

Streamlined Digital Products Sourcing Workgroup Bullets

Background:

- **Destination-based sourcing rules:** The Streamlined Agreement adopts a destination-based framework for sourcing products, including digital goods and services. Under this framework, sellers generally must source sales of such digital products under the following hierarchy:
 - Seller’s business location.
 - Other location known to the seller.
 - Purchaser address in the seller’s books and records or obtained at the consummation of sale.
 - As a last resort, the location first available for transmission of digital goods or the location from which a service was provided.
- **Growth of electronic commerce:** Since the original adoption of the Streamlined sourcing rules, digital commerce has continued to grow and various questions from member states and taxpayers have come up relative to digital products.
- **Establishment of a working group:** At the Streamlined Governing Board’s October 2011 meeting in Seattle, the Governing Board directed work be started to clarify the sourcing of digital products. Subsequently, the Digital Products Sourcing Workgroup was formed.
- **Work group Scope:** Identify interpretive issues related to the sourcing of specified digital products, develop recommendations, draft interpretive rule language, and recommend amendment to the SSUTA if needed.
 - The workgroup limited its scope to specified digital products as defined under the SSUTA, meaning digital audio-visual works (e.g. movies), digital audio works (e.g. music), and digital books. The idea was to address those products where the states and business community had common definitions, common understanding, and which comprised a significant portion of today’s electronic commerce.
 - This approach has allowed the group to focus on sourcing and not whether the products themselves should be considered digital products.
 - There has been some discussion that additional rules might be developed later for other digital products if needed. However, before this occurs it may be necessary for the Governing Board and business community to consider adopting additional definitions.
- **Workgroup membership and involvement:** The workgroup consists of a good mix of industry folks and Streamlined member states, including business notables such as Apple, Amazon, and AT&T. We have been meeting since January of 2012 and expect the work to continue at least for the rest of the year. We would invite you folks here to participate if you are interested. If nothing else, the work being done may have lessons for your state and provide ideas for best practices relating to the taxation and sourcing of digital products.
- **Underlying goals:** While not explicit, the overall goal of this effort is to create simple, clear, and reasonable guidance for states and sellers, guidance that promotes consistent and uniform sourcing.

General substantive issues areas for discussion

Sourcing to the location of receipt

- How does the concept of “receipt” apply for purposes of sourcing under the SSUTA?

- From a tax policy perspective, sourcing to the location “receipt” is the most desirable result under the SSUTA because this location most closely coincides with the location where taxable consumption is likely to occur
- This is the topic the workgroup has currently been focusing on, discussing...
 - When is it appropriate to consider a purchaser as having taken possession or made first use of a specified digital product?
 - What does possession or first use mean in the context of specified digital products?
 - Is seller deemed to know the location receipt if the purchaser provides instructions indicating where that purchaser will take receipt?
 - To make our discussions a bit more concrete take the following examples:
 - Consider a company targeting travelers who want to watch movies but have spotty or no Internet connection while in transit. The company installs kiosks at various convenience store locations where customers can pay to rent from movies which are currently available for download from the touch-screen kiosks. Is the Kiosk the location of receipt? What are important factors to consider when addressing this set of facts?
 - Now change the facts and imagine that the seller’s store location provides Wi-Fi for the download of movies? Is this receipt? Would it matter whether the Wi-Fi was exclusively associated with a server at that seller’s place of business or rather connected to the Internet such that the movies are downloaded from server in some distant state? You can see how even seemingly simple transactions can pose complex questions.
 - Consider another company that makes available 1000s of movie titles. Purchasers can either buy permanent copies of the movie titles or they can stream the same movies for a twenty-four hour period. The company also provides the broadband internet connection terminating at the purchaser’s home that the purchaser must use to obtain the content. This might be similar to a cable provider. Does the seller know the location of receipt because it provides the required broadband to a known service address?
 - Why is addressing these issues important? The answer is two-fold. First, again sourcing to the location of “receipt” is preferable, if possible, because this location best coincides with taxable consumption. Second, understanding these issues is important in understanding when it is reasonable to expect sellers to use the other sourcing rules, which arguably is much of the time for specified digital products.

Sourcing allocation

- This item raises the issue as to how sellers may source specified digital products where the products are sold in multiple locations to a purchaser? This is a big issue for some sellers today. Typically, you might see this where a specified digital product, perhaps a digital training video, is made available from a central server and accessed from multiple customer employee locations simultaneously.
 - In such cases must everything be sourced to one location? Is allocation allowed?
 - The group will be looking for input from participants, but the starting point in this discussion will be SSUTA’s existing method for allocating computer related services.
 - Under the SSUTA today, computer related services such as remotely accessed data processing services received in multiple locations may, but are not required, to be allocated to multiple locations.
 - Allocation is permissible only if the purchaser and seller agree to allocate the retail sale to multiple locations based on a reasonable and consistent method, the seller

sources the retail sale to those locations using such method, and assuming the locations and allocation are provided by the purchaser by the time of the invoice.

- Does and should this approach apply to specified digital products that are provided in the same or similar manner? From a tax policy perspective, it makes sense to allow allocation as it better mirrors the economic reality of the transaction. However, how do you do so in a way that is both simple and minimizes risk of tax avoidance?

Collecting and maintaining buyer address information

- The SSUTA provides that where receipt is unknown to the seller, the seller will source sales to the customer's address. Sourcing to a customer address represents a reasonable proxy for taxable consumption and generally is a relatively straightforward concept to apply.
- As a practical matter, most transactions are likely to be sourced under these rules because this is the only information available to the seller.
- Questions have arisen as to how the SSUTA rules apply in following situations:
 - Situations where the seller may not be collecting and/or maintaining purchaser address information.
 - Situations where the seller does not otherwise collect purchaser address information because of arrangements with third parties? This is a business model that seems to be increasingly popular. This item contemplates transactions involving payment systems such as PayPal and other blind forms of payment offered through electronic marketplaces.

Origin sourcing

- The final issue we will take up relates to clarifying how specified digital products are sourced when there is no customer address information available to the seller. In these situations, specified digital products are now sourced to “the location...from which the digital good...was first available for transmission by the seller.”
 - What does this language mean?
 - Does the language adequately address a seller that outsources final delivery of a specified digital product that it sells to third parties?

Other issues

- As this effort progresses, more issues are bound to come up.
- Again, we invite you to join our calls if you have an interest.

Remote access software workgroup

- Bruce consider talking a little about the remote access software workgroup if you have time. I think this subject is related to this topic and it is timely. Plus, your state has a specific interest and it might be interesting for FTA members to hear how Streamlined address these types of issues.