

## Deeper Down the Rabbit Hole: Pennsylvania Sales and Use Tax Implications of Online Digital Marketplaces

By Timothy J. Horstmann

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In the July 2011 edition of *PA Tax Law News*, we introduced our readers to the basics on sales and use taxation of digital goods and services in Pennsylvania. In this edition, we delve deeper into this relatively uncharted territory, and consider Pennsylvania Sales and Use Tax implications with respect to the evolving world of online digital marketplaces.

The concept of an “online digital marketplace” is not new. For years consumers have purchased software from Amazon, Apple’s iTunes, Google’s Android Market and other similar services whereby consumers receive their purchases by direct download. In Pennsylvania, virtually all purchases of software from these marketplaces are subject to the sales and use tax, regardless of the method of delivery.

Recently, however, consumers have been given the option of making purchases at new digital marketplaces that exist within the user experience provided by a software application used by the consumer. Most commonly seen in video gaming applications, consumers typically make “in-game” purchases of items used in the game to provide a temporary or continuing change in the play experience. For example, the popular “Angry Birds” series of games, in which players use a sling shot to launch bird-like projectiles at fixed targets, offers players the option of purchasing, in-game, an additional projectile, the “Mighty Eagle,” to help the player clear particularly difficult levels in the game.

Other gaming applications take the concept of the digital marketplace further, and feature persistent online worlds complete with in-game markets where players may barter *with each other* for in-game items. For example, in the upcoming video game “Diablo III,” players will have the option of buying and selling items acquired within the game at the “Auction House,” a digital marketplace established by the game developer but made up solely of transactions among the game’s players. To pay for their purchases, players will have the option of using in-game currency, their own in-game items as barter, or actual real-world currency.

Are such in-game purchases subject to tax in Pennsylvania? While the Department of Revenue has yet to issue formal guidance on the issue, it is possible that, based on existing regulations, the Department may consider such purchases to be subject to tax.

As discussed in our earlier newsletter, purchase of a “digital good” in Pennsylvania is subject to tax if the purchase involves the transfer of canned computer software. The Department distinguishes between “executable” canned computer software and “readable” canned computer software, with only the former being subject to sales and use tax in Pennsylvania. “Executable” canned computer software programs are programs with which the user can manipulate and interact, such as video games and productivity programs. “Readable” canned computer software programs are programs which the user may only experience, but not manipulate, such as music, movies and books.

Therefore, under the Department’s interpretation, an in-game purchase will be subject to tax, if a “transfer” occurs. It is arguable whether a meaningful transfer of software occurs in these transactions, as the purchaser does not receive a new executable piece of software, but merely pays for a change in the playing experience for which he has already purchased and paid tax. However, the Department’s regulations define “canned computer software” to include “updates, enhancements and upgrades” to that software. The Department has signaled that it considers in-game purchases as purchases of “upgrades or enhancements” to the taxable software application already purchased, and therefore considers these purchases to be subject to tax.

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