

## DRAFT FOR DEVELOPMENT PURPOSES ONLY-NOT FOR PUBLIC DISTRIBUTION

### Digital goods sourcing workgroup recommendation

**Issue:** Proper calculation of the sales or use tax on sales of digital goods and liability relief if only 5-digit zip code is obtained.

- If a seller only obtains a 5-digit zip code from the purchaser of a digital good and calculates the applicable state and/or local taxes based on that 5-digit zip code following the SSUTA requirements (lowest rate in that 5-digit zip code based on the state's rate and boundary databases), will the state hold the seller liable for the tax that would have been calculated if a complete street address was obtained from the seller?
- If a seller requests a complete street address from the purchaser and the purchaser refuses to provide that information since it is not needed for delivery of the digital good, can the seller collect the tax at the highest state and/or local rates for that 5-digit zip code?

**Background:** The question of whether a complete street address is required or needed when selling digital goods is important to the states, as well as CSP's and sellers of digital goods.

Since no physical product is being delivered, sellers may only obtain the information necessary to process the payment for the digital good. In some cases, this is just the 5-digit zip code for the billing address of the credit card used to make payment. Using just a 5-digit zip code will, in many cases, not result in the proper calculation of the actual state and/or local sales and use taxes that are due on the transaction.

Although sellers can request full address information, some purchasers may refuse to provide the information since it really is not needed to receive the product or because of the type of product being purchased the purchaser does not want to provide their address.

The Federal Bill (Digital Goods & Services Tax Fairness Act) has been introduced on a number of occasions, which seeks uniformity for siting amongst the states and localities for digital goods and services. Given that Congress has been reluctant to pass legislation dealing with state and local tax issues, states and industry would both be well served to address this issue.

A State and Local Advisory Council (SLAC) workgroup was formed to discuss the issues involved and to make a recommendation to the Governing Board. The workgroup consists of State representatives, local governmental representatives, business representatives and CSP representatives. The workgroup has met regularly since mid-June of this year.

A survey was sent to all member state SLAC, Audit and Certification committee members. The survey posed 5 questions. Two of the questions addressed the "due diligence" standard found in SSUTA Sec. 305. Three questions addressed tax calculation and liability when a seller requests, but the purchaser does not provide a delivery address and when a seller does not request a delivery address. Fifteen responses were received. Three states indicated that they are a single

rate state so that this issue did not impact them. Two states indicated that they do not tax digital goods therefore, they are not impacted by this issue. The remaining 10 states that responded were somewhat split in their responses to the questions.

Based on the survey results and discussions within the workgroup, the following recommendation is made.

**Recommendation:** It is the recommendation of the SLAC workgroup that if a Seller does not obtain a complete street address or 9-digit zip code, the seller should calculate and collect the tax at the highest combined state and local rates in the 5-digit zip code. If multiple local jurisdictions within a 5-digit zip code have the same highest rate, the seller or CSP may select any of those jurisdictions and report the tax as being collected for that jurisdiction. If a seller/CSP that does not obtain a complete street address or 9-digit zip code chooses not to collect the tax at the highest rate, the seller/CSP may be held liable for that tax upon audit by the state.

Other options:

- Collect at rate in current database based on 5-digit zip
- Identify new FIPS code at highest rate and state would have to allocate between applicable jurisdictions (multiple jurisdictions with same rate)
- State assigned FIPS code with rate state wants CSP/Seller to collect (multiple jurisdictions with different rates)
- Tell seller/CSPs that they have exercised due diligence if they get address and use USPS look-up

**Rationale:** Section 305.F. of the SSUTA requires that member states: “Provide and maintain a database that assigns the proper tax rates and jurisdictions to each five-digit and nine-digit zip code within a member state. The state must apply the lowest combined tax rate imposed in the zip code area if the area includes more than one tax rate in any level of taxing jurisdictions. If a nine-digit zip code designation is not available for a street address or if a seller or CSP is unable to determine the nine-digit zip code designation applicable to a transaction after exercising due diligence to determine the designation, the seller or CSP may apply the rate for the five-digit zip code area. For the purposes of this section, there is a rebuttable presumption that a seller or CSP has exercised due diligence if the seller or CSP has attempted to determine the tax rate and jurisdiction by utilizing software approved by the Governing Board that makes this assignment from the address and zip code information applicable to the transaction.”

Under the rate and jurisdiction database provisions, a certain level of detail is expected. A seller should not automatically go to the 5-digit zip code. Local jurisdictions expect that a 9-digit zip code will be obtained so that the proper local tax can be calculated. In order to determine the 9-digit zip code, obtaining an address is necessary.