

NCSL Executive Committee Task Force on State and Local Taxation

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Digital Taxation and Augmented Reality

Steve Kranz

Partner

McDermott Will & Emery LLP

Washington, DC

skranz@mwe.com

(202) 756-8180

Tom Foulkes

Vice President State Government Affairs

Entertainment Software Association

Washington, DC

tfoulkes@theesa.com

(202) 340-0884

www.mwe.com

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- 2. Pokémon GO**
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2016 STATE AND LOCAL RECAP

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■ Pennsylvania

- In July, the General Assembly approved an expansive revenue package (H.B. 1198) that included a significant expansion of the sales and use tax base that captures most digital goods, eff. Aug. 1, 2016.
- New statutory language provides that tangible personal property “shall include the following, whether electronically or digitally delivered, streamed or accessed and whether purchased singly, by subscription or in any other manner, including maintenance, updates and support:
 - (i) video; (ii) photographs; (iii) books; (iv) any other otherwise taxable printed matter; (v) applications, commonly known as apps; (vi) games; (vii) music; (viii) any other audio, including satellite radio service; (ix) canned software, notwithstanding the function performed; or (x) any other otherwise taxable tangible personal property electronically or digitally delivered, streamed or accessed.”
- Digital periodicals (magazines and newspapers) not captured.

■ Alabama

- **February - March 2016:** Digital Goods Bills Introduced
 - S.B. 242 (statutory “digital goods” imposition).
 - H.B. 349 and S.B. 345 (companion exemption bills).
- **March 9, 2016:** Senate Finance and Taxation Education Committee rejects SB 242.
- **April 12, 2016:** HB 349 passed by the Alabama House.
- **April 26, 2016:** Commissioner Magee expresses concerns with HB 349 in letter to legislature.
 - Because certain taxpayers are paying tax (while others are not) the Commissioner stated that **the DOR will not be initiating any new audits or finalizing any preliminary assessments.**
 - Encouraged formation of working group to develop legislation.

▪ Alabama (cont.)

- **May 16, 2016:** Alabama Legislature adjourns *sine die*—no digital goods bills enacted.
- **Summer 2016:** Senate President Pro Tem Del Marsh asks stake holders and experts to participate in digital goods working group.
- **Oct. 12, 2016:** First working group meeting.
 - Introductory. Included both DOR, local and industry reps.
 - *Goal* – to produce legislation for the 2017 regular session (begins Feb. 7, 2017).
- **Nov. 1, 2016:** Second (last?) working group meeting.
 - Substantive. No consensus between DOR and interested parties.
 - DOR tasked to draft legislation – awaiting draft.

- **Other states proposing digital tax increases:**
 - **Oklahoma** – Gov. Mary Fallin Executive Budget Proposal.
 - **West Virginia** – HB 2704 (2016) would have repealed a number of exemptions and imposed sales and use tax on products transferred electronically.
 - **Connecticut** – State Tax Panel Final Report.

▪ Kentucky

- *Netflix, Inc. v. Finance and Administration Cabinet Dep't of Revenue*, Order No. K-24900 (Bd. Tax App. Sept. 23, 2015) (Netflix's streaming services provided did not meet the definition of "multichannel video programming services"); *aff'd* No. 15-CI-01117 (Franklin Cty. Cir. Ct., Aug. 23, 2016).
 - DOR filed notice of appeal on Sept. 20, 2016.

▪ South Carolina

- Revenue Ruling No. 16-5 (July 6, 2016) (finding charges for streamed TV programs, movies, music, and other similar content are charges for communication services, subject to sales and use tax).

▪ Connecticut

- Conn. Dep't of Revenue Services Ruling No. 2015-5 (Nov. 3, 2015) (finding digital content streaming services to be subject to sales and use tax in Connecticut by characterizing them as taxable "computer and data processing services" which are taxable at a reduced rate).

Local Developments: Streaming Services

■ City of Chicago

- Amusement Tax Ruling No. 5 (June 9, 2015) provided that tax applies to streamed video, music, games and movies.
- *Labell et al. v. City of Chicago*, No. 2015 CH 13399 (first amended complaint filed Dec. 15, 2015).
 - Argued that the ruling:
 1. Is a new tax in violation of City's home rule authority;
 2. Violates the Internet Tax Freedom Act;
 3. Violates the Illinois Uniformity Clause; and
 4. Violates the U.S. Commerce Clause.
 - **July 26, 2016** – City's motion to dismiss partially granted (first argument only).

Local Developments: Streaming Services

■ California Cities

- Coalition of 40+ California Cities hired an attorney to draft a ruling interpreting their current Utility Users Tax (UUT) imposition on “video programming” to apply to streamed video content.
- Two cities (Alameda and Watsonville) expanded their UUT ordinances by ballot measure in 2016 election.
 - Broadly drafted—could be interpreted to tax video games and audio services.
 - Both effective 10 days after voter approval, but Watsonville permits a transition period (ending April 1, 2017).
- Remaining cities are considering adopting a draft ruling that was initially broadly defined to capture a host of digital content, but was recently scaled back to only apply to OTT content providers that also offer live broadcast TV on a recurring subscription basis.
 - As drafted, the ruling would be implemented starting May 1, 2017.

Internet Tax Freedom Act (“ITFA”)

- **Feb. 2016** – Congress *permanently* extended ITFA after it was temporarily extended 8 times since its initial enactment in 1998.
 - Included as part of a larger trade bill. See H.R. 644 (2016); P.L. 114-125.
- ITFA provides a moratorium on Internet access taxes and prohibits states, or their political subdivisions, from imposing new taxes on Internet access services.
- ITFA also prohibits state and local governments from imposing multiple or discriminatory taxes on electronic commerce.
 - The ban on multiple taxes prohibits more than one state, or more than one local jurisdiction at the same level of government (i.e., more than one county or city), from imposing a tax on the same transaction, unless a credit is offered for taxes paid to the other jurisdiction.
- The ban on discriminatory taxes prohibits additional taxes or an alternative tax rate on a good, service, or information delivered electronically that would differ from the tax or rate applied to the same, or similar, good, service, or information if it were purchased through traditional commerce (e.g., brick and mortar stores).
 - In other words, under the moratorium the same tax rate must be applied to similar items regardless of how they were purchased.

Digital Goods and Services Tax Fairness Act

[H.R. 1643; S. 851] [114th Congress]

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- Re-introduced in House on March 26, 2015 by TX Rep. Lamar Smith.
 - Passed out of House Judiciary Committee on June 17, 2015 after a hearing; yet to be introduced in the House for floor consideration.
 - Companion bill in the Senate introduced by SD Sen. John Thune.
- The act provides a sourcing regime based on a customer's "tax address."
- No state or local jurisdiction may impose a sales or use tax on digital goods or services unless it gives credit for comparable taxes paid to other states for the same transaction.
- Digital goods cannot be taxed at a higher rate than the rate for comparable tangible personal property or services that is not delivered electronically.

POKÉMON GO [AUGMENTED REALITY]

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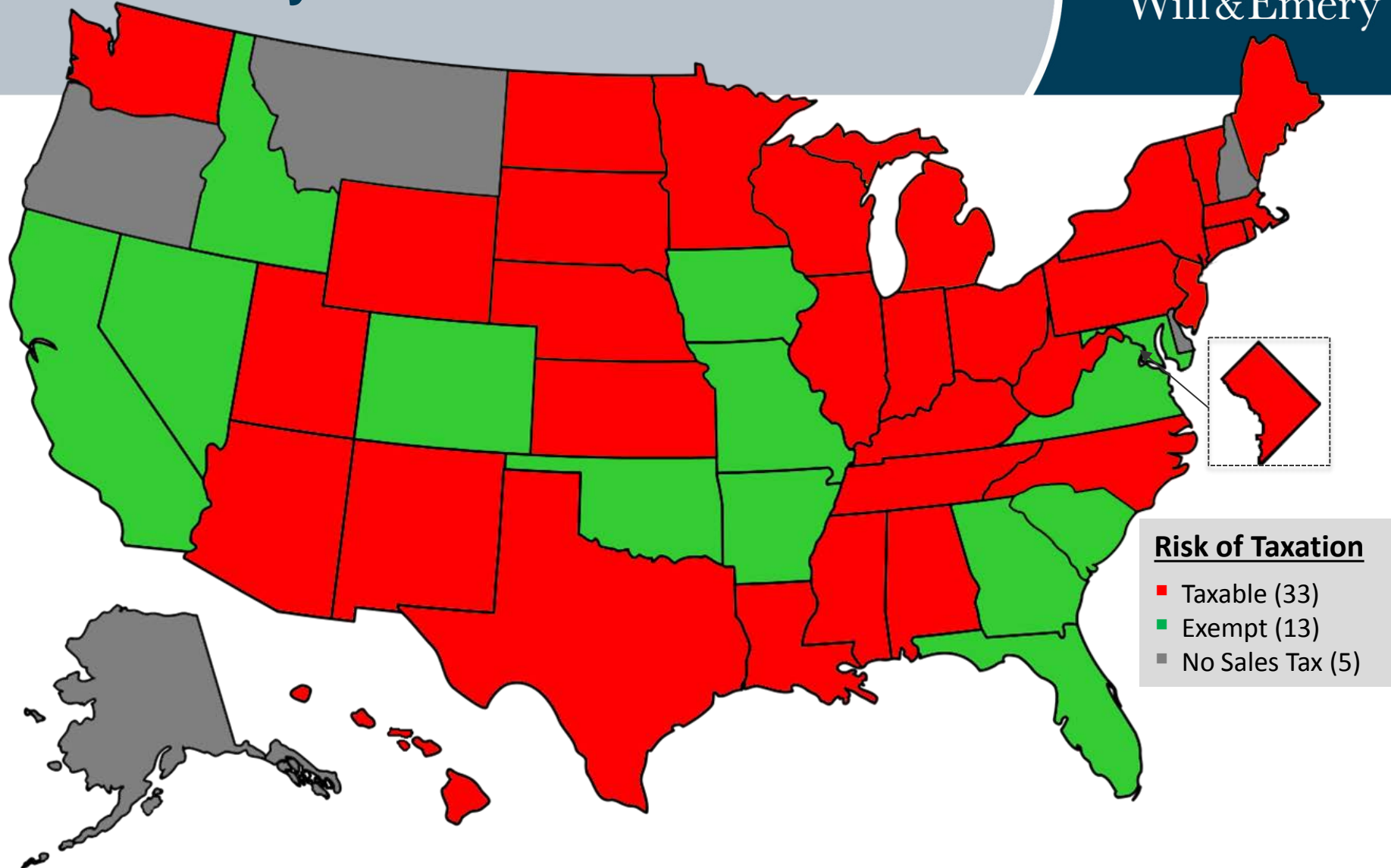
- The increasing popularity of augmented (and virtual) reality raises many of the same issues that the Task Force has been discussing for years.
 - From a policy perspective, should AR/VR transactions be taxed?
 - If so, how should the AR/VR content and transaction be **characterized**?
 - Is it software, a digital product, a service, intangible or something else?
 - What is being purchased? App or software? In-app purchase of digital content or virtual currency? Advertising?
 - To whom should the transaction be **sourced**?
 - Depends on characterization.

- Potential flows of money in the augmented reality space raise interesting tax issues.
 - Example: In Pokémon GO, users can utilize Lures (in-app purchases that allow them and others to reap a number of benefits) to increase retail foot traffic.
 - All users playing the game can see the Lure location on their GPS map.
 - Cost to the promoter/business is trivial (a little over \$1 per hour) and has the potential to significantly increase sales.
 - This is likely an advertising service in many states, but practically it is impossible to determine whether a Lure was purchased for business purposes or pleasure.

STATE OF DIGITAL TAX



Taxability of Prewritten Software Delivered Electronically*

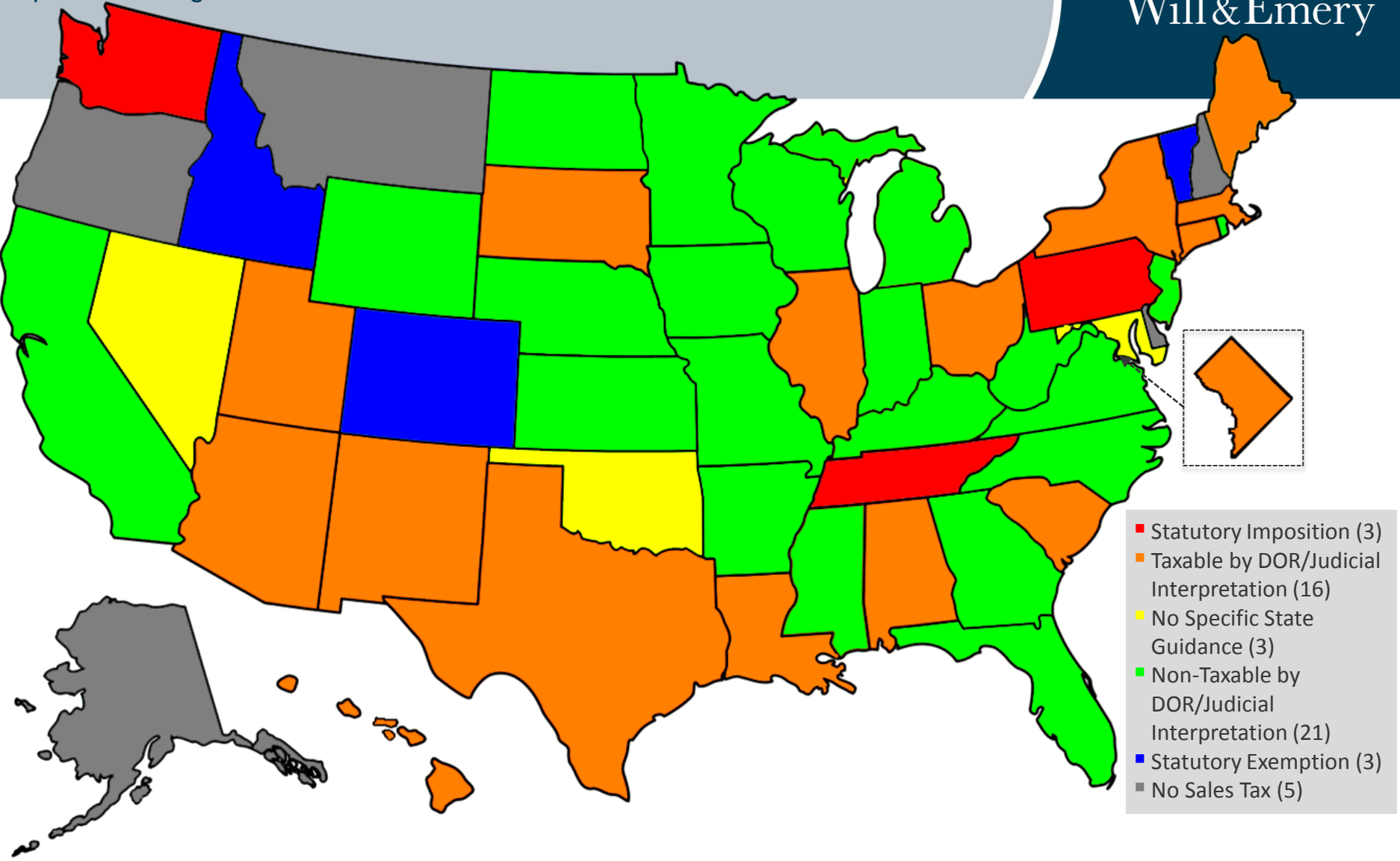


*Note: Updated through Nov. 2016. Prewritten software is defined as canned (non-custom) software delivered through an electronic medium.

Taxability of SaaS*

Updated through November 2016

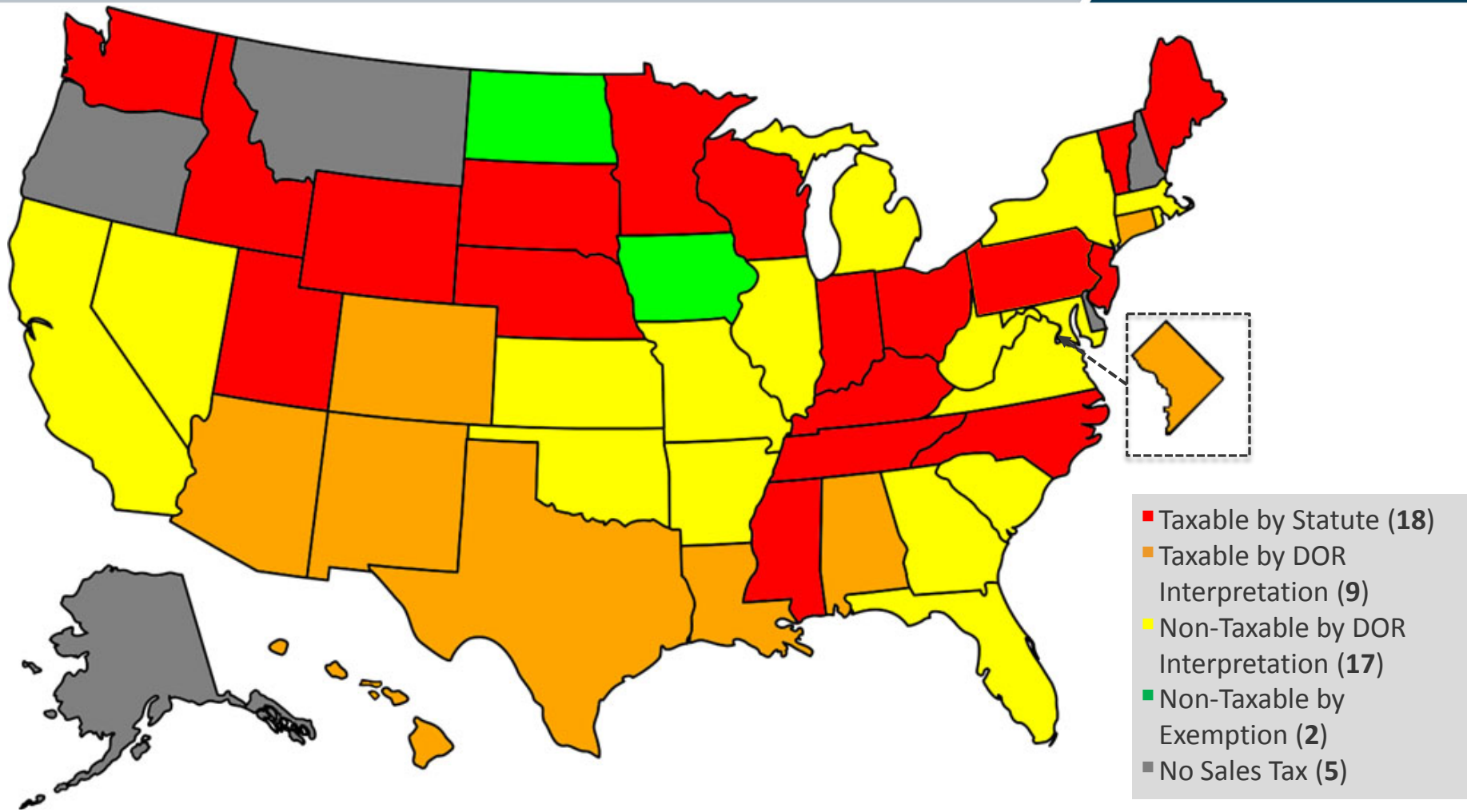
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*Note: Software as a Service is defined as a service that provides remote access to software applications to the customer. Consideration was given to the taxability of SaaS with and without a license agreement when analyzing risk. 18

Taxability of Digital Products*

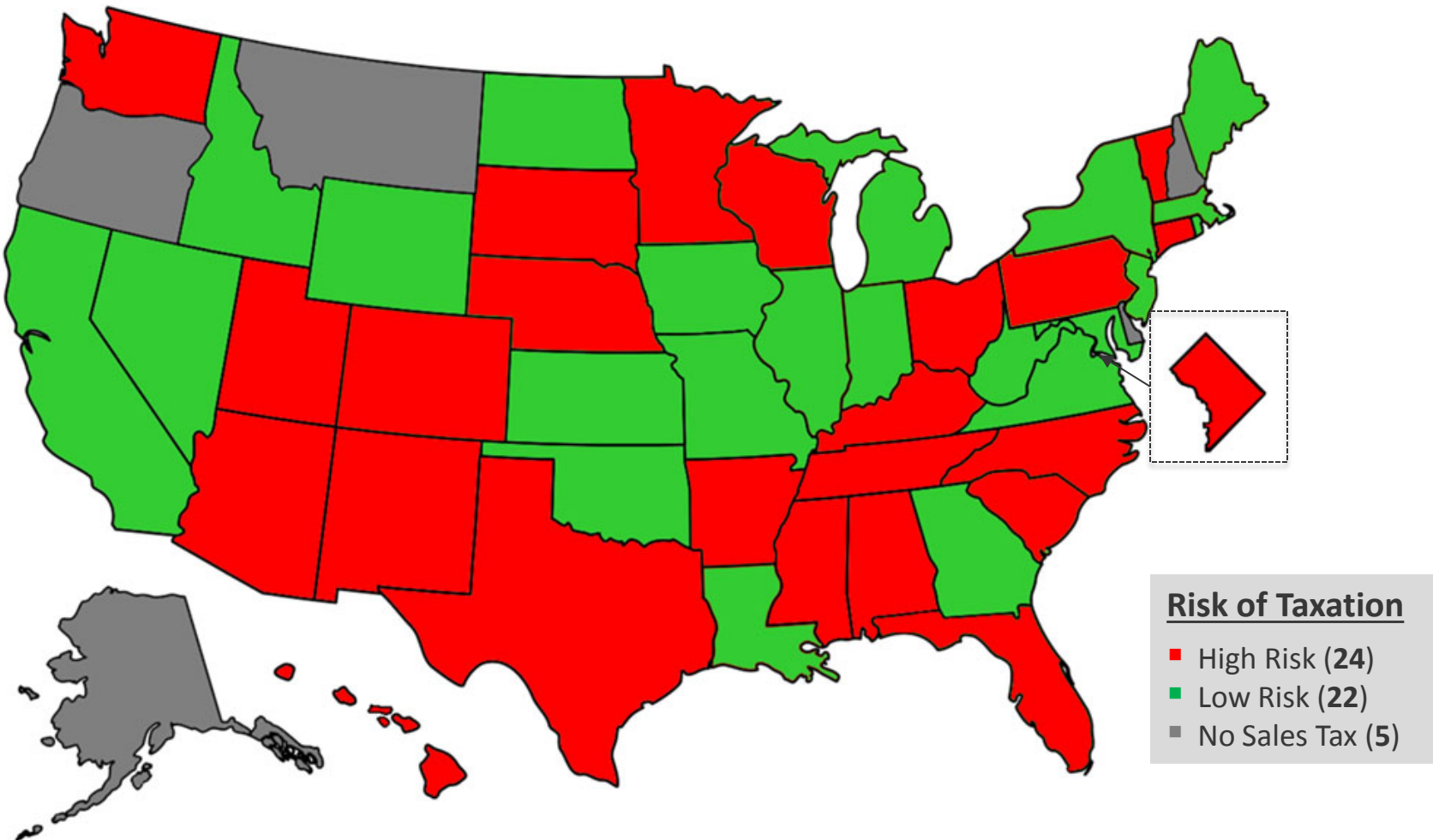
Updated through November 2016



*Note: Digital products include digital audio, digital audio-visual and digital books delivered electronically.

Taxability of Streamed Video Content*

Updated through November 2016



*Note: All states have the same risk for streamed audio except Arkansas—which we consider to be Low Risk for audio.

- **Virtual Reality (VR) & Augmented Reality (AR)**
- **Internet of Things (IoT)**
 - Transactions conducted with no human involvement.
 - Example: your smart fridge automatically orders milk or eggs from a grocery delivery service when you are running low.
- **Blockchain & Virtual Currency (VC)**
 - Blockchain is a secure distributed ledger that simultaneously records transactions on a large number of computers in a network. Secure, and increasingly popular in B2B.
 - Where does the transaction take place for tax purposes when the identity or location of the counterparty is unknown?
 - What's the taxable value if the transaction is settled in a virtual currency?
- **Big Data as a Service (BDaaS)**
 - Delivery of statistical analysis tools or data by an outside provider that helps businesses understand and use insights gained from large information sets on a real-time basis in order to gain a competitive advantage. Very valuable to businesses.
 - Example: Access to Twitter, Facebook, or Google search data on a real time basis.
- ***Everything On-Demand!***

Questions?

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entertainment
software
association

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Vice President State Government Affairs
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Washington, DC
tfoulkes@theesa.com
(202) 340-0884

LinkedIn Group: State Tax Policy Exchange

Blog: www.insidesalt.com