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**Finance Committee**

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**HB 2620**

**Brief Description:** Concerning excise taxation of certain products and services provided or furnished electronically.

**Sponsors:** Representatives Hunter and Moeller; by request of Department of Revenue.

**Brief Summary of Bill**

- Clarifies ambiguities and corrects unintended consequences with respect to the digital products tax legislation adopted in 2009.

**Hearing Date:** 1/22/10

**Staff:** Jeffrey Mitchell (786-7139).

**Background:**

Retail sales and use taxes are imposed by the state, most cities, and all counties. Retail sales taxes are imposed on retail sales of most articles of tangible personal property and digital products and some services. Generally, a retail sale is the sale of property, products, or services to the final consumer or end user. Sales for resale or for incorporation into other property, goods, or services to be sold are not considered retail sales.

If retail sales taxes were not collected when the property, services, or digital products were acquired by the user and retail sales taxes would have otherwise applied, then use taxes apply to the value of most tangible personal property and digital products and some services used in this state. Use tax rates are the same as retail sales tax rates. The state sales and use tax rate is 6.5 percent. Local sales and use tax rates vary from 0.5 percent to 3.0 percent, depending on the location. The average local tax rate is 2.0, for an average combined state and local tax rate of 8.5 percent.

In 2009 the Legislature adopted comprehensive legislation (ESHB 2075) addressing the sales and use taxation and business and occupation taxation of digital products, ranging from

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downloaded music to streamed video. Engrossed Substitute House Bill 2075 clarifies how taxes apply to products that exist only as computer bits and bytes. Specifically, the bill defines digital products as digital goods and digital automated services transferred electronically, extends sales and use taxes to most resale purchases of these products, provides certain exemptions for businesses and end users, requires sellers of digital products to electronically file their tax returns, and provides amnesty to those who did not collect or pay sales or use tax on digital products that were taxed before July 26, 2009 (the effective date of the ESHB 2075). "Digital automated services" (DAS) are services transferred electronically that use one or more software applications. Examples include: search engine services, online gaming subscription services allowing game playing with other remote players, and online digital photography editing services. Services that are primarily the result of human effort performed in response to a customer request are not considered DAS.

Prior to the adoption of ESHB 2075, the Department of Revenue (DOR) considered downloaded digital goods (books, movies, music, etc.) as tangible personal property that were subject to sales or use tax. Furthermore, at the time ESHB 2075 was adopted, prewritten computer software was already included within the definition of tangible personal property and therefore subject to sales and use tax. ESHB 2075 applies sales or use tax to all digital products and prewritten computer software, regardless of how the digital products or software are accessed (downloaded, streamed, remotely accessed, etc.).

Digital products that are subject to sales or use tax include: downloaded digital goods (books, music, movies, etc.), streamed digital products, and remotely accessed digital products.

Because ESHB 2075 is complicated legislation, DOR decided to implement ESHB 2075 in a phased process allowing the DOR to obtain substantial stakeholder input as it developed rules to implement the bill. Through this process, a number of ambiguities and unintended consequences have been discovered.

### **Summary of Bill:**

The overriding purpose of the bill is to clarify ambiguities and correct unintended consequences related to the passage of Engrossed Substitute House Bill 2075. This is done in a number of ways.

The definition of retail sale is clarified to specifically include remotely accessing prewritten computer software to perform data processing. "Data processing" includes check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities.

A person is not considered a final consumer, and therefore not subject to sales or use tax, if the person purchases a digital product, code, or prewritten computer software for the purpose of incorporating the product, code, or software into a new product, code, or software for sale. This would have no impact for sales and use taxes because an exemption already exists for this type of transaction; however, sales now subject to the business and occupation (B&O) wholesaling rate would be subject to the retailing rate.

The definition of digital automated service is modified to specifically exclude: live presentations, digital goods, the storage of digital products and software, and data processing services. (Data processing services are distinct from accessing prewritten computer software to perform data processing, described earlier.)

Photographs sent electronically by a photographer to the end user are specifically included within the definition of digital good.

Royalty B&O tax is clarified to include licensing of digital products to persons who are not the end users of the products.

Clarification is made that the provision of subscription television services and subscription radio services are subject to the general service B&O tax rate.

For purposes of municipal B&O taxes, the sale of digital products is deemed to occur at the location where delivery occurs. (Rules similar to the destination based sourcing rules for sales taxes are used to help make this determination.)

To simplify administration the sales and use tax exemption for standard digital information is broadened to include all digital goods used for business purposes.

The nexus safe harbor provision in ESHB 2075 is clarified to include computer software. Therefore, the storage of computer software on servers located in Washington would not establish nexus for the purpose requiring a business to pay state taxes.

The amnesty provision in ESHB 2075 is amended by providing amnesty for sales taxable labor and services rendered with respect to installing, repairing, altering, or improving of digital goods prior to the effective date of ESHB 2075 (June 26, 2009), and requiring taxpayers seeking a refund or credit for overpaid B&O taxes to have first paid all sales tax.

Most provisions of the bill apply retroactively as well as prospectively.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect on July 1, 2010.