

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

## **Taxation of Digital Products & Digital Codes**

### **Introduction**

This rule provides a structured approach for determining tax liability for digital products and digital codes. For purposes of this rule, a digital product includes digital goods or digital automated services, which are described in detail below. The sale or use of digital products and digital codes is generally subject to retail sales or use tax unless purchased for resale or some other exemption applies.

This rule is organized into six sections. Each section addresses a question or topic relevant to the determination of whether a person is selling or purchasing a digital product or digital code and, if so, what are the tax consequences that follow from such activity.

- I. Are the products or services transferred electronically?
- II. Does the product or service meet the general definitions of “digital product” or “digital code”?
- III. Are there applicable exclusions from the general definitions of digital product and digital code?
- IV. Are the sales of the digital product or digital code sourced to Washington?
- V. Are there applicable retail sales or use tax exemptions for the purchase or use of the digital product or digital code?
- VI. Miscellaneous provisions.

Examples included in this rule identify a number of facts and then state a conclusion; they should be used only as a general guide. The tax results of all situations must be determined after a review of all the facts and circumstances. Note, many of the examples that require tax collection by the seller assume that the seller has “tax nexus” with Washington.

### **I. Are the Products or Services Transferred Electronically?**

**Introduction:** Goods or services must be transferred electronically in order to be digital products. If a product is transferred by means of a tangible storage media (e.g. compact disc, magnetic tape, etc.), it is not a digital product. Digital codes need not be transferred electronically in order to be digital codes, but may be obtained by any means, including tangible storage media.

**Transferred electronically:** “Transferred electronically” means the product is obtained by the purchaser by means other than tangible storage media. Generally, this means the product is transferred using the public internet, a private network, or both. However, it is not necessary that

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

the product be delivered to the purchaser. As long as the purchaser may access the product, it will be considered to have been electronically transferred to the purchaser. For example, whether a digital movie is downloaded by the user or streamed by the user, it is considered to be “transferred electronically.” Alternatively, the same movie purchased on tangible media (e.g. DVD, etc.) is the purchase of tangible personal property and is not considered to be either the sale of a digital good or transferred electronically.

## **II. Is the Product a Digital Product or Digital Code?**

**Introduction:** The term “digital product” means digital goods and digital automated services. Digital products transferred to an end user are generally subject to retail sales or use tax regardless of whether the purchaser’s right of use is permanent, less than permanent (e.g. 24-hour period), or the purchaser is obligated to make continued payments as a condition of the sale (e.g. “subscriptions”). See Part VI of this rule for a discussion of who is an end user.

1. **Digital goods:** This term is broadly defined as sounds, images, data, facts, or information, or any combination thereof, transferred electronically, with certain exclusions discussed in Part III of this rule. “Digital goods” includes “specified digital products” and any other types of electronically transferred products that fall within the general broad definition of “digital goods.”
  - a. **Specified digital products:** This term means electronically transferred digital audio-visual works, digital audio works, and digital books.
    - i. **Digital audio works:** These are products that result from the fixation of a series of musical, spoken, or other sounds. Digital audio works include ringtones, recorded or live music, readings of books or other written materials, speeches, and other sound recordings. For example, a music file (e.g., MP3 format) accessed or downloaded through the internet is a digital audio work.
      1. A “ringtone” is a digitized sound file that is downloaded onto a device and may be used to alert the customer with respect to a communication.
    - ii. A ringtone does not include “ring-back tones” or other digital audio files that are not stored on the purchaser’s communication device.
    - iii. **Digital audio visual works:** These products are a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any. Digital audio visual works include movies, music videos, videos of live events, and news and entertainment programs. For example, a movie downloaded or accessed via the internet is a digital audio visual work.
    - iv. **Digital books:** These are books in a digital format that are generally recognized in the ordinary and usual sense as books. A digital book does not

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

include periodicals, magazines, newspapers, chat rooms, or weblogs. For example, a cookbook in a PDF format downloaded or accessed through the internet is a digital book.

- b. **Examples of other digital goods:** Of the following list illustrates the types of products that are digital goods but are not a “specified digital product.” This list is not all-inclusive:
    1. A digital schematic of a lawnmower engine transferred electronically.
    2. A digital car history report transferred electronically.
    3. A digital picture used as a desktop graphic on a personal computer and transferred electronically.
    4. Digital periodicals or magazines transferred electronically.
    5. A digital presentation that includes still photos and accompanying audio content transferred electronically.
  - c. **Digital goods prior to July 26, 2009:** The mere accessing or streaming of a digital good was not a retail sale before July 26, 2009 because the customer did not receive possession of the digital good. The mere accessing or streaming of digital goods was subject to the service and other activities business and occupation (“B&O”) tax. The sale of a digital good to a customer who downloaded the digital good was a retail sale because the customer received possession of the digital good.
2. **Digital automated services:** These are services transferred electronically that use one or more software applications.
- a. **Examples of digital automated services.** The following list illustrates the types of online services that are digital automated services:
    - Example 1: Online searchable database:** An information service that uses one or more software applications to electronically transfer news or other information and that may provide features such as: searching, chart creation, and the ability to print retrieved information or to electronically send retrieved information to others.
    - Example 2: Online data gathering service:** Service that uses one or more software applications to “crawl the internet” in order to identify, gather, and categorize digital documents according to specified criteria.
    - Example 3: Online gaming service:** A service that allows players to play against each other by accessing a game application via the internet. The same game application purchased in stores for single player use would be prewritten software.
    - Example 4: Online rental facilitation service:** A service that facilitates the listing of rental units, screening of applicants, acceptance of rental applications, management of building maintenance requests, and/or acceptance of online rental payments.



This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.

### III. Are There Applicable Exclusions from the General Definitions of Digital Product and Digital Code?

**Introduction:** For certain products or services transferred electronically that otherwise meet the definition of digital good, digital automated service, or digital code, (as discussed in section II) there may be a specific exclusion from the applicable definition. If an exclusion applies, then the product or service will generally not be considered a digital good, digital automated service, or digital code for retail sales and use tax purposes. For example, a service that is transferred electronically and that uses one or more software applications will generally be subject to retail sales tax as a digital automated service. However, if the service is performed using primarily human effort (e.g. manual data entry), then an exclusion applies, and the service will not be a digital automated service.

1. **Exclusions from the definition of digital good are:**
  - a. **Telecommunications and ancillary services** as defined in RCW 82.04.065. These services may be used to distribute or supply digital goods, digital automated services, and digital codes, but are not themselves any of these products.
  - b. **Computer software** as defined in RCW 82.04.215. These are coded instructions designed to cause a computer or automatic data processing equipment to perform a task. A digital good may have coded instructions, but a digital good's main function or purpose is to provide content (e.g. the images, sounds, facts, data, or information).
  - c. **The internet and internet access** as defined in RCW 82.04.297. Internet access refers to a service that allows users to connect to the internet as well as obtain certain services that are incidental to the provision of internet access when furnished to users as part of such service (e.g. email or personal electronic storage capacity, which is furnished with access to the internet).
  - d. **Professional or personal services** represented in electronic form are not a digital good. This exclusion applies where the service primarily involves the application of human effort by the service provider, and the human effort originated after the customer requested the service. See subsection (2)(a) of this Part III for a discussion of the term "primarily." For example, an electronic engineering report created at the customer's request that reflects an engineer's professional analysis, calculations, and judgment, which is sent to the customer electronically, is considered evidence of a professional service and not a digital good. In contrast, a digital template for a last will and testament that was originally drafted by an attorney but made accessible to multiple customers on the internet (a "fill-in-the-blank will") is either a digital good or a digital automated service (depending on the functionality) and would not be a representation of a professional service because the fill-in-the-blank will was not created for a specific client.



**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

color of their website by selecting from a series of options contained in check boxes and drop down menus. EFG purchases access to the templates and creates its own website. ABC's sale to EFG is a retail sale because ABC expended no human effort after the EFG requested the service. ABC merely provided EFG access to its software-driven service. EFG purchased a digital automated service. The fact that EFG expended some human effort in completing the website using the templates is not relevant since this was not a service performed by ABC.

**Example 8:** ABC, contracts to provide service to EFG. The contract term is for two years, and includes essential software application integration activities. The integration activities include custom programming and other human effort that will take place intermittently over a period of one month. The contract price states that the integration activities performed in the first month will cost \$2,000. After the integration activities are completed, there will be a monthly service fee of \$2,000 for use of the service during the contract term. Thus, the total cost of the service over the two year contract term is \$48,000 ((23 months x \$2,000 = \$46,000) + (\$2,000 for integration activities in the first month) = \$48,000). The human effort component of the integration activities is 1 month of the 24 month contract term. Therefore, the human labor time spent performing the service is 1/24, or 4%, of the total contract term. Additionally, the revenue associated with the human labor is \$2,000, of the total contract value of \$48,000. Therefore the revenue associated with the human effort is 2/48, or 4%, of the total revenue associated with performing the service. Based on these two factors, the service provided by ABC to EFG does not require primarily human effort (i.e. human effort is approximately 4% for both factors) and is therefore not excluded from the definition of digital automated service.

- b. **Loaning or transferring money or the purchase, sale, or transfer of financial instruments.** For purposes of this section, "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. For example, the electronic transfer of money from a savings account to a checking account, whether done for the customer by a bank teller or by an ATM machine, is not a digital automated service.

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

- c. **Dispensing cash or other physical items from a machine.** For example, an ATM is not performing a digital automated service when it dispenses cash to users of the ATM.
- d. **Payment processing services,** including services such as electronic credit card processing activities conducted online or in physical retail stores via electronic transmission.
- e. **Pari-mutuel wagering and handicapping contests** as authorized by chapter 67.16 RCW.
- f. **Telecommunications services and ancillary services** as those terms are defined in RCW 82.04.065. For additional information, refer to the discussion above concerning the comparable exclusion from the definition of digital goods.
- g. **The internet and internet access** as those terms are defined in RCW 82.04.065. For additional information, refer to the discussion above concerning the comparable exclusion from the definition of digital goods.
- h. **Remotely accessed software.** Remotely accessed software provided on a standalone basis is excluded from the definition of digital automated service. However, software that is used in connection with a service that is transferred electronically would generally be included in the definition of a digital automated service.

**Example 9:** ABC sells remotely accessed gaming software that is identical in all substantive respects to the same software available in stores for individual use and installation on home computers. ABC's sales to consumers would be treated as a sale of prewritten software remotely accessed and therefore is excluded from the definition of digital automated services.

**Example 10:** Same facts as above except that ABC, in addition to selling the remotely accessed software, also sells a monthly subscription services that includes online multiplayer capabilities, game rankings, and gaming tournaments. The additional monthly subscription ABC is selling is a digital automated service. In this case the customers are not merely receiving the individual use of software, but instead an online gaming service facilitated by the software.

- i. **Online Education Programs** provided by the following:
  - i. Public or private elementary or secondary schools; or
  - ii. 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. Sections 1001 and 1002), as existing on July 1, 2009. This would include most colleges and universities. For the purposes of this section, an online educational program must be encompassed within the institution's accreditation.

**Example 11:** ABC University, a qualifying institution of higher education under the federal higher education act of 1965, provides an accredited online

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

Spanish course for which it charges a quarterly access and use fee to students. The course is remotely accessed by students logging into a website and accessing a fully interactive program that includes components of video, text, and audio, as well as extensive software code. This service would generally be considered a digital automated service. However, it is specifically excluded from the definition of digital automated service as an online educational program.

- j. **Live presentations** such as lectures, seminars, workshops, or courses, where participants are connected to other participants and presenters via the internet or other networks, allowing the participants and the presenters to give, receive, and discuss information together in real time.

**Example 12:** ABC provides an online seminar service for EFG. ABC provides a panel of live speakers that make a presentation to EFG's employees listening to and viewing the seminar through an internet connection supplied by third party service providers. The seminar allows EFG's employees and panelists to ask and answer questions on a real time basis. ABC's online seminar service is transferred electronically and uses one or more software applications and therefore would generally be considered a digital automated service. However, this type of service allowing live interaction is specifically excluded from the definition of digital automated service.

**Example 13:** Same facts as above, except that ABC records the seminar and charges EFG a fee for each employee that accesses the seminar from ABC's website. The recorded presentation allows EFG employees to merely watch the presentation, but it does not allow EFGs employees to ask questions on a real time basis. Because there is no live interaction, ABC is selling a digital good.

**Example 14:** ABC provides online training courses to EFG for a fee. The courses provide key interactive elements such as study guides, knowledge testing, and automated help, all facilitated by one or more software applications. Such courses are not live presentations and do not provide human interaction. The specialized course offerings are digital automated services.

- k. **Travel agent services**, including online travel services, and automated systems used by travel agents to book reservations.
- l. **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

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

ii. the service recipient's website, but only when the service provider's technology is used either to:

1. create or host the service recipient's website or
2. process orders from customers using the service recipient's website.

**Example 15:** ABC provides online services to sellers wishing to sell their products on the internet. EFG contracts with ABC to allow EFG to “list and sell” coffee mugs on ABC’s website. EFG pays ABC a service fee based on a percentage of each sales transaction completed on ABC’s website. This online marketplace service is excluded from the definition of digital automated services.

iii. **Exclusion limitation:** The services described in this section do not include the underlying sale of the products or services, digital or otherwise, by the person receiving the service. For instance, in example 15, the sale by EFG of coffee mugs would still generally be subject to retail sales tax and retailing B&O tax as the sale of tangible personal property.

m. **Advertising services**, which means all services directly related to the creation, preparation, production, or the dissemination of advertisements. Advertising services include: 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. Advertising services also include online referrals, search engine marketing and lead generation optimization, web campaign planning, the acquisition of advertising space in the internet media, and the monitoring and evaluation of website traffic for purposes of determining the effectiveness of an advertising campaign. Advertising services do not include web hosting services and domain name registration.

**Example 16:** ABC provides promotional services to customers wishing to market their products using the internet. EFG sells widgets on the internet and hires ABC to provide its promotional services. ABC consults with EFG on its marketing needs and then creates a marketing plan. ABC also creates and distributes online banners, links, and targeted email “blasts” that promote EFG’s business. All of the services provided by ABC are advertising services excluded from the definition of digital automated services.

**Example 17:** ABC is paid by EFG for each click on a sponsored link provided by EFG to ABC and posted on one of ABC’s websites. The services provided by ABC are advertising services excluded from the definition of digital automated services.

n. **Storage, hosting, and back-up.** The mere storage of digital products, digital codes, computer software, or master copies of software is specifically excluded from the

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

definition of digital automated services. This exclusion includes providing space on a server for web hosting or the backing up of data or other information.

**Example 18:** ABC, charges EFG a fee for 25 terabytes of storage space under its “basic storage service” offering. ABC also charges EFG an additional and optional fee for security, web filtering, application firewalls, and load balancing under its “premium service” package offering. The “basic storage” services are mere storage services and excluded from the definition of digital automated services. However, the charges for the optional premium services are more than mere storage or hosting services. As such, the premium services are not excluded from the definition of digital automated services.

- o. **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: (1) extract the required information in an appropriate form, or (2) to convert the data to usable information. Data processing services include check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities. Data processing does not include remote access software.

**Example 19:** EFG, in preparation for litigation, hires ABC, Inc. (ABC) to use its automated technology to search EFG’s computers, and gather documents for a specified time period relevant to the lawsuit. ABC’s service also provides tools that allow EFG to categorize, copy, store, and notate the gathered documents. ABC’s service is not data processing. The services performed primarily involve gathering data, and providing tools that allow the customer to categorize, copy, store and notate documents in preparation for litigation. Accordingly, ABC’s sale of its services is the sale of digital automated services.

**Example 20:** ABC provides check processing services to EFG, a bank operating in Washington. ABC accepts scanned checks provided by EFG. ABC then uses its software and technology to extract the check dollar amount, account number, and verify the check has been signed. ABC then provides this extracted and reformatted data back to EFG allowing it to reconcile its customer’s accounts. ABC provides data processing services excluded from the definition of digital automated services.

## **IV. Are Sales Sourced to Washington?**

**Introduction:** Once it is determined that a transaction involves the sale of a digital product or digital code, the sale must be sourced to Washington to be subject to Washington’s state and

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

local retail sales taxes. Sales of digital products are sourced under the same rules that apply to other retail sales, as provided in RCW 82.32.730 and as outlined below.

1. **Business Location:** When a digital product or digital code is received by the buyer at a business location of the seller, the sale is sourced to that business location.

**Example 21:** Frank goes to ABC, brick-and-mortar store in Washington and purchases a music file from an electronic kiosk in the store that connects to ABC's website using the internet and a computer. Frank purchases and downloads the music file inside ABC's store by connecting his digital music player to ABC's kiosk in its store. The sale of the music file is sourced to ABC's store location in Washington.

2. **Place of Receipt:** If the first sourcing rule explained above in (1) of this subsection does not apply, the sale is sourced to the location where receipt takes place.

- a. The digital product or digital code may be received by the buyer at the buyer's location or by the buyer's donee (e.g., a gift recipient) at the donee's location.
- b. In the context of digital products and digital codes, "receive" and "receipt" means: (i) making first use of digital automated services, or (ii) taking possession or making first use of digital goods or digital codes, whichever comes first.

**Example 22:** EFG, located in Olympia, Washington, purchases a digital automated service from ABC. EFG's employees access and make first use the service at their workstations located in Olympia. If ABC knows that the digital automated service is received in Olympia, it will source the sale of the digital automated service to that location.

3. **Address in Records:** If the first two sourcing rules explained above in (1) and (2) of this subsection do not apply, the sale is sourced to the location indicated by an address for the buyer that is available from the seller's business records maintained in the ordinary course of businesses, so long as use of this address does not constitute bad faith. For example, any address of the buyer held by the seller that reasonably estimates the receipt location will be sufficient, including an address contained in a relevant service contract, or an address used for accounts receivable purpose.

**Example 23:** EFG, located in Olympia, Washington, purchases a digital automated service from ABC. The purchase contract between EFG and ABC provides that EFG may have 5 users access the digital automated service from any of EFG's multiple locations. In this case, ABC does not know where the digital automated service is received. However, ABC has EFG's Olympia address in its business records and will therefore source the sales to EFG's Olympia address.

4. **Address Obtained During Sale:** If the first three sourcing rules explained above in (1), (2), and (3) of this subsection do not apply, the sale is sourced to the location indicated by an address for the buyer obtained during the consummation of the sale. For example, an address obtained during consummation of the sale would include the address of a buyer's payment

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

instrument (e.g., billing address for a credit card), if no other address is available, so long as use of this address does not constitute bad faith.

- a. **IP Address:** The buyer’s IP address is acceptable location information obtained at the time of sale if an address cannot otherwise be obtained during consummation of the sale.
5. **Origin:** If the first four sourcing rules explained above in (1), (2), (3), or (4) of this subsection do not apply, including the circumstance where the seller is without sufficient information to apply those provisions, then the sale must be sourced to the location determined by the address from which the digital good or digital code was first available for transmission by the seller, or from which the digital automated service was provided. Any location that merely provided the digital transfer of the product sold shall be disregarded.
6. **Sourcing for use tax purposes:** The sales sourcing rules above in section IV, are for sourcing sales subject to retail sales tax under RCW 82.08.020 and RCW 82.32.730. What follows below is a discussion of use tax reporting obligations with respect to digital goods, digital automated services, and digital codes. Generally, use tax applies to the use of a digital product or digital code in Washington if retail sales tax has not already been paid and no exemption otherwise applies.
  - a. **Digital good or digital code:** “use” means 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.
  - b. **Digital automated service:** “use” means the first act within this state by which the taxpayer, as a consumer, uses, enjoys, or otherwise receives the benefit of the service.

**Example 24:** ABC located in New York sells a digital automated service to EFG located in Washington. EFG has employees in Washington who use the internet to access ABC’s services via an internet web browser. Assuming that ABC does not have nexus with Washington and is not required to charge and collect retail sales tax on the sale of its service to EFG. EFG has a use tax reporting obligation because it uses, enjoys, or otherwise receives the benefit of ABC’s service at its location in Washington.

## **V. Are there Applicable Retail Sales or Use Tax Exemptions for the Purchase or Use of the Digital Product or Digital Code?**

**Introduction:** After determining that a digital product or digital code has been sold or used and the sale or use is sourced to Washington, exemptions from retail sales or use tax should be examined. What follows is a not an exhaustive list of exemptions but instead an explanation of the most common exemptions. Some exemptions may apply only with respect to certain digital products (e.g., some exemptions apply only to digital goods, not digital automated services). Exemptions may also require an exemption certificate or reseller permit.

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

- 1. Resale:** The purchase of a digital product or digital code for resale is not subject to retail sales or use tax. Sellers should obtain from buyers a copy of the buyer’s reseller permit, a properly completed “Digital Products and Remote Access Software Exemption Certificate,” or otherwise comply with RCW 82.04.470 to substantiate the wholesale nature of the sale is required for this exemption to be taken by the buyer. See RCW 82.32.780.
- 2. Component of a new product:** Generally, persons who purchase, acquire, own, hold, or use any digital product or digital code for purposes of incorporating it into a new product for sale will not be subject to retail sales tax on such a purchase. The digital product or digital code must become a component of the new product for sale. A digital code becomes a component of a new product if the digital good or digital automated service acquired through the use of the digital code becomes incorporated into a new product.
  - a. Product:** For purposes of this subsection, “product” means a digital product, an article of tangible personal property, or the service of providing consumers with the right to access prewritten computer software (which is defined as a retail sale). For example, an industrial drill manufacturer and seller combine hardware, software, and data to create a new product, i.e. the drill. The embedded software uses the variance data to control the hardware during drill operations. The data is a digital good purchased for use as a component of a new product for sale (i.e. the drill). Sellers should obtain from buyers a copy of the buyer’s reseller permit, a properly completed “Digital Products and Remote Access Software Exemption Certificate,” or otherwise comply with RCW 82.04.470 to substantiate the wholesale nature of the sale.
- 3. Made available free to the general public:** Retail sales and use taxes do not apply to the purchase or use by a business or other organization of a digital product (including a digital product acquired through the use of a digital code) in order to make that digital product available free of charge for the use or enjoyment of the general public. Buyers claiming this exemption must provide the seller with a properly completed “Digital Products and Remote Access Software Exemption Certificate” or other exemption certificate acceptable to the department.
  - a. "General public"** means all persons and is not limited or restricted to a particular class of persons, except that the general public includes:
    - i. Certain classes of persons defined by their residency or ownership:** The general public includes a class of persons residing or owning property within the boundaries of any state (e.g., Washington), political subdivision of a state (e.g., King County), or a municipal corporation (e.g., Seattle).

**Example 25:** The City of Evergreen (a municipal corporation) makes satellite images of land parcels available for free only to persons residing in Evergreen. Residents are required to enter their zip code prior to accessing the images and certify that they are a resident of the

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

City. Accordingly, the City of Evergreen can purchase the satellite images exempt from retail sales and use tax.

- ii. **Library Customers:** With respect to libraries, the term general public includes authorized library patrons.
- b. **Buyer must have the legal rights to provide the digital product to the general public:** The exemption provided in this subsection (3) does not apply unless the purchaser has the legal right to broadcast, rebroadcast, transmit, retransmit, license, relicense, distribute, redistribute, or exhibit the digital product, in whole or in part, to the general public.

**Example 26:** EFG purchased 1,000 digital audio files from ABC for a “give away” to the first 1,000 people to visit EFG’s website as part of a marketing campaign conducted by EFG. When people visit EFG’s website, it provides them free access to one of the 1,000 digital audio files for download. EFG purchased the digital audio files from ABC with the right to redistribute them to the general public. Accordingly, EFG’s purchase from ABC qualifies for the exemption because it has made the digital audio files available free of charge to the general public pursuant to a contract that gives EFG such rights of redistribution in this manner. EFG only purchased 1,000 files and therefore must limit its distribution to the first 1,000 people. Most “give-aways” will have similar quantity limitations but this fact alone will not disqualify such transactions under the “general public” requirement.

**4. Purchased solely for business purpose:**

- a. **Introduction:** Retail sales and use tax does not apply to the sale to or use by a business of digital goods (and services rendered in respect to those digital goods), where the digital goods and services rendered in respect to digital goods are purchased solely for business purposes. This exemption only applies to purchases of digital goods and does not apply to the purchase of digital automated services, prewritten software, or remote access software.
- b. **Digital codes:** This exemption also applies to the sale to or use by a business of a digital code if all of the digital goods to be obtained through the use of the code will be used solely for business purposes. If the digital code purchased by a business for a business purpose provides access to both digital goods and digital automated services, the purchase of the digital code does not qualify for this exemption.
- c. **“Business purposes”** means the digital good is relevant to the buyer’s business needs. This exemption does not apply to the purchase for personal or household purposes or for any activity conducted by a governmental entity.
- d. **Prior periods.** For the period July 26, 2009, through June 30, 2010, the “business purpose” exemption applied only to “standard digital information.” Standard digital information is a subset of digital goods.

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

- i. **Standard digital information** is a digital good that consists primarily of data, facts, and/or information that is not generated or compiled for a specific client or customer. Standard digital information does not include a digital good that is comprised primarily of sounds or images.

**5. Multiple Points of Use:** Retail sales tax does not apply to the sale of digital products or digital codes to a buyer that provides the seller with a valid exemption certificate claiming multiple points of use (MPU). Buyers may use the department’s “Digital Products and Remote Access Software Exemption Certificate” to claim this exemption. Note, however, that Washington use tax still applies to the use of the digital product or digital code used in Washington.

- a. **Requirements:** A buyer is entitled to use an exemption certificate claiming MPU only if the buyer is a business or other organization and the digital product purchased (or to be obtained by using the digital code purchased) will be concurrently available for use within and outside Washington. A buyer is not entitled to use an exemption certificate claiming MPU for digital products and digital codes purchased for personal use.
- b. **Concurrently Available:** “Concurrently available for use within and outside this state” means that employees or other agents of the buyer may use the digital product simultaneously from one or more locations within this state and one or more locations outside this state.

**Example 27:** ABC sells an online patent searching service (digital automated service) to EFG for use at EFG’s headquarters in Washington and its R&D facility in California. EFG receives the right for five employees (users) in Washington and five employees (users) in California to use the digital automated service, which may be accessed and used simultaneously by these ten employees. In this case, the digital automated service is concurrently available for use by EFG both within Washington and outside Washington, and therefore EFG may claim the MPU exemption for its purchase of the digital automated service from ABC.

- c. **Apportionment (allocation) of use tax:** For purposes of this subsection on multiple points of use, “allocation” and “apportionment” will have the same meaning. A business or other organization subject to use tax on digital products or digital codes that are concurrently available for use within and outside this state is entitled to apportion the amount of tax due this state based on users in this state compared to users everywhere. Additionally, the department may authorize or require an alternative method of allocation supported by the taxpayer’s records that fairly reflects the proportion of in-state to out-of-state use by the taxpayer. For example, in the case of EFG in example 27 above, EFG would allocate one-half of the users to Washington because five of its ten users are in Washington (e.g.  $5/10 = 50\%$  ). Thus





**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

- c. 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, including business e-mail communications.

**Example 29:** Gary, an employee of ABC creates a digital audio-visual presentation using presentation authoring software and his innate creative capacity. Gary distributes the presentation internally to various divisions within ABC in order to train ABC personnel on changes to company tax policies. Gary has created and distributed an item that meets the definition of “digital good.” However, the distribution and use of this digital good is not subject to use tax as long as it is used solely “internally” or “solely for the business needs” of ABC.

## **VI. Miscellaneous Provisions**

1. **“Retail services” (not including digital products), which may also be transferred electronically:** Washington imposes retail sales and use tax on certain enumerated services under RCW 82.04.050 (“retail services”). For example, the sale of credit bureau services is subject to retail sales tax. However, when a retail service (other than a digital product) is transferred electronically and also meets the definition of digital automated service or digital good, such services will be treated as digital products and are eligible for all applicable digital products retail sales and use tax exemptions as described above in Part V of this rule. Retail services that are not transferred electronically or those retail services that are excluded from the definitions of digital good or digital automated service (e.g., telecommunications services and ancillary services) continue to be taxed as non-digital product retail services.

**Example 30:** ABC sells a digital report addressing Company Q’s creditworthiness prepared prior to a customer request for the report. The “canned report” is then listed on ABC’s website for sale. An employee of EFG purchases and downloads a digital copy of ABC’s “canned” credit report from ABC’s website for EFG’s business purpose. ABC is selling a digital good generally subject to retail sales tax. However, if the report is purchased by EFG solely for a business purpose and transferred electronically, it is exempt from retail sales tax.

**Example 31:** ABC sells credit reports delivered in a digital format. EFG requests that ABC prepare a report for EFG’s individual business purposes. After receiving the request, ABC’s employee manually searches and aggregates information from various online databases to prepare the report for EFG. ABC then sends the report electronically as a digital file to EFG. ABC is not selling a digital good or a digital automated service because the digital item supplied to EFG is merely a representation of a personal/professional service or primarily human effort performed by ABC’s employee. Therefore, ABC’s services are not a “digital product.” However, ABC is still required to charge and collect retail sales tax because ABC is still providing credit bureau services, a retail service subject to retail sales tax.

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

- Example 32:** ABC sells online subscriptions to a credit reporting service. The service includes online access to searchable databases, digital data analysis, and digital data reporting tools. EFG is a management company that investigates the credit worthiness of new clients and therefore desires to purchase ABC's service. EFG purchases a subscription to access ABC's online service. ABC is providing a digital automated service to EFG to be used solely by EFG for its business purpose. However, the "used solely for a business purpose" exemption is limited to digital goods and is not applicable to digital automated services. Accordingly, ABC is required to charge and collect retail sales tax from EFG on the sale of its subscription.
2. **Royalties B&O tax and digital products:** the royalties B&O tax is imposed upon every person engaging within this state in the business of granting of intangible rights. For example, a transaction involving the licensing of a digital photograph delivered electronically with the right to publish in a newspaper would be subject to royalties B&O. However, royalties B&O does not apply to transactions involving the licensing of digital goods, digital codes, or digital automated services to the end user as defined in RCW 82.04.190(11).
  3. **Substantial nexus** is not established in Washington if a business's only contact with the state of Washington is ownership of, or rights in, computer software as defined in RCW 82.04.215, including computer software used in providing a digital automated service; master copies of software; a digital goods or digital codes residing on servers in Washington. For purposes of this section, "substantial nexus" means the requisite connection that a person must have with a state to allow the state to subject the person to the state's taxing authority, consistent with the commerce clause of the United States Constitution.
  4. **Amnesty:** Before July 26, 2009, retail sales of downloaded digital goods on a permanent or non-permanent basis were subject to retail sales tax. This did not include accessed or streamed digital goods. However, amnesty is available to those who did not collect or pay retail sales or use tax on digital goods and digital codes during that time. Sales of digital automated services were subject to service and other B&O tax before July 26, 2009, and amnesty does not extend to these transactions because they were not subject to retail sales tax during that time period.
    - a) **Refunds and credits of retail sales or use tax:** No refund or credit will be given for state and local retail sales and use taxes properly paid on the sale or use, before July 26, 2009, of digital goods or of installing, repairing, altering, or improving digital goods.
    - b) **No B&O tax refund or credit unless sales tax was paid:** If a taxpayer paid B&O tax under the service and other activities classification prior to July 26, 2009, on income received from retail sales of digital products or digital codes, the taxpayer may not receive a refund or credit for the difference between the B&O tax actually paid and the B&O tax that should have been paid under the retailing classification unless the taxpayer has remitted the retail sales tax for those sales.

**This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.**

- 5. Bundled transactions:** A “bundled transaction” is the retail sale of two or more products, which are distinct and identifiable for one non-itemized price. Because retail sales of digital products and digital codes are subject to retail sales tax, the general rules on the taxation of bundled transactions may apply to transactions involving digital products and digital codes. See RCW 82.08.190 and 82.08.195 for more information on the tax treatment of bundled transactions.
- 6. Property tax:** The excise tax laws relating to digital products and digital codes do not have any relevance in the characterization of digital goods and digital codes as tangible or intangible personal property for purposes of property taxation and may not be used in any way in construing Title 84 RCW. See section 1201, chapter 535, Laws of 2009.