



Arizona is Re-examining the Taxation of Digital Goods and Services

In this month's state and local tax (SALT) column, Busby explains why an Arizona legislative committee is re-examining the application of state and local sales taxes to proceeds from digital goods and services, the scope of its review, and where the panel seems to be leaning after its first few meetings.

Arizona's Joint Legislative Ad Hoc Study Committee on the Tax Treatment of Digital Goods and Services has been meeting roughly once a month since the end of July. When the next legislative session begins in January, it is likely to recommend legislation that will clarify whether digital goods and services are subject to Arizona sales tax.

The Need for Transparency

The committee was formed at the request of the business community, which is concerned by aggressive positions that the Department of Revenue has quietly advanced in audits and in private taxpayer rulings based on sales tax laws enacted long before digital goods and services were even contemplated.

For instance, given the DOR's expansive view of Arizona's definition of tangible personal property and of what constitutes a lease, it has taken the position that proceeds from online research databases, online computer backup services, cloud storage services, and online website building and hosting businesses are subject to sales tax as proceeds from renting tangible personal property.

Likewise, given its expansive view of Arizona's definition of tangible personal property, the DOR believes that many companies worldwide receiving income from digital goods licensed to customers with billing addresses in Arizona are subject to both state and municipal sales taxes, even though the companies do not have a physical presence in the state.

According to a legislative staffer's presentation, Arizona is one of just nine states that impose tax on digital goods based merely on its revenue agency's interpretation of the law. By contrast, 17 states opt not to tax digital goods based on their interpretations of the law, 18 impose tax on digital goods via statute, and two have statutes that specifically exempt digital goods.

The Committee's Charge

The committee is expected to review:

- The DOR's positions and its efforts to disseminate those positions;
- Legal issues regarding the taxation of digital goods and services in Arizona and other states;
- The administrative implications of taxing digital goods and services, including the impact on both taxpayer compliance and tax administration;
- The tax treatment of digital goods and services in other states, including



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the economic impact;

- The potential Arizona tax impact of taxing digital goods and services; and,
- Recent legislative and regulatory actions designed to address the tax treatment of digital goods and services in Arizona and other states.

Initial Leanings

During the committee's first meeting, Rep. Michelle Ugenti-Rita (R), its co-chair, interrupted a legislative staffer during his overview presentation to clarify that, while some states have responded to the advent of digital goods and services by expanding their tax bases to specifically tax such goods and services, Arizona may not go in that direction. That point was consistent with her statement upon the committee's formation that "as people's behavior changes with advancements in technology, government too must not hinder technological innovations or growth in our economy."

Before the first meeting, the committee's other co-chair, Sen. David Farnsworth (R), said that it "is designed to examine Arizona's tax structure to assure it is keeping pace with the rapid development and expansion of digital technologies, while at the same time guaranteeing that Arizona retains its competitive business climate."

During the committee's initial meeting:

- Both co-chairs inquired about the state's potential exposure for refund claims if one or more taxpayers successfully challenge the DOR's positions in this area;
- DOR Deputy Director and committee member Grant Nülle argued that an exemption for digital goods and services could have a substantial fiscal impact; and,
- Arizona Tax Research Association President Kevin McCarthy, a committee member, questioned whether an exemption that merely clarifies that digital

goods and services never should have been taxed in the first place should be considered to have a fiscal impact.

As of the first week in November, after three committee meetings and with the next legislative session only two months away, only one thing is certain: this issue is likely to keep many lobbyists busy next year! ■

*Join James Busby and your
peers at the next
ADOR Luncheon
at the ASCPA offices on
Dec. 12
from noon-1:00 p.m.*