

Cite as Det. No. 14-0276, 35 WTD 97 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 14-0276
)	
...)	Registration No. . . .
)	

RCW 82.04.050(3)(c), RCW 82.04.050(6)(b)(i): B&O TAX – CHANGE IN LAW – CREDIT BUREAU SERVICE – DIGITAL AUTOMATED SERVICE -- DATA PROCESSING. The sale of electronic access to a computer program that assembled data prescribed by its customers, and evaluated it through algorithms in such a way as to predict the creditworthiness of potential borrowers, were providing a retail “credit bureau service” prior to the July 26, 2009 change in the law, and a digital automated service thereafter. It was not a data processing service.

RCW 82.08.02088: RETAIL SALES TAX – EXEMPTION – MULTIPLE POINTS OF USE. Taxpayer was not entitled to the Multiple Points of Use exemption because it did not come into the law until July 26, 2009, after the sales that might have been so exempted occurred.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Bauer, A.L.J. – A seller of interactive web-based computer programs, that assists lenders in evaluating the credit risks of potential borrowers, objects to the assessment of retail sales taxes and penalties. We deny Taxpayer’s petition.¹

ISSUES

1. Whether Taxpayer’s web-based [Computer Program] was a credit bureau service taxable as a retail sale, or a data processing service taxable, under the service and other activities classification of the B&O tax.
2. Whether Taxpayer was entitled to the RCW 82.08.02088 multiple points of use retail sales tax exemption for its sales of [Computer Program A] to [Telephone Company], [that] used it throughout the country to evaluate the creditworthiness of potential customers.

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

3. . . .
4. Whether, under RCW 82.32.105, Taxpayer is entitled to a waiver of the substantial underpayment penalty because it has always paid its taxes.

FINDINGS OF FACT

The Department of Revenue's (Department's) Audit Division (Audit) audited the books and records of [Taxpayer], a company headquartered in [out of state], for the period January 1, 2008 through June 30, 2011 (audit period).² As a result of this review, Audit issued the above-referenced assessment on July 24, 2013 for the following amounts:

\$. . .	Retail Sales Tax
. . .	B&O Tax Under the Retailing Classification
. . .	B&O Tax Under the Wholesaling Classification
. . .	B&O Tax Under the Service and Other Activities Classification
. . .	Total Taxes Due
. . .	Interest through July 24, 2013
. . .	5% Assessment Penalty for Substantial Underpayment
\$. . .	Total Due

Taxpayer appealed the assessment on August 23, 2014. The assessment has not been paid.

[Computer Program]

Taxpayer's [Computer Program]³ is Taxpayer's internally-developed web-based program residing on Taxpayer's servers. Taxpayer sells access to [Computer Program] to financial institutions, consumer loan companies, retail establishments, retailers, car dealerships, mobile phone companies, etc. (Taxpayer's customers) so that they may customize the program to their own specifications in order to evaluate the credit risk of potential borrowers. Taxpayer's customers access [Computer Program] via a secure internet web service.

Taxpayer's customers tailor [Computer Program] according to their own business needs by defining the parameters and values of the information they want to use in evaluating the credit risk of potential borrowers. As part of its service, Taxpayer can send an implementation manager to its customers in order to assist them in developing an interface to the service, and to address technical questions and validate test results.

Once Taxpayer's customers have established a [Computer Program] interface, their potential borrowers (whether business or consumer) complete either a paper or electronic credit application. Taxpayer's customers separately contract with one (or more) of the major Credit Bureaus to obtain credit histories. Taxpayer's customers then feed that information into

² Taxpayer's Assistant Treasurer signed a Statute of Limitations Waiver covering the period January 1, 2008 through December 31, 2008, thereby extending the statute of limitations through July 31, 2013.

³ [Computer Program] also includes, for purposes of this determination, the [Computer Program A] sold to [Telephone Company].

[Computer Program], and the algorithm therein -- based on Taxpayer's customers' own credit criteria -- assigns numerical values to each piece of data and calculates credit risk scores. These scores are electronically provided to Taxpayer's customers for their use in determining which potential borrowers meet their own specific requirements for credit worthiness.

Taxpayer describes [Computer Program] as a data processing service, and not a credit bureau service.

Multiple Points of Use Exemption [(Telephone Company)]

Taxpayer sold [Computer Program A] to [Telephone Company] in . . . , Washington. These sales continued through February 2009. Taxpayer billed [Telephone Company's] . . . office. According to Taxpayer, [Telephone Company] used the program throughout the country to quickly determine whether potential customers were good credit risks. Taxpayer did not charge [Telephone Company] retail sales tax, so Audit assessed retail sales tax on these sales.

On appeal, Taxpayer has provided the Department with a Digital Products and Remote Access Software Exemption Certificate signed by [Telephone Company] on January 20, 2013, for its purchases of [Computer Program A] through February 2009.

...

Penalties

Taxpayer was assessed a 5% substantial underpayment penalty in the amount of \$ Taxpayer has been a conscientious taxpayer, incurring only two penalties in recent years: \$. . . in August 2011, and \$. . . in August 2011.

ANALYSIS

1. [Computer Program].

Washington imposes retail sales tax on certain services. RCW 82.04.050(3)(c) provides that credit bureau services are retail in nature:

The term "sale at retail" or "retail sale" includes the sale of or charge made for personal, business, or professional services including amounts designated as interest, rents, fees, admission, and other service emoluments however designated, received by persons engaging in the following business activities: . . . (c) Credit bureau services

Excise Tax Advisory 3107.2009 (ETA 3107) describes what activities are considered to be "credit bureau services:"

Credit bureau services include the assembly or evaluation of information bearing on the credit worthiness of any person for the purpose of furnishing such information to third parties. Credit bureau services are not limited to assembly or evaluation of information

provided for the purpose of extending credit. Credit bureau services also include the assembly or evaluation of information provided to third parties who use such information to decide whether to accept a check or other form of payment, enter into a lease transaction, or make any decision where credit worthiness is a consideration.

Taxpayer asserts that it was not engaging in credit bureau services because it merely developed and provided access to software that its customers used to make decisions using either their own data, or data they licensed from other parties Taxpayer argues that it did not track or store the data analyzed by its customers through their use of its decision engines; it simply developed and provided the tools to customers for their own use. Taxpayer argues that its decision engines were provided in the form of licensed applications or software tools, hosted software applications, and specific model licenses, and that it had neither insight into the detail of the data that is analyzed by its customers, nor access to the outputs and results of the data analysis.

The definition of “credit bureau services,” however, is broader than the compilation of information, the conduct of credit investigations, and the sale of original credit reports. As ETA 3107 states, the definition of “credit bureau services” also included “the assembly and evaluation of information” provided for the purpose of extending credit.

We hold that Taxpayer’s activities in providing [Computer Program] to its customers satisfied the definition of “credit bureau services” because [Computer Program] both “assembled and evaluated information” so that its users were able to make decisions as to the credit worthiness of prospective borrowers.

In 2009, the Legislature passed comprehensive new digital products legislation, Engrossed Substitute House Bill (ESHB) 2075, which became effective July 26, 2009 (change in the law). This change in the law amended the definition of retail sales of prewritten software to include “remote access software” (RAS). Therefore, RCW 82.04.050(6)(b)(i) now provides:

The term [retail sale] also includes the charge made to consumers for the right to access and use prewritten computer software, where possession of the software is maintained by the seller or a third party, regardless of whether the charge for the service is on a per use, per user, per license, subscription, or some other basis.

Included within the definition of digital products are both “digital automated services” and “digital goods.” RCW 82.04.050(8). A “digital automated service” is defined as “. . . any service transferred electronically that uses one or more software applications” The term “digital good” is defined as “. . . sounds, images, data, facts, or information, or any combination thereof, transferred electronically.” RCW 82.04.192(3) and (6).

Since the enactment of the new law, the Department has treated credit bureau services, which are still retail services, also as digital products when they are transferred electronically and otherwise meet the definition of either a digital good or a digital automated service. WAC 458-20-15503(601).⁴

⁴ WAC 458-20-15503(601) provides:

Taxpayer made [Computer Program] available to its customers electronically. The [Computer Program] service uses “one or more software applications.”⁵ [Computer Program] accordingly fits within the definition of a “digital automated service.” While Taxpayer’s [Computer Program] had a digital goods component (facts, data, and information), that component was further integrated into a service that included an analysis of this data by [Computer Program] algorithms in order to automatically evaluate the creditworthiness of potential borrowers. Accordingly, we hold that Taxpayer’s [Computer Program], after the change in the law, also constituted digital automated services subject to retail sales tax.

Taxpayer argues it was not engaging in either “credit bureau services” or “digital automated services” because it was providing “data processing” services taxable under the service and other activities classification of the B&O tax and not subject to retail sales tax.

Before the change in the law, WAC 458-20-155 provided:

Distinction Between Sales and Services

Liability for sales tax or use tax depends upon whether the subject of the sale is a product or a service. If . . . data processing services are performed, such that the only tangible personal property in the transaction is the paper or medium on which the information is printed or carried, the activity constitutes the rendering of professional services, similar to those rendered by a public accountant, architect, lawyer, etc., and the retail sales tax or use tax is not applicable to such charges. This includes the sales of software in connection with custom programs written to meet a particular customer's specific needs. The programs are considered to be the tangible evidence of a professional service rendered to a client and not subject to retail sales tax or use tax.

(Emphasis added.) WAC 458-20-15501(401)(b), effective January 16, 2009, provided a definition of “data processing services:

"Data processing services" includes, but is not limited to, word processing, data entry, data retrieval, data search, information compilation, payroll processing, business accounts processing, data production, and other computerized data and information storage or manipulation. "Data processing services" also includes the use of a computer or computer time for data processing whether the processing is performed by the provider of the computer or by the purchaser or other beneficiary of the service.

Retail services. Washington imposes retail sales and use tax on certain enumerated services under RCW 82.04.050 ("retail services"). For example, the sale of credit bureau services is subject to retail sales tax. However, when a retail service is transferred electronically and also meets the definition of digital automated service or digital good, such service will be treated as a digital product and is eligible for all applicable digital products retail sales and use tax exemptions as described above in Part 5 of this rule. . . .

(Emphasis added.)

⁵ This web based applications necessarily require a set of coded software instructions to operate. See RCW 82.04.215 for a definition of software.

Det. No. 11-0001 32 WTD 93 (2013) held that this definition would apply to periods prior to the 2009 change in the law.

After the change in the law, RCW 82.04.192(3)(b) provides a statutory definition of “data processing services”:

"Digital automated service" does not include: . . . (xv) Data processing services. For purposes of this subsection (3)(b)(xv), "data processing service" means a primarily automated service provided to a business or other organization where the primary object of the service is the systematic performance of operations by the service provider on data supplied in whole or in part by the customer to extract the required information in an appropriate form or to convert the data to usable information. Data processing services include check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities. Data processing does not include the service described in RCW 82.04.050(6)(b) . . . ⁶

(Emphasis added.)

Taxpayer's [Computer Program] . . . did not meet either definition of “data processing.” Instead, [Computer Program] not only assembled the data prescribed by Taxpayer's customers, but also evaluated it, through algorithms, in such a way as to predict the creditworthiness of potential borrowers.

Thus, we hold that Taxpayer's [Computer Program] constituted a “credit bureau service” and, additionally, a “digital automated service” after the change in the law. Both activities were retail services subject to the B&O tax under both the retailing classification of the B&O tax and the retail sales tax. Taxpayer's [Computer Program] did not constitute “data processing” taxable under the service and other activities classification of the B&O tax.

2. Multiple Points of Use Exemption [(Telephone Company)].

RCW 82.08.02088 provides:

⁶ RCW 82.04.050(6)(b) provides:

(i) The term [“sale at retail” or “retail sale”] also includes the charge made to consumers for the right to access and use prewritten computer software, where possession of the software is maintained by the seller or a third party, regardless of whether the charge for the service is on a per use, per user, per license, subscription, or some other basis.

(ii)(A) The service described in (b)(i) of this subsection (6) includes the right to access and use prewritten computer software to perform data processing.

(B) For purposes of this subsection (6)(b)(ii), "data processing" means the systematic performance of operations on data to extract the required information in an appropriate form or to convert the data to usable information. Data processing includes check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities.

(1) The tax imposed by RCW 82.08.020 does not apply to the sale of digital goods, digital codes, digital automated services, prewritten computer software, or services defined as a retail sale in RCW 82.04.050(6)(b) to a buyer that provides the seller with an exemption certificate claiming multiple points of use. An exemption certificate claiming multiple points of use must be in a form and contain such information as required by the department.

(2) A buyer is entitled to use an exemption certificate claiming multiple points of use only if the buyer is a business or other organization and the digital goods or digital automated services purchased, or the digital goods or digital automated services to be obtained by the digital code purchased, or the prewritten computer software or services defined as a retail sale in RCW 82.04.050(6)(b) purchased will be concurrently available for use within and outside this state. A buyer is not entitled to use an exemption certificate claiming multiple points of use for digital goods, digital codes, digital automated services, prewritten computer software, or services defined as a retail sale in RCW 82.04.050(6)(b) purchased for personal use.

(3) A buyer claiming an exemption under this section must report and pay the tax imposed in RCW 82.12.020 and any local use taxes imposed under the authority of chapter 82.14 RCW and RCW 81.104.170 directly to the department in accordance with RCW 82.12.02088 and 82.14.457.

(4) For purposes of this section, "concurrently available for use within and outside this state" means that employees or other agents of the buyer may use the digital goods, digital automated services, prewritten computer software, or services defined as a retail sale in RCW 82.04.050(6)(b) simultaneously from one or more locations within this state and one or more locations outside this state. A digital code is concurrently available for use within and outside this state if employees or other agents of the buyer may use the digital goods or digital automated services to be obtained by the code simultaneously at one or more locations within this state and one or more locations outside this state.

Thus, under Multiple Points of Use exemption, buyers of digital products (both digital goods and digital automated services) may provide the seller with an exemption certificate stating it will be using the digital product in multiple states. The seller does not collect sales tax and the buyer has the responsibility to pay use tax on the portion used in Washington.

RCW 82.08.02088 and the Multiple Points of Use exemption, however, were first enacted with the change in the law on July 26, 2009. Before that date, the Multiple Points of Use exemption did not exist. Taxpayer's sales of —[Computer Program A] all predated that enactment. Thus, the exemption certificate is not effective.

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4. Substantial Underpayment Penalty.

RCW 82.32.090(2) provides:

If the department of revenue determines that any tax has been substantially underpaid, there is assessed a penalty of five percent of the amount of the tax determined by the department to be due. . . . As used in this section, "substantially underpaid" means that the taxpayer has paid less than eighty percent of the amount of tax determined by the department to be due for all of the types of taxes included in, and for the entire period of time covered by, the department's examination, and the amount of underpayment is at least one thousand dollars.

Because Taxpayer substantially underpaid its tax liability, the penalty was correctly imposed. RCW 82.32.105(1) provides for the waiver of penalties:

If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any penalties imposed under this chapter with respect to such tax.

Thus, the penalty may be waived only if there were circumstances beyond Taxpayer's control that caused the underpayment. WAC 458-20-228(9)(a)(ii) describes seven circumstances that justify the waiver of penalties under this criteria, which are generally immediate, unexpected, or in the nature of an emergency that resulted in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay. None of those seven examples apply in this case.

Taxpayer's past compliance, while commendable, is not a basis upon which the substantial underpayment assessment penalty may be waived. Even the fact that Taxpayer may have misunderstood its tax liabilities is not justification for waiver, as WAC 458-20-228(9)(a)(ii)(B) specifically provides that even a misunderstanding or lack of knowledge of a tax liability does not qualify as a circumstance beyond the taxpayer's control.

Taxpayer's petition as to this issue is denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 27th day of August, 2014.