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
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
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

RAS  DAS  Digital Goods

The Cloud
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