

Digital Products Taxation

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Agenda

- ▶ History of digital products taxation in Washington
- ▶ Current taxing framework
- ▶ What's next for the Department of Revenue

History of Taxing Digital Products

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Prior to 2007

▶ Trends

▶ Increased

- ▶ Internet usage

- ▶ Bandwidth

- ▶ Product and services offered

- ▶ Increasing number of disputes around digital transactions

What Are Digital Transactions?

▶ Examples

- ▶ Books
- ▶ Music
- ▶ Video
- ▶ Information services
- ▶ Cloud services
 - ▶ Software
 - ▶ Storage
 - ▶ Computing power



Tipping Point?

- ▶ A taxpayer requested a specific exemption for its industry
- ▶ Raised questions and a need to modernize
- ▶ Focused industry, the Department, and Legislature on evolving tax issues

Research and Collaboration

- ▶ In 2007 the Department was directed to study the taxation of digital products
 - ▶ Legislators
 - ▶ Industry
 - ▶ Academics
 - ▶ Government representatives
- ▶ Reviewed
 - ▶ Current treatment of digital goods in WA
 - ▶ Other states and countries
 - ▶ Treatment under Streamlined Sales and Use Tax Agreement

Challenges Identified by Committee

- ▶ Antiquated laws
 - ▶ Uncertainty in application of law and need to modernize
- ▶ Erosion of tax base as items move to digital
 - ▶ E.g. books, music, and video moving into digital world
 - ▶ Also cloud computing with software and infrastructure outsourced
 - ▶ Other
- ▶ Streamlined Sales and Use Tax Agreement requirements for taxing digital products
 - ▶ Cannot tax digital goods as tangible personal property
 - ▶ Need to create special categories

Guiding Principles, Part I

- ▶ **Simplicity**
 - ▶ Must be administrable
- ▶ **Conformity (with Streamlined Sales and Use Tax Agreement)**
 - ▶ Create specific categories
- ▶ **Technology neutral**
 - ▶ Industry, delivery method, etc. (Example: must treat online and offline transactions the same)

Guiding Principles, Part II

- ▶ Revenue impact
 - ▶ Up, down, or neutral
- ▶ Competitiveness
 - ▶ Compare other states and countries
- ▶ Long term solution
 - ▶ Solution must be durable
 - ▶ Address evolution away from tangible equivalents

Original Alternatives

- ▶ Do not tax digital products
 - ▶ Simplicity
 - ▶ Lost revenue
 - ▶ Advantage for online products is unfair
- ▶ Tax digital products
 - ▶ Specific approach
 - ▶ Repeated legislative amendments could be challenging
 - ▶ Easier to control tax burden on transactions
 - ▶ General approach
 - ▶ Avoid repeated amendments
 - ▶ Follow tradition of taxing all tangible personal property with taxing all digital products unless exempted

Current Status

- ▶ Initial legislation enacted in 2009
- ▶ Clarifying legislation in 2010
- ▶ Solid working framework for 10 years with reasonable success
 - ▶ May need to consider updating certain aspects

Taxing Digital Products

The background features abstract, overlapping geometric shapes in various shades of blue, ranging from light sky blue to deep navy blue. The shapes are primarily triangles and polygons, creating a modern, layered effect. The overall composition is clean and professional, with the text centered on a white background.

Washington Law

- ▶ Digital products are subject to retail sales tax:
 - ▶ Digital codes
 - ▶ Digital goods
 - ▶ Remote Access Software (RAS)
 - ▶ Digital Automated Services (DAS)

Digital Codes

- ▶ Have not been an issue
- ▶ Provides purchaser the right to obtain a digital good or DAS
 - ▶ Example: digital code inside bottle cap allows the purchaser the right to obtain an MP3 file

Digital Goods

- ▶ Streamlined Sales and Use Tax Agreement definition
 - ▶ “Specified digital goods” such as digital books, music, and video
- ▶ Washington definition
 - ▶ Sounds, images, data, facts or information or any combination thereof
 - ▶ digital picture, engine schematic, PDF file

Remote Access Software (RAS)

- ▶ Washington taxes prewritten software as tangible personal property
 - ▶ Tangible media
 - ▶ Downloaded
- ▶ Prewritten software accessed remotely is a retail service
 - ▶ Purchaser is charged for the right to access and use prewritten software, where possession is maintained by seller or a third party

Digital Automated Services (DAS)

- ▶ Beyond software and digital goods
- ▶ Digital Automated Service (DAS) is unique:
 - ▶ “...any service transferred electronically that uses one or more software applications...”
 - ▶ Broad imposition but many exclusions
- ▶ With DAS category Washington addressed:
 - ▶ Rapid change in business models and technology
 - ▶ Changes could make digital goods and RAS categories obsolete

Exclusions from DAS

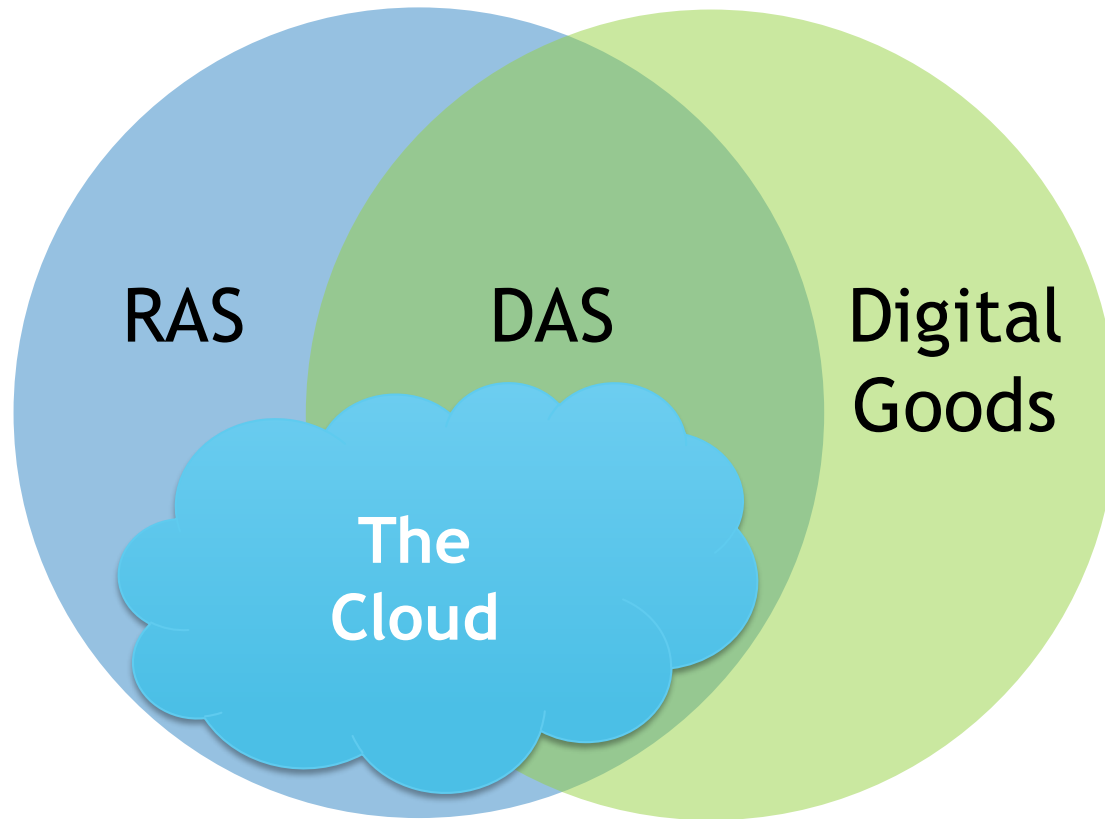
- ▶ Human effort by the seller
- ▶ Loaning or transferring of money or the purchase, sale, or transfer of financial instruments
- ▶ Payment processing services
- ▶ Online educational programs
- ▶ Live presentations
- ▶ Online marketplace facilitators
- ▶ Advertising services
- ▶ The mere storage of digital products
- ▶ Data processing services

Exemptions for Digital Products

- ▶ Purchases for resale
- ▶ Digital products made available for free to the general public
- ▶ Multiple Points of Use (MPU)

- ▶ Exemptions only for digital goods
 - ▶ Manufacturing Machinery and Equipment (M&E)
 - ▶ Solely for a business purpose

How it Fits Together



What's Next for WA?

- ▶ **Current Landscape.**
 - ▶ Comprehensive and durable framework
 - ▶ Framework is 11 years old and may benefit from updating
 - ▶ Digital goods and services significant part of the economy
 - ▶ Wayfair has made taxing out of state taxpayers easier
- ▶ **Administrative Rule Making:**
 - ▶ Stakeholder work
 - ▶ Exemptions and exclusions clarified and revisited
 - ▶ MPU exemption
 - ▶ Advertising exclusion