

Multiple Agency Fiscal Note Summary

Bill Number: 2620 S HB	Title: Excise taxation
-------------------------------	-------------------------------

Estimated Cash Receipts

Agency Name	2009-11		2011-13		2013-15	
	GF- State	Total	GF- State	Total	GF- State	Total
Department of Revenue	(940,000)	(972,000)	(1,326,000)	(1,366,000)	(397,000)	(443,000)
Total \$	(940,000)	(972,000)	(1,326,000)	(1,366,000)	(397,000)	(443,000)

Local Gov. Courts *						
Local Gov. Other **	Non-zero but indeterminate cost. Please see discussion.					
Local Gov. Total						

Estimated Expenditures

Agency Name	2009-11			2011-13			2013-15		
	FTEs	GF-State	Total	FTEs	GF-State	Total	FTEs	GF-State	Total
Department of Revenue	.0	26,300	26,300	.0	0	0	.0	0	0
Total	0.0	\$26,300	\$26,300	0.0	\$0	\$0	0.0	\$0	\$0

Local Gov. Courts *									
Local Gov. Other **	Non-zero but indeterminate cost. Please see discussion.								
Local Gov. Total									

Estimated Capital Budget Impact

Agency Name						
Total \$						

--

Prepared by: Ryan Black, OFM	Phone: 360-902-0417	Date Published: Final
-------------------------------------	-------------------------------	---------------------------------

* See Office of the Administrator for the Courts judicial fiscal note

** See local government fiscal note

FNPID 26764

FNS029 Multi Agency rollup

Department of Revenue Fiscal Note

Bill Number: 2620 S HB	Title: Excise taxation	Agency: 140-Department of Revenue
-------------------------------	-------------------------------	--

Part I: Estimates

☐ No Fiscal Impact

Estimated Cash Receipts to:

Account	FY 2010	FY 2011	2009-11	2011-13	2013-15
GF-State-State 01 - Taxes 01 - Retail Sales Tax	(8,691,000)	(11,178,000)	(19,869,000)	(25,056,000)	(28,883,000)
GF-State-State 01 - Taxes 05 - Bus and Occup Tax	8,604,000	10,325,000	18,929,000	23,730,000	28,486,000
Performance Audit-State 01 - Taxes 01 - Retail Sales Tax	(14,000)	(18,000)	(32,000)	(40,000)	(46,000)
Total \$	(101,000)	(871,000)	(972,000)	(1,366,000)	(443,000)

Estimated Expenditures from:

Account	FY 2010	FY 2011	2009-11	2011-13	2013-15
GF-STATE-State 001-1	26,300		26,300		
Total \$	26,300		26,300		

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

- ☒ If fiscal impact is greater than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.
- ☐ If fiscal impact is less than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).
- ☐ Capital budget impact, complete Part IV.
- ☐ Requires new rule making, complete Part V.

Legislative Contact:	Phone:	Date: 02/17/2010
Agency Preparation: Steve Smith	Phone: 360-570-6080	Date: 03/01/2010
Agency Approval: Don Gutmann	Phone: 360-570-6073	Date: 03/01/2010
OFM Review: Ryan Black	Phone: 360-902-0417	Date: 03/01/2010

Request # 2620-2-1

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

Note: This fiscal note reflects language in SHB 2620.

BACKGROUND:

Engrossed Substitute House Bill (ESHB) 2075, an act relating to the excise taxation of certain products and services provided or furnished electronically (digital products), was passed during the 2009 legislative session and enacted into law. ESHB 2075 was a complex bill that involved the taxation of electronic commerce, a relatively new and fluid industry. The intent of the bill was to provide consistency and certainty in the Washington tax code, maintain conformity with the Streamlined Sales and Use Tax Agreement, and encourage economic development. In the course of implementing the bill, the Department of Revenue (Department) discovered several ambiguities that, if not corrected, create unintended consequences. This legislation is a follow up to ESHB 2075 to clarify ambiguities and conform the law to the original intent of the Legislature.

SUMMARY OF THE PROPOSED LEGISLATION:

This proposal clarifies the definition of digital automated services. This proposal excludes the following from the definition of digital automated services: digital goods; advertising services; the mere storage of digital goods, digital codes, and software; data processing services; live interactive online presentations, such as seminars, lectures, workshops, and educational courses; and certain services provided to online sellers to facilitate sales via the website of the online seller.

While data processing services are not considered digital automated services under this proposal, the sale of mere access to prewritten computer software that the customer uses to perform data processing, where possession of the software is maintained by the seller or a third party, is a retail sale.

This proposal clarifies that the primarily human effort exclusion from the definitions of digital automated services and digital goods (digital products) only applies to human effort performed by the seller, not the buyer of the digital product.

This proposal clarifies that the definition of digital goods does not include the Internet.

The definition of digital goods is also revised to provide that the sale of digital goods includes the charge by a photographer for taking photographs that are transferred electronically to the customer if the customer is an end user of the photographs. This change would ensure consistent tax treatment of tangible and digital photographs.

The business and occupation (B&O) tax definition of royalties is clarified to exclude amounts received from the licensing of digital products to an end user of the digital products.

The definition of "Internet access" in RCW 82.04.297 is amended to exclude a telecommunications service purchased, used, or sold by Internet service providers, where the telecommunications service is used to provide access to the Internet. This will ensure that these services remain taxed under the "retailing" B&O tax classification.

This proposal clarifies that income derived by cable and satellite television providers, with respect to their monthly subscription fee revenue and sales of other programming that is exempt from sales tax, remains subject to B&O tax under the "service and other activities" classification.

The sales and use tax exemption for digital products made available free of charge is clarified as applying only to digital products made available to the general public by a business or other organization.

This proposal treats sales of digital products that will become components of a new product for sale as wholesale sales, consistent with the treatment of sales of tangible ingredients and components. This does not change the sales and use tax treatment of components but does slightly increase the B&O tax rate from the 0.471 percent retailing rate to the 0.484 wholesaling rate on the gross proceeds of sales of components.

This proposal makes a technical change to RCW 82.08.195(7) that addresses the bundling of digital products to correct an oversight in ESHB 2075.

In addition, the nexus "safe harbor" statute is amended to provide that the Department may not consider a person's ownership of, or rights in, software located in this state, including software used in providing a digital automated service, in determining whether the person has substantial nexus with this state.

The amnesty provisions of ESHB 2075 are amended to provide relief for the failure to pay or collect sales or use tax before the July 26, 2009, effective date of ESHB 2075 on labor and services rendered in respect to installing, repairing, altering, or improving digital goods. The amnesty statute is also amended to provide that, for periods before July 26, 2009, a taxpayer must have remitted sales tax to the Department on the retail sale of digital goods for that taxpayer to be entitled to a refund or credit of any excess B&O tax paid as a result of reporting B&O tax on such sales under the service and other activities classification rather than the retailing classification.

This proposal adds provisions for determining where the sale of digital products occurs for purposes of municipal B&O taxes on income received from the sale of digital products. These provisions largely align with the state and local sales tax sourcing provisions for the sale of digital products.

Lastly, the sales and use tax exemption for sales of standard digital information used solely for business purposes is broadened slightly to exempt all sales of digital goods used solely for business purposes. This expansion merely adds sounds and images to the existing exemption for data, facts, and information.

The proposal would take effect July 1, 2010. However, most of the proposal would apply both prospectively and retroactively to July 26, 2009, the effective date of ESHB 2075. The expansion of the sales and use tax exemption for standard digital information to include all digital goods used solely for business purposes is prospective only. Also, the changes relating to sales of components are prospective only.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

ASSUMPTIONS/DATA SOURCES

Data is from eMarketer, the Online Publishers Association, Strategy Analytics, the Yankee Group, the International Digital Publishing Forum, iSupply, the International Federation of the Phonographic Industry (IFPI), DFC Intelligence, E-Stats and the economic census (Census Bureau), Implan (M-2604000 Minnesota Implan Group), the Washington (State) Input-Output Model, Bureau of Economic Analysis data, the Federal Communication Commission's Video Competition Report, and Washington State tax data.

REVENUE ESTIMATES

This proposal is designed to avoid unanticipated revenue increases and decreases, as well as to clarify the original intent of ESHB 2075. The true fiscal impact of this proposal is from the few minimal expansions to the existing exemptions. The unintended consequences of ESHB 2075 have not been implemented to this point. Currently, taxpayers are largely reporting in accordance with this proposal.

General Fund revenues are estimated to decline by \$101,000 in Fiscal Year 2010.

Local sales and use taxes will decline by \$2.7 million in Fiscal Year 2010.

TOTAL REVENUE IMPACT:

State Government (cash basis, \$000):

FY 2010 - \$ (101)
 FY 2011 - \$ (871)
 FY 2012 - \$ (762)
 FY 2013 - \$ (604)
 FY 2014 - \$ (367)
 FY 2015 - \$ (76)

Local Government, if applicable (cash basis, \$000):

FY 2010 - \$ (2,717)
 FY 2011 - \$ (3,495)
 FY 2012 - \$ (3,772)
 FY 2013 - \$ (4,062)
 FY 2014 - \$ (4,358)
 FY 2015 - \$ (4,669)

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing

To implement this legislation, the Department will incur costs of approximately \$26,300 in Fiscal Year 2010. These costs are to print and mail a special notice to tax practitioners and impacted businesses informing them of changes in the taxation of products and services provided or furnished electronically.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years					
E-Goods and Services	26,300		26,300		
Total \$	\$26,300		\$26,300		

Part IV: Capital Budget Impact

NONE.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will continue to use the standard process to amend WAC 458-20-155 and WAC 458-20-15501 that was begun with passage of ESHB 2075.

LOCAL GOVERNMENT FISCAL NOTE

Department of Community, Trade and Economic Development

Bill Number: 2620 S HB	Title: Excise taxation
-------------------------------	-------------------------------

Part I: Jurisdiction-Location, type or status of political subdivision defines range of fiscal impacts.

Legislation Impacts:

- ☒ Cities: Significant (greater than \$1 million) decrease in sales and use tax revenue, and indeterminate impact on city B&O tax revenue
- ☒ Counties: Significant (greater than \$1 million) decrease in sales and use tax revenue
- ☒ Special Districts: Significant (greater than \$1 million) decrease in sales and use tax revenue
- ☐ Specific jurisdictions only:
- ☐ Variance occurs due to:

Part II: Estimates

- ☐ No fiscal impacts.
- ☒ Expenditures represent one-time costs: Potential one-time costs for some cities administering B&O to update their systems.
- ☐ Legislation provides local option:
- ☒ Key variables cannot be estimated with certainty at this time: Impact on city B&O tax

Estimated revenue impacts to:

Indeterminate Impact

Estimated expenditure impacts to:

Indeterminate Impact

Part III: Preparation and Approval

Fiscal Note Analyst: Darleen Muhly	Phone: (360) 725-5030	Date: 02/24/2010
Leg. Committee Contact:	Phone:	Date: 02/17/2010
Agency Approval: Steve Salmi	Phone: (360) 725 5034	Date: 02/24/2010
OFM Review: Ryan Black	Phone: 360-902-0417	Date: 02/24/2010

Part IV: Analysis

A. SUMMARY OF BILL

Provide a clear, succinct description of the bill with an emphasis on how it impacts local government.

SUMMARY:

This bill is intended to make technical corrections to ESHB 2075 passed last session.

The bill clarifies the definition of digital automated services, excluding from the definition of digital automated services the following: digital goods; advertising services; the mere storage of digital goods, digital codes, and software; data processing services; live interactive online presentations, such as seminars, lectures, workshops, and educational courses; and certain services provided to online sellers to facilitate sales via the website of the online seller.

While data processing services are not considered digital automated services under this proposal, the sale of mere access to prewritten computer software that the customer uses to perform data processing, where possession of the software is maintained by the seller or a third party, is a retail sale.

This bill also clarifies that the primarily human effort exclusion from the definitions of digital automated services and digital goods (digital products) only applies to human effort performed by the seller, not the buyer of the digital product, and clarifies that the definition of digital goods does not include the Internet.

The definition of digital goods is also revised to provide that the sale of digital goods includes the charge by a photographer for taking photographs that are transferred electronically to the customer if the customer is an end user of the photographs. This change would ensure consistent tax treatment of tangible and digital photographs.

The business and occupation (B&O) tax definition of royalties is clarified to include amounts received from the licensing of digital products to persons who are not an end user of the digital products.

The definition of "Internet access" in RCW 82.04.297 is amended to exclude a telecommunications service purchased, used, or sold by Internet service providers, where the telecommunications service is used to provide access to the Internet. This will ensure that these services remain taxed under the "retailing" B&O tax classification.

This bill clarifies that income derived by cable and satellite television providers, with respect to their monthly subscription fee revenue and sales of other programming that is exempt from sales tax, remains subject to B&O tax under the "service and other activities" classification.

The sales and use tax exemption for digital products made available free of charge is clarified as applying only to digital products made available to the general public by a business or other organization.

This proposal treats sales of digital products that will become components of a new product for sale as wholesale sales, consistent with the treatment of sales of tangible ingredients and components. This does not change the sales and use tax treatment of components but does slightly increase the state B&O tax rate from the 0.471 percent retailing rate to the 0.484 wholesaling rate on the gross proceeds of sales of components.

This bill makes a technical change to RCW 82.08.195(7) that addresses the bundling of digital products to correct an oversight in ESHB 2075.

In addition, the nexus "safe harbor" statute is amended to provide that the Department may not consider a person's ownership of, or rights in, software located in this state, including software used in providing a digital automated service, in determining whether the person has substantial nexus with this state.

The amnesty provisions of ESHB 2075 are amended to provide relief for the failure to pay or collect sales or use tax before the July 26, 2009, effective date of ESHB 2075 on labor and services rendered in respect to installing, repairing, altering, or improving digital goods. The amnesty statute is also amended to provide that, for periods before July 26, 2009, a taxpayer must have remitted sales tax to the Department on the retail sale of digital goods for that taxpayer to be entitled to a refund or credit of any excess B&O tax paid as a result of reporting B&O tax on such sales under the service and other activities classification rather than the retailing classification.

This bill adds provisions for determining where the sale of digital products occurs for purposes of municipal B&O taxes on income received from the sale of digital products. These provisions largely align with the state and local sales tax sourcing provisions for the sale of digital

products.

Lastly, the sales and use tax exemption for sales of standard digital information used solely for business purposes is broadened slightly to exempt all sales of digital goods used solely for business purposes. This expansion merely adds sounds and images to the existing exemption for data, facts, and information.

Although the bill would take effect on July 1, 2010, most of it would apply both prospectively and retroactively to July 26, 2009, the effective date of ESHB 2075. The expansion of the sales and use tax exemption for standard digital information to include all digital goods used solely for business purposes is prospective only. Also, the changes relating to sales of components are prospective only.

DIFFERENCES BETWEEN THIS BILL AND THE PREVIOUS VERSION:

This bill contains a wording change in the definition of data processing services in Section 203. This bill also includes a new section (902 in the substitute bill), not in the previous version, stating that the act takes effect July 1, 2010. Neither of these differences changes the fiscal impacts addressed in this fiscal note.

B. SUMMARY OF EXPENDITURE IMPACTS

Briefly describe and quantify the expenditure impacts of the legislation on local governments, identifying the expenditure provisions by section number, and when appropriate, the detail of expenditures. Delineate between city, county and special district impacts.

This bill would create indeterminate expenditure impacts for cities that collect B&O taxes. The bill adds provisions for determining where the sale of digital products occurs for city B&O taxes. These provisions largely align with the state and local sales tax sourcing provisions. Many cities are already treating the sale of digital goods as provided in the bill, according to the Association of Washington Cities (AWC). However, this may not be the case for all cities, so some cities may need to update their systems.

C. SUMMARY OF REVENUE IMPACTS

Briefly describe and quantify the revenue impacts of the legislation on local governments, identifying the revenue provisions by section number, and when appropriate, the detail of revenue sources. Delineate between city, county and special district impacts.

This bill would have significant (greater than \$1 million) indeterminate revenue impact on local government. This bill would decrease local government sales tax revenue by 2.7 million if fiscal year 2010 and have indeterminate impact on city B&O tax revenue.

CITY B&O TAX REVENUE IMPACTS:

According to AWC, 38 cities imposed B&O taxes in 2009, and three (Seattle, Bellevue and Tacoma) made up approximately 79 percent of city B&O revenue in the state. Seattle and Bellevue already treat many of the sales of digital goods, for example, games, books, music, etc. primarily under the retail classification.

According to the City of Seattle, the primary impact for cities with digital goods business would be in the area of service. Seattle already treats many of the sales of digital goods, for example, games, books, music etc. primarily under the retail classification.

LOCAL GOVERNMENT SALES AND USE TAX IMPACTS:

the bill would result in the following decrease in local sales and use tax revenue, according to the Department of Revenue (DOR):

FY 2010 -- (\$2,717,000)
FY 2011 -- (\$3,495,000)
FY 2012 -- (\$3,772,000)
FY 2013 -- (\$4,062,000)
FY 2014 -- (\$4,358,000)
FY 2015 -- (\$4,669,000)

The decreased revenue distribution among cities, counties and special districts is as follows:

	County	City	Special District
FY 2010	\$(995,237)	\$(1,018,639)	\$(675,954)
FY 2011	\$(1,280,219)	\$(1,310,321)	\$(869,511)
FY 2012	\$(1,381,684)	\$(1,414,172)	\$(938,425)
FY 2013	\$(1,487,911)	\$(1,522,897)	\$(1,010,573)
FY 2014	\$(1,596,335)	\$(1,633,871)	\$(1,084,214)
FY 2015	\$(1,710,255)	\$(1,750,469)	\$(1,161,587)

METHODOLOGY:

The distributions in this note for cities, counties, and special districts are based on DOR data for local sales and use tax distributions from 2008. Mitigation payments and distributions to hospital benefit zones are not factored into this distribution. This results in a distribution of 37.00 percent to counties, 37.87 percent to cities and 25.13 percent to special districts. The 1 percent DOR administrative fee has also been deducted.

SOURCES:

Department of Revenue Fiscal Note

Department of Revenue Local Tax Distributions

Association of Washington Cities

City of Bellevue Tax Division

City of Seattle Revenue and Consumer Affairs Division