STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Amended:	**03/24/08**	Bill No:	**AB 1956**
Tax:	**Sales and Use**	Author:	**Calderon**
Related Bills:			

BILL SUMMARY

This bill would, among other things, require the Board to submit a report to the Legislature on transactions involving digital property within this state that includes, among other things, a proposed regulation that would provide that sales of digital property are subject to tax for purposes of the Sales and Use Tax Law.

SUMMARY OF AMENDMENTS

The amendments since the previous analysis make clarifying changes and add provisions that authorize the Board to adopt a regulation authorized by the bill, and that state that the adoption, amendment, or repeal of a regulation authorized by the bill is exempt from the rulemaking provisions of the Administrative Procedure Act.

ANALYSIS

CURRENT LAW

Existing law provides that the sales or use tax applies to the sale or use of tangible personal property in this state, unless otherwise exempted or excluded by statute. Section 6014 of the Sales and Use Tax Law defines "tangible personal property" as personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. Section 6006 of the Sales and Use Tax Law defines "sale" to include the producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting.

Under existing law, Section 7051 requires the Board to enforce the Sales and Use Tax Law and authorizes the Board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of those laws.

Currently, the Board has two regulations that interpret the Sales and Use Tax Law and its application to digitally transmitted property. Specifically, Regulation 1502, *Computer Computers, Programs, and Data Processing*, interprets and makes specific the law applicable to sales of specified data processing services. Under subparagraph 1502 (f)(1)(D), the regulation provides that the sale or lease of a prewritten program *is not* a taxable transaction if the program is transferred by remote telecommunications from the seller's place of business, to or through the purchaser's computer, and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction.

Regulation 1540, *Advertising Agencies and Commercial Artists*, interprets and makes specific the laws applicable to charges made by these industries. Subparagraph (b)(2)(B) discusses the application of sales and use tax to sales of electronically transmitted sales of artwork. Specifically, the regulation provides that a transfer of

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electronic artwork *in tangible form* is a sale. However, the regulation further provides that a transfer of electronic artwork from an advertising agency or commercial artist to the client or to a third party on the client's behalf that is *not in tangible form is not a sale of tangible personal property*, and the charges for the transfer are not subject to tax.

Also, the Board has a substantial body of annotations that summarize the conclusions reached in selected rulings of the Board's Legal staff that state that charges for remote transfers of electronic data via a telecommunications network are not taxable because there is no transfer of tangible personal property. (See, e.g., Sales and Use Tax Law Annotations 120.0101.800 (7/10/96) [weather data], 120.0106 (7/17/92) [economic data], 120.0107.800 (3/29/96) [graphics], 120.0108.180 (1/28/97) [artwork], 120.0309 (10/23/95) [university library resources], 120.0518 (3/11/94) [illustrations], 120.0662 (4/18/96) [illustrations], and 120.0663 (3/12/96) [advertisement layouts].)

Under the law, all regulations issued by state agencies are generally required to be adopted pursuant to the Administrative Procedures Act, unless expressly exempted by statute (Government Code section 11346).

PROPOSED LAW

This bill would state legislative findings and declarations regarding the transmission of digital property and the Sales and Use Tax Law, and would add Section 7061 to that law to require the Board to submit a report to the Legislature that includes:

(a) A draft of a proposed regulation that would provide that sales of digital property are subject to tax for purposes of the Sales and Use Tax Law.

(b) The revenue impact of the proposed regulation.

(c) Changes required to administer the proposed regulation.

The bill would authorize the Board to adopt regulations to implement proposed Section 7061, and would expressly provide that the adoption, amendment, or repeal of a regulation authorized by that section would be exempted from the rulemaking provisions of the Administrative Procedures Act, as specified.

The bill would become operative January 1, 2009, and the report would be due on or before 60 days of that date.

IN GENERAL

Regulation Procedures Generally. The Board's legal staff or staff of the affected department of the Board is generally responsible for drafting any proposed regulations deemed necessary to clarify the laws the Board administers. Once the staff prepares a proposed regulation, it is then distributed to various interested parties and affected industries for their information and input. Staff then meets with those parties to identify and resolve any issues or language concerns. After a series of meetings, staff prepares discussion papers that highlight any unresolved issues and fiscal estimates, and submits those with the proposed regulation for review by the Board's Business Taxes Committee. The Committee considers the issues and subsequently makes a recommendation for Board action as to whether the Board desires to authorize publication of the proposed regulation.

If the Board votes to authorize publication, the Board holds public hearings on the proposed regulatory action, and considers written and oral testimony by interested parties and Board staff. If after hearing and discussing the testimony the Board

ultimately adopts the proposed regulation, it is then forwarded to the Office of Administrative Law (OAL) for approval. The OAL is charged with the review of regulations as provided in the Administrative Procedure Act (Government Code Sections 11340) and bases its approval using all of the following standards:

(1) Necessity.
(2) Authority.
(3) Clarity.
(4) Consistency.
(5) Reference.
(6) Nonduplication.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author in order to address the application of sales and use tax to charges for digitally transmitted property in consideration of the increased use and sophistication of the Internet and electronic devices that store, organize and play audio and visual files.

2. **The March 24, 2008 amendments** make clarifying changes and add provisions that authorize the Board to adopt a regulation authorized by the bill, and that state that the adoption, amendment, or repeal of a regulation authorized by the bill is exempt from the rulemaking provisions of the Administrative Procedure Act. With these amendments, the Board would not be required to obtain OAL's approval for any proposed regulation on this issue, nor obtain OAL's approval of any amendments to those regulations that currently address this issue.

3. **Is the Board the proper authority to decide whether digital downloads are subject to California's sales and use tax?** Any action by the Board to tax retail transfers of digital media would substantially deviate from existing precedents and authorities and would place a significant burden on the Board to provide a reasonable basis for the interpretive change. With such a substantial deviation from existing precedents and authorities, perhaps the Legislature would be the proper authority to address this issue.

4. **Is there a statutory authority upon which to adopt a regulation that would impose sales and use tax on sales of digitally transmitted property?** The Board has by regulation already addressed this issue with respect to electronic transmission of certain items, and concluded that the electronic transmission of property is not a transfer of tangible personal property, and the charges for the transfer are not subject to tax. However, the Board has not specifically examined subdivision (b) of Section 6006 of the Sales and Use Tax Law (and its counterpart Section 6010 ((b)) and its relation to the electronic transmission of goods. Under these provisions of law, producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting is includable in the definition of "sale" and "purchase." A cell phone or computer, for example, might possibly be regarded as materials furnished directly or indirectly for processing or imprinting the digital transmitted property, and the sale of digital transmitted property could possibly fall within these provisions of law.

Notwithstanding these provisions however, If the Board were to consider adoption of any regulation on this issue, the Board would certainly first have to consult with experts in physics and engineering to determine the nature and attributes of remote downloads. Telecommunications networks employ different kinds of signals, and sales related to such signals may not be subject to tax under any reasonable interpretation of the existing statutory authorities.

COST ESTIMATE

Some administrative costs would be incurred in drafting the proposed regulation, notifying interested parties, holding public hearings, and preparing discussion and issue papers. These costs would be absorbable.

REVENUE ESTIMATE

Enactment of this bill would have no effect on the state's revenues. Notwithstanding the concerns expressed above regarding the appropriateness of such action, if the Board were to ultimately adopt a regulation to impose the sales and use tax on the transfer of digital property, we estimate that state and local revenues could increase by approximately $114 million annually. The basis of this amount would include charges for digitally-transmitted goods such as newspapers, periodicals, books, music, video games, movies and software, which would no longer be excluded from the imposition of California's sales and use tax.

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