



# 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



# Current Status

- ▶ Initial legislation enacted in 2009
- ▶ Clarifying legislation in 2010
- ▶ Solid working framework for 10 years with reasonable success

# 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 text is centered in a clean, dark blue font.

# Washington Law

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

# 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
  - ▶ Includes services provided exclusively in connection
- ▶ With DAS category Washington addressed:
  - ▶ Rapid change in business models and technology
  - ▶ Changes could make digital goods and RAS categories obsolete



# Unpacking Digital Automated Services

- ▶ Service elements?
  - ▶ Supply of digital goods/information
  - ▶ Coordination/facilitation with other services and functions (pull data on credit)
  - ▶ Automation (route requests)
- ▶ Transferred electronically
  - ▶ Dashboard or internet interface (not tangible media)
- ▶ Software
  - ▶ Coded instructions acting on computer





# Examples of Digital Automated Services

- ▶ Online legal research platforms
- ▶ Online multiplayer games
- ▶ Content delivery networks
- ▶ Cloud computing platforms

## Comparing RAS & DAS

- ▶ RAS is solely prewritten software that is made remotely accessible.
  - ▶ To the extent that *components similar to digital goods and/or additional services are supplied* with the prewritten software the sale may be the sale of a *digital automated service*.
- ▶ DAS = Prewritten software remotely accessed + “components” (e.g. digital goods) or “additional services” or “functionality”

# DAS Exclusions

# Frequently Used Exclusions

- ▶ Advertising
- ▶ Data Processing
- ▶ Marketplace

# Advertising

- ▶ Advertising services means all services directly related to the creation, preparation, production, or the dissemination of advertisements.
- ▶ Advertising services do not include web hosting services and domain name registration.

## Includes Traditional Activities

- ▶ Layout
- ▶ Art direction
- ▶ Graphic design
- ▶ Mechanical preparation
- ▶ Production supervision
- ▶ Placement, and
- ▶ Rendering advice to a client concerning the best methods of advertising that client's products or services.

## Also Includes Digital

- ▶ Online referrals
- ▶ Search engine marketing and lead generation optimization
- ▶ Web campaign planning
- ▶ The acquisition of advertising space in the internet media
- ▶ The monitoring and evaluation of web site traffic for purposes of determining the effectiveness of an advertising campaign.

# Data processing

- ▶ Data processing services means a primarily automated service provided to a business or other organization where the primary object of the service is the systematic performance of operations by the service provider on data supplied in whole or in part by the customer to:
  - ▶ (i) Extract the required information in an appropriate form, or
  - ▶ (ii) to convert the data to usable information.



# Examples

- ▶ check processing
- ▶ image processing
- ▶ form processing
- ▶ survey processing
- ▶ payroll processing
- ▶ claim processing



# Marketplace

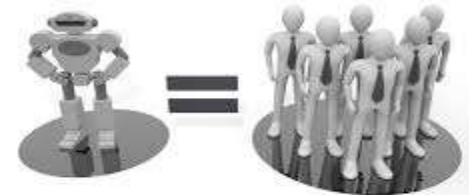
- ▶ Online marketplace related activities, which are services that allow the person receiving the services to make online sales of products or services, digital or otherwise, using either:
  - ▶ (i) The service provider's website; or
  - ▶ (ii) The service recipient's website, but only when the service provider's technology is used either to:
    - ▶ (A) Create or host the service recipient's website; or
    - ▶ (B) Process orders from customers using the service recipient's website.

## Example Areas for Clarification



# Primarily Human Effort

- ▶ Any service that primarily involves the application of human effort by the seller, and the human effort originated after the customer requested the service
  - ▶ Rule: "primarily" means greater than fifty percent of the effort to perform the service involved human labor.
  - ▶ Rule: Determine whether the fifty percent or greater threshold is satisfied, the average of the time and cost factors is considered.
- ▶ Combination of service using software and human effort
- ▶ A professional using software as a tool to perform service
  - ▶ Software automation is not the thing sold to the customer



# Services Exclusively in Connection

- ▶ A retail sale of digital automated services includes *any services provided by the seller exclusively in connection with the digital automated services*, whether or not a separate charge is made for such services.
- ▶ Ancillary services
  - ▶ Implementation
  - ▶ Help desk

# What's Next?

- ▶ Administrative Rule Making:
  - ▶ Stakeholder work
  - ▶ Exemptions and exclusions clarified and revisited
    - ▶ MPU exemption
    - ▶ Advertising exclusion
- ▶ Issues the Department will continue to evaluate
  - ▶ Primarily Human Effort
  - ▶ Services in connection with DAS

