

SENATE BILL REPORT

SB 5541

As Reported by Senate Committee On:
Ways & Means, April 1, 2015

Title: An act relating to improving tax fairness for businesses engaged in electronic commerce by eliminating inconsistent tax treatment of digital business inputs, ensuring that prewritten computer software developers remain eligible for the manufacturing machinery and equipment sales and use tax exemption, and providing greater clarity for out-of-state sellers concerning their tax obligations.

Brief Description: Improving tax fairness for businesses engaged in electronic commerce by eliminating inconsistent tax treatment of digital business inputs, ensuring that prewritten computer software developers remain eligible for the manufacturing machinery and equipment sales and use tax exemption, and providing greater clarity for out-of-state sellers concerning their tax obligations.

Sponsors: Senator Hill; by request of Department of Revenue.

Brief History:

Committee Activity: Ways & Means: 2/03/15, 4/01/15 [DPS, w/oRec].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 5541 be substituted therefor, and the substitute bill do pass.

Signed by Senators Hill, Chair; Braun, Vice Chair; Dammeier, Vice Chair; Honeyford, Vice Chair, Capital Budget Chair; Hargrove, Ranking Member; Keiser, Assistant Ranking Member on the Capital Budget; Ranker, Ranking Minority Member, Operating; Bailey, Billig, Brown, Conway, Fraser, Hasegawa, Hatfield, Kohl-Welles, O'Ban, Parlette, Rolfes, Schoesler and Warnick.

Minority Report: That it be referred without recommendation.

Signed by Senators Becker, Hewitt and Padden.

Staff: Dean Carlson (786-7305)

Background: Digital Products. In 2009 the Legislature enacted Engrossed Substitute House Bill 2075 which addressed the topic of the taxation of digital products. The legislation defined digital goods as products that include sounds, images, data, or facts that are

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transferred electronically. Digital automated services were defined as an electronically delivered service that uses one or more software applications, such as credit reports, online games, and searchable databases. The legislation required sales tax to be due on sales to the end user of both digital goods and digital automated services. The legislation provided a sales tax exemption for digital goods used solely for business purposes, but did not provide the exemption for digital automated services.

Manufacturing Machinery and Equipment Exemption (M&E Exemption). In 1995 the Legislature created the manufacturing machinery and equipment sales and use tax exemption. With this, machinery and equipment used to manufacture items of tangible personal property for sale were exempt from sales and use tax. This exemption applies in the software industry for the manufacture of standard pre-written software as the software is sold on disc on other tangible storage media. However, the industry has evolved and much prewritten software is sold and transferred by electronic means without tangible storage media. Questions have risen as to whether or not the machinery and equipment used in the manufacture of standard pre-written software qualifies for the M&E exemption when it is transferred electronically rather than by tangible storage media.

Remote Seller's Nexus. In recent years, several states, most notably New York, have passed legislation establishing what is known as click-through nexus. Click-through nexus requires remote sellers to either collect or pay taxes to a state when they have established an agreement with a resident of that state to refer customers to the remote sellers for consideration. This is most often done from a link on a website.

Summary of Bill (Recommended Substitute): Digital Products. The sales tax exemption for digital goods used solely for business purposes is extended to include digital automated services.

M&E Exemption. The M&E exemption applies to developers of standard pre-written software regardless of how the software is delivered to buyers, including electronic delivery.

Remote Seller's Nexus. For purposes of collecting sales tax and paying the business and occupation tax, remote sellers are deemed to have nexus in this state if the remote seller enters into an agreement with a Washington resident for a commission or other consideration to directly or indirectly refer potential customers, by a link on an Internet website or other method, to the remote seller. The remote seller must also have at least \$10,000 in sales to this state in the preceding year. A mechanism is provided for a remote seller to rebut the presumption that they have click-through nexus. The nexus provisions expire July 1, 2025.

EFFECT OF CHANGES MADE BY WAYS & MEANS COMMITTEE (Recommended Substitute): Provides an expiration for the click-through nexus provisions. Provides a mechanism for a remote seller to rebut the presumption that they have click-through nexus.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: The bill contains an emergency clause and takes effect on July 1, 2015.

Staff Summary of Public Testimony on Original Bill: PRO: This is an important update to the tax code. Similar activities should be taxed the same. This is the case for digital goods and digital automated services. Click-through nexus has been upheld in other states. This is about consistent tax policy. This is a culmination of several deals over the years. For digital products, we wanted to make sure that digital inputs are not taxed twice. The reason this is important is because the way the law stands now, it works against businesses in the state. In other states, tax isn't charged on these digital products. This is a modest step in leveling the playing field between brick and mortar retailers and online retailers.

Persons Testifying: PRO: Amber Carter, Assn. of WA Business; Mark Johnson, WA Retail Assn.; Drew Shirk, Dept. of Revenue; Beckie Krantz, LegiCrawler Analytics.

Persons Signed in to Testify But Not Testifying: No one.