, prewritten software, or remote access software.
  - (2) Government entities may not take this exemption on purchases of standard digital information.
  - (3) Examples
    - (a) Financial information, such as stock quotes and prices, purchased and downloaded by an investment advisor to determine net asset value of a mutual fund at the end of each day’s trading.
    - (b) AA Data, Inc., provides a daily report of bond ratings for electronic download by its investment management company consumers. Each investment management company downloads the same report. AA provides standard financial information that falls within the standard digital information exemption if the purchaser buys the information for a business purpose. If the purchaser provides an exemption certificate, AA does not collect or remit retail sales tax.
    - (c) Digital schematics of a lawnmower posted on a manufacturer’s website that are available for a fee for use by repair facilities.
    - (d) Machine readable cataloging (MARC) records transferred electronically for use by private libraries in tracking their inventory.
    - (e) GIS data transferred electronically for mapping purposes by the businesses.
    - (f) Hydrogeological information purchased by a hydro-drilling company.
    - (g) Driver accident records purchased by an insurance company to determine insurance rates.

**e) Multiple Points of Use.**

- i) Digital product, prewritten software, or remote access software, for concurrent use by the buyer in and out of Washington State is exempt from retail sales tax. A buyer may

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purchase digital products, digital codes, prewritten computer software, or remote access software for concurrent use by businesses' employees located inside and outside the state. A business claiming this exemption must report and pay use tax on that portion of the digital products, digital code, or remote access software used in Washington. The taxable amount is determined by the number of users in this state compared to users everywhere. Generally, digital products and remote access software are used in Washington when the buyer first accesses, downloads, possesses, opens, stores, enjoys, or receives the benefit of the service in this state. A buyer may not claim a multiple points of use exemption for personal use.

ii) Based on the buyer's records, the buyer may apportion the use tax in proportion to the in-state to out-of-state users. This is not limited to the number of employees that actually use the product.

(1) Number of employees in this state

(2) Divide it by the number of employees everywhere.

iii) Thus, even if delivery of the product occurs in Washington, a person eligible for the MPU exemption only owes use tax on the apportioned value. The Department may authorize or require an alternative method of apportionment, supported by the taxpayer's records, that fairly reflects the proportion of in-state to out-of-state use.

(1) For example, if a business with one hundred employees nationwide, twenty of which are in WA, purchases two prewritten software licenses for use by an employee in WA and an employee in OR and the software is delivered to WA, then the business will likely be required to apportion the use tax based on the two employees are located rather than on the business's number of employees in this state divided by the number of employees everywhere.

f) **Common digital goods exempt from tax:**

i) Digital goods that are not offered for sale are exempt from tax when they are:

(1) Noncommercial (such as personal email communications);

(2) Created solely for an internal audience; or

(3) Created solely for the business needs of the person who created the digital good and is not the type of digital good that is offered for sale, such as business email communications.

ii) Examples:

(1) Email correspondence between two employees at a company.

(2) Email correspondence between a grandparent and grandchild.

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- (3) A newsletter created by a company for its employees that is distributed via email or on the company's intranet site would be a common digital good created solely for an internal audience.
- g) **M&E exemption.**
  - i) M&E includes digital goods. Digital goods used directly in a manufacturing operation are exempt under the M&E exemptions, provided all of the requirements of the exemption are met. See WAC 458-20-13601 for more information on the M&E exemption.
  - h) Radio and television broadcasts
    - i) Television and radio broadcasts of regular programming are not subject to sales or use tax.
      - (1) Regular programming is scheduled programming which the viewer does not choose when it is broadcast. The viewer cannot stop, pause, rewind, or otherwise control the broadcast of the scheduled programming.
      - (2) The fact that a customer uses a recording device, such as a VCR or DVR, does not result in the broadcaster's programming being characterized as a digital good.
    - ii) However, if a broadcaster sells programming on a pay-per-program basis that allows the buyer to access a specific program or library of programs at any time for a specific charge, then sales tax applies.
      - (1) There is an exemption for cable companies' sales of pay-per-program programming if the cable company is subject to a franchise fee on the gross revenue from the sale. If the cable company does not pay a franchise fee on the income from the pay-per-program programming, then the cable company must collect and remit retail sales tax on the sale of pay-per-program programming.
      - (2) Satellite providers have a federal exemption from local sales and use tax when they sell programming on a pay-per-program basis. Satellite providers must collect and remit the 6.5% state portion of the retail sales tax.
      - (3) Cable companies and satellite provider income from sales of pay-per-program programming is subject to retailing B&O tax.
- i) **Newspapers.**
  - i) The sale of newspapers transferred electronically is exempt if it is the electronic version of a printed newspaper. The electronic version must:
    - (1) Share content with the printed newspaper; and

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- (2) Be prominently identified by the same name as the printed newspaper or otherwise conspicuously indicate that it is a complement to the printed newspaper.
  - ii) "Printed newspaper" means a publication issued regularly at stated intervals at least twice a month and printed on newsprint in tabloid or broadsheet format folded loosely together without stapling, glue, or any other binding of any kind, including any supplement of a printed newspaper
- 3) Miscellaneous provisions.**
- a) Sourcing sales of digital products and digital codes.
    - i) The standard sourcing rules from the Streamlined Sales and Use Tax Agreement (SSUTA) apply to the sourcing of digital products and digital codes.
    - ii) Under the SSUTA, sales of digital products and digital codes are sourced the same as other sales. Sales are sourced according to the following hierarchy:
      - (1) The seller's place of business if the purchaser receives the digital product at the seller's place of business;
        - (a) Customer hooks up their Mp3 player in the brick and mortar store to download purchased songs.
        - (b) In store computer terminal is used to access DAS (like a wedding registration).
      - (2) If not received at the seller's place of business, the location where the purchaser receives the digital product and digital code;
        - (a) Seller electronically delivers copies of digital goods to multiple locations of the Purchaser. The Seller has the information identifying the multiple locations for the electronic delivery of the digital goods. The Seller sources the retail sale to each jurisdiction where the Purchaser receives the prewritten computer software.
        - (b) Seller electronically delivers a digital good to the Purchaser's server in State A. The Seller has information identifying the location of the server in State A. Purchaser subsequently downloads copies of the digital good to its multiple locations. The Seller sources the retail sale to the jurisdiction where the Purchaser receives the digital good; at the location of the server in State A. Seller has no responsibility to source the retail sale to any other state.
        - (c) Purchaser headquartered in State A also has locations in States B and C. The Seller electronically transfers digital goods to the Purchaser's server located in State B. The Seller has information identifying all of these locations. The Purchaser's digital goods will be accessed by its employees in all three states. The Seller sources the retail sale to the jurisdiction where the Purchaser receives the digital good, at the location of the

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server in State B. Seller has no responsibility to source the retail sale to any other state.

- (3) If the location where the purchaser receives the digital product and digital code is not known, the purchaser's address available in the seller's business records;
    - (a) Purchaser accesses a digital automated service from an unknown location(s). The Seller has information identifying an address that is maintained in the Seller's files for business purposes. The Seller sources the retail sale to the jurisdiction for the address of the business location of the Purchaser available in the Seller's business records.
  - (4) If no address is available in the seller's business records, the purchaser's address obtained at the time of sale (e.g., purchaser's payment instrument) when use of this address does not constitute bad faith;
    - (a) The Seller makes retail sales of digital codes by allowing Purchasers to electronically download the digital code from Seller's website. In connection with the retail sale, the Purchaser discloses an address associated with the credit card used to pay for the digital code. This is the only location information the Seller receives from the Purchaser in connection with the retail sale. The Seller sources the retail sale to the jurisdiction of the address for the Purchaser associated with the credit card payment.
    - (b) The Seller makes retail sales of digital products. In connection with the retail sale, the Purchaser uses a payment method that does not disclose any location information besides an IP address. The Seller sources the retail sale to the jurisdiction associated with the IP address.
  - (5) If no address is obtained at the time of sale, the address where the digital product and digital code is first made available for transmission by the seller.
    - iii) The majority of such sales will likely be sourced according to the buyer's billing address available in the seller's business records or obtained at the time of sale since most businesses will not know the actual location of the buyer at the time of the purchase.
- b) Bundled transactions.
- i) See RCW 82.08.190 and 82.08.195 for more information on the tax treatment of bundled transactions.
- c) Royalties
- i) Similar to licenses for software, some licenses for digital products are considered a retail sale of the underlying digital product and some licenses are considered royalties for the granting of intangible rights, such as copyrights. These circumstances are dependent on the facts and will have to be looked at on a case by case basis.

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- ii) For example, the licensing of photographs delivered electronically for publication in a newspaper would be classified as royalties for B&O tax. The transaction would not be the sale of a digital good and the transaction would not be subject to retail sales tax.
- d) Nexus: If a company's only contact with the state of Washington is putting a digital product, digital code, or software on a server in Washington, merely having something on a third party server in WA does not establish nexus for that company. If an out-of-state person owns the server, then owning the server can be considered to determine nexus.
- e) Amnesty is given to those who did not collect or pay sales or use tax on digital goods, digital codes, and the installation, repairing, altering, or improving of digital goods that were subject to tax before July 26, 2009. Before July 26, 2009, sales of digital goods for download (permanent or non-permanent does not matter) were subject to retail sales and use tax. Sales of DAS and RAS are subject to Service & other B&O tax before July 26, 2009 and amnesty does not extend to any B&O tax liability for sales of DAS and RAS before July 26, 2009.
- f) Property tax. The law does not characterize digital goods and digital codes as tangible or intangible personal property for purposes of property taxation.