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Washington State Tax Update and Amnesty Program Reminder

As first mentioned in the December 28th issue of GBQ's *BottomLine* newsletter, Washington State is currently offering a temporary amnesty program that waives penalties and interest on certain unpaid Washington State business taxes, including the state business and occupation ("B&O") tax. The program began on February 1, 2011 and ends on April 30, 2011. However, an amnesty application and all outstanding tax returns and amended tax returns must be filed by April 18, 2011. This amnesty program is applicable to both registered and unregistered businesses, so this is a program many taxpayers may want to take advantage of, especially due to new legislation enacted by Washington State in 2010. Below is a recap of this important legislation. Now is the time to review these rules to be certain your company does not have an outstanding tax liability in Washington State.

Overview

Today's ever-changing business landscape has created such phrases as "cloud computing", "Software as a Service" (SaaS), and "remote access software". Unfortunately, the manner in which many states tax such transactions for sales tax purposes has been left open for loose interpretation, forcing businesses to rely on sometimes outdated information. As a result, the Washington state legislature passed two bills in 2009 and 2010 that made significant changes to state sales and use tax.

Engrossed Substitute House Bill 2075 (ESHB 2075), effective 7/26/09, and Substitute House Bill 2620 (SHB 2620), updating ESHB 2075 and effective on 7/1/10, specifically define the term "digital products" for Washington sales and use tax purposes.

Additionally, the sales tax legislation aims to address the following in the state of Washington:

- Attempt to make the taxation of various technologies uniform,
- Require sellers of digital products to file their tax returns electronically,
- Provide amnesty to taxpayers who did not pay or collect sales and use tax on digital products that were taxed before the effective date of the act, and
- Detail how a credit or refund of B&O tax paid functions.

Finally, Second Engrossed Substitute Senate Bill 6143 (2ESSB 6143) prescribes economic nexus rules for out-of-state businesses engaged in service activities.

Digital Products

"Digital products" as defined by ESHB 2075 and SHB 2620 means digital goods and digital automated services that are transferred electronically. "Digital goods" include sounds, images, data, facts, or information transferred electronically. However, a digital good does not include telecommunications services, computer software, and internet access.

Digital automated services are any service transferred electronically utilizing one or more software applications. Examples of digital automated services include photo sharing services, car history report services and search engines.

Sales and Use Tax

Washington sales and use tax is imposed on the sale of digital goods, digital codes, and digital automated services, and it does not matter whether the consumer is entitled to permanent or nonpermanent use of the digital product purchased. Examples of digital products that will be subject to sales and use tax include downloaded digital goods such as movies, music, streamed and accessed



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digital goods, remote access software, and digital automated services.

Business Purpose Exemption

Washington sales and use tax is applied broadly to most retail digital transactions. However, the tax does not apply to the sale of digital goods if the goods are purchased solely for business purposes.

Business and Occupation Tax

In addition to the Washington sales and use tax required to be collected by the retailer of the digital good, the gross receipts are also taxable under the B&O tax's retailing or wholesaling classification. The return must be filed, and the tax must be paid electronically. Taxpayers who have nexus in Washington will have to pay B&O Tax at a rate of 0.471% on the gross proceeds of retail sales of digital products and 0.484% on the gross proceeds of wholesale sales of digital products.

It is also worth noting a taxpayer will not have nexus with the state of Washington solely because the taxpayer owns or has ownership rights in digital goods or digital codes residing on servers located in the state of Washington.

Remote Access Software

Remote access software is prewritten software in which the customer pays the seller for the right to access and use the software. However, the software still resides on the seller's server or the server of a third party. Prior to the effective date of ESHB 2075, remote access software was classified as "Service and Other Activities" for the purpose of the B&O Tax. However, subsequent to ESHB 2075, the sale of remote access software is considered to be a retail sale and classified as such for B&O tax purposes. As discussed above, the sale of remote access software is also subject to Washington sales and use tax.

Economic Nexus Standard

Another hot topic on the agenda of many state taxation and revenue departments is the concept of nexus, primarily for income and franchise tax purposes. Beginning June 1, 2010, businesses engaged in "apportionable activities" in Washington will be subject to Washington B&O tax once nexus is established under the new Economic Nexus Standard prescribed in 2ESSB 6143.

Apportionable Activities

"Apportionable activities" include activities taxable under the service, royalties, and several other B&O tax classifications. Such businesses establish economic nexus with the state of Washington (regardless of physical presence) if any one of the following is true during a calendar year:

- (1) commercially domiciled in Washington;
- (2) property in Washington with an average value exceeding \$50,000;
- (3) payroll in Washington exceeding \$50,000, including certain third party costs;
- (4) sales in Washington exceeding \$250,000;
- or
- (5) at least 25% of its worldwide property, payroll, or sales are in Washington.

2ESSB 6143 further clarifies that once economic nexus has been established for B&O tax purposes related to apportionable activities of service providers, it will continue so long as one of the five thresholds is met and for one year after no thresholds have been met.

Safe Harbor

The new economic nexus rule effectively creates a safe harbor for service businesses that have physical presence in Washington but do not meet any of the economic nexus thresholds (meaning a lack of an economic presence). Thus, an employee of a service business who visits the state of

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Washington to solicit a sale will not create nexus in Washington through his visit alone.

Physical Presence Nexus

Physical presence is still required for the retailing, wholesaling, and other B&O classifications not subject to the new economic nexus rules. For example, physical presence in Washington by an employee or other agent of the taxpayer who engages in activities in Washington that are significantly associated with the taxpayer's ability to establish or maintain a market for its products in Washington will create nexus.

Action Items

GBQ SALT professionals are available to assist in understanding the applicability of this legislation and the effects it may have on your business. GBQ SALT professionals can also assist your company in determining if it has established nexus with Washington and in applying for the Washington State Amnesty Program.

For more information, please contact:

Matthew E. Stamp, JD, LLM
Director, State & Local Tax Services
614.947.5302
mstamp@gbq.com

Sara L. Goldhardt, CPA
Senior Manager, State and Local Tax Services
614.947.5243
sgoldhardt@gbq.com

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