

Proposed Arizona Legislation Addresses Digital Goods and Services

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In this installment of SALT From My Saddle, Busby summarizes some of the provisions of S.B. 1460 that, if enacted, will clarify that prewritten software and specified digital goods are subject to Arizona sales and use taxes and that digital services are not taxable.

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On February 4 Arizona Sen. Michelle Ugenti-Rita (R) introduced legislation to address the taxation of digital goods and services in Arizona.

Ugenti-Rita: Arizona's Digital Champion

For two years, Ugenti-Rita has worked tirelessly to clarify the taxation of digital goods and services in Arizona. First, in 2017 as co-chair of Arizona's Joint Legislative Ad Hoc Study Committee on the Taxation of Digital Goods and Services, she listened intently as businesses and tax professionals complained that, in their opinion, Arizona taxing authorities

have been unlawfully imposing tax on digital goods and services.¹

Then last year, while serving as the chairman of the Arizona House Ways and Means Committee, Ugenti-Rita sponsored legislation that addressed the taxation of digital goods and services.² Because of her efforts, her bill sailed through the House last year. But, unfortunately, it stalled in the Senate.³

Bill Would Permit Taxes on Digital Goods Prospectively

Now in her first term in the Arizona Senate, Ugenti-Rita introduced S.B. 1460. If enacted, her bill will specify that prewritten software and specified digital goods will be subject to Arizona's state and local sales and use taxes in the future.

The bill defines "prewritten software" and specifies that it includes computer software maintenance contracts (another defined term), custom software that is later sold to a person other than the original purchaser, and proceeds from customizing software if not separately stated.

The bill defines "specified digital goods" as (1) digital audiovisual works; (2) digital audio works; (3) digital books, articles, periodicals, and other prewritten works; and (4) digital visual works.

¹ See James G. Busby Jr., "Arizona is Reexamining the Taxation of Digital Goods and Services," *State Tax Notes*, Sept. 4, 2017, p. 967, for more information about the committee's efforts.

² See Busby, "Arizona Intends to Clarify Taxation of Digital Goods and Services," *State Tax Notes*, Feb. 19, 2018, p. 711.

³ See Busby, "Arizona Left Providers of Digital Goods and Services in a Pickle," *State Tax Notes*, June 4, 2018, p. 1003.

Bill Would Clarify That Digital Services Are Not Taxable

If enacted, the bill will clarify that, consistent with a recent amendment to Arizona's constitution,⁴ digital services are not subject to tax. The bill defines "digital services" as cloud-based or remotely accessed software and other services that are provided electronically and are not specifically identified as taxable transactions in Arizona's tax statutes.

Ugenti-Rita's Urgent Call to Action

During the 2017 ad hoc study committee hearings, Ugenti-Rita listened to businesses and tax professionals complain that Arizona taxing authorities are unlawfully imposing tax on digital goods and services. But because many businesses didn't show up at the legislative committee hearings last year to support her bill, Ugenti-Rita is now urging businesses that are concerned about the Arizona Legislature's failure to specify which digital goods and services are taxable to make their voices heard this year as the Legislature debates her bill.

Because of the aggressive positions Arizona taxing authorities are taking,⁵ providers of digital goods and services will be in a damned-if-you-do, damned-if-you-don't position until the Legislature acts. That is, to the extent they choose to collect tax on their proceeds from providing digital goods and services to Arizona customers without specific statutory authority to do so, they expose themselves to potential class action lawsuits for allegedly collecting more tax than is lawfully due. Yet if they do not collect tax from their Arizona customers and the Department of Revenue determines that they should have paid tax, they may have to pay tax that they did not collect from their customers, along with penalties and interest, if audited.

Accordingly, interested parties should weigh in on S.B. 1460. ■

⁴ See Busby, "Arizona Constitutional Amendment Prohibits New Taxes on Services," *State Tax Notes*, Nov. 26, 2018, p. 781.

⁵ See Busby, "Arizona's Tortured Method of Imposing Sales Taxes on Services," *State Tax Notes*, Mar. 20, 2017, p. 1031.

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