

An Introduction To Sales And Use Taxation Of Digital Goods And Services In Pennsylvania

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Digital goods and services have become a major player in the modern marketplace. Today's businesses rely to an increasing degree on goods and services delivered "through the air" by vendors that often will have no traditional markers of presence in a jurisdiction. In most states, the revenue codes on the books do not consider the tax implications of a sale of a "digital good or service."

A "digital good or service" is an amorphous concept not easily defined. The concept revolves around a transaction between a buyer and seller, and typically will include a transfer, or transfers, of digital information – bits and bytes - electronically. A transaction involving a digital "good" generally will consist of a transfer by electronic means of computer software from seller to buyer. This form of digital transaction is perhaps the most well-known, as consumers and businesses have likely purchased software, and software updates, from a seller, but received the purchased software electronically via a download.

In a "digital service," the seller will make available to the buyer the use of computer software, but no meaningful download of software from the seller occurs. Rather, the buyer will access the software via website, and have some ability to interact with the software by inputting its own data. The buyer's ability to interact with the software is typically restricted in ways not seen in a "digital download." "Digital service" transactions are commonly seen in business settings, and are used for data entry and management.

Many states' taxing authorities have struggled with how to address for purposes of state and local taxation these goods and services and the companies that buy and sell them. Often, state revenue statutes and administrative codes are silent, leaving it up to the state taxing authority to issue guidance. In Pennsylvania, this has been the case, and the Department of Revenue has been left with the task of determining the tax implications of digital goods and services through

administrative bulletins and private letter rulings.

With respect to the tax implications of a sale of a digital good, in Pennsylvania such purchases, when involving computer software, are subject to the sales and use tax, regardless of the method of delivery. Digital goods other than software are not taxed. Additionally, Pennsylvania distinguishes between sales of “canned” computer software and “custom” computer software, with the latter not being subject to tax. It is the Department’s position that computer software is “custom” when it is designed, created and developed for and to the specifications of an original purchaser; all other software is “canned.” A purchase of “custom computer software” is not subject to sales and use tax.

The Department has issued two private letter rulings addressing the taxation of “digital services.” In both rulings, the Department’s position was that such services are taxable if and only if the software accessed by the purchaser is not “custom computer software,” and is based on a computer server or data center that is located in Pennsylvania. If the server or data center is located in Pennsylvania, the software is taxable to the seller as a provider of computer services. However, if the buyer’s access is evidenced by a “license to use” the software, such charges will be taxable at retail.

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