

Arizona Addresses Sales Taxation of Over-the-Top Services

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In this installment of SALT From My Saddle, Busby highlights the provisions of a new Arizona law that confirms that proceeds from over-the-top services are not subject to sales tax and addresses its implications for companies that stream audio or video over the internet.

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Although its Legislature considered bills this year¹ and last,² unlike most states, Arizona still has not enacted broad legislation to specify which digital good and services, if any, are

¹This year lawmakers are still weighing S.B. 1460, which provides that pre-written software and specified digital goods would be subject to Arizona's state and local sales and use taxes in the future, but clarifies that, consistent with a recent amendment to Arizona's constitution (see James G. Busby Jr., "Arizona Constitutional Amendment Prohibits New Taxes on Services," *State Tax Notes*, Nov. 26, 2018, p. 781), digital services are not subject to tax. See Busby, "Proposed Arizona Legislation Addresses Digital Goods and Services," *State Tax Notes*, Feb. 25, 2019, p. 683. However, at this point, S.B. 1460 is not expected to pass. See Busby, "Update on Arizona's Three Huge Tax Issues," *State Tax Notes*, Apr. 29, 2019, p. 419.

²In 2018 lawmakers were poised to address this issue but, in the end, they failed. See Busby, "Arizona Intends to Clarify Taxation of Digital Goods and Services," *State Tax Notes*, Feb. 18, 2019, p. 711; and Busby, "Arizona Left Providers of Digital Goods and Services in a Pickle," *State Tax Notes*, June 4, 2018, p. 1003.

subject to sales tax. Yet, without statutory direction, Arizona state and local taxing authorities have asserted in confidential audit assessments and in obscure private taxpayer rulings that proceeds from digital goods and a variety of digital services are subject to sales tax as proceeds from renting tangible personal property.³

S.B. 1019 Confirms That Over-the-Top Services Are Exempt

However, the Arizona Legislature recently passed, and Gov. Doug Ducey (R) recently signed, S.B. 1019 — a measure that confirms that "over-the-top services" are not subject to Arizona's sales tax on proceeds from intrastate telecommunications activity, and prohibits Arizona cities and towns from levying any type of tax on proceeds from such services.⁴

This legislation was not critical for out-of-state companies that stream video or audio content to customers in Arizona because Arizona courts ruled long ago that proceeds from video content transmitted from out of state are not subject to Arizona's sales tax on proceeds from intrastate telecommunications activity,⁵ and representatives of Arizona's taxing authorities acknowledged the treatment of such proceeds at public hearings in recent years.

³See Busby, "Arizona's Tortured Method of Imposing Sales Tax on Services," *State Tax Notes*, Mar. 20, 2017, p. 1031.

⁴Laws 2019, Ch. 189.

⁵See, e.g., *Cable Plus Co. LP v. Arizona Department of Revenue*, 197 Ariz. 507 (App. 2000); and *People's Choice TV Corp. Inc. v. City of Tucson*, 202 Ariz. 401 (2002).

The Broad Definition of Over-the-Top Services

The Legislature defined “over-the-top services” to mean “audio or video programming services that are received by the purchaser by means of an internet connection, regardless of the technology used, that include linear or live programming and that are generally considered comparable to programming provided by a radio or television broadcast station and includes related on-demand programming that is provided at no additional charge, regardless of whether the services are provided independently or packaged with other audio or video programming.”⁶

The Implications of S.B. 1019

S.B. 1019 is important not only because it defines “over-the-top services” and explicitly confirms that proceeds from such services are not subject to sales tax, but also because of what it implies.

First, the Legislature’s broad declaration that “‘over-the-top services’ means audio or video programming services that are received by the purchaser by means of an internet connection,” followed by inclusive rather than exclusive terms, suggests that, at least after S.B. 1019 goes into effect later this year, the Legislature intends that all proceeds from streaming audio or video over the internet are tax-exempt.

Further, the fact that the Legislature included the language of this exemption in the statute for the state’s sales tax on proceeds from intrastate telecommunications activities rather than in the statute for its tax on proceeds from renting tangible personal property demonstrates that it always intended that proceeds from streaming services would be taxed as proceeds from intrastate telecommunications activities rather than as proceeds from renting tangible personal property, if at all.

Finally, the fact that the Department of Revenue did not oppose this bill despite these

implications leads one to wonder whether it is going to back down from the position it has taken in audits — that companies that stream video to their customers over the internet are subject to the state’s sales tax on proceeds from renting tangible personal property.⁷ ■

⁶Laws 2019, Ch. 189, section 2.

⁷See, e.g., TX2018-000073, a case before the Arizona Tax Court in which the DOR argues that Netflix’s proceeds from streaming videos to its customers in the state are subject to Arizona’s tax on proceeds from renting tangible personal property.