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Pennsylvania

Pennsylvania Follows Trend in Taxing Digital Downloads, Ends Vendor Discount

Tax-free digital downloads are history in Pennsylvania.

As of Aug. 1, anyone in the Keystone State who downloads a book, streams a video, buys an app or subscribes to a digital music stream will pay a 6 percent sales-and-use tax on the purchase.

The new tax on digital downloads like Pokemon Go is part of a revenue package, Act 84 of 2016, that Pennsylvania Gov. Tom Wolf (D) signed into law July 13 as part of this year's budget.

Pennsylvania joins more than 20 states that tax digital downloads in some form, according to a Bloomberg BNA analysis of state tax data.

\$46.9 Million Annually. The expansion in tax base to include digital forms of music, video and other products, increasingly popular with consumers, makes sense from a revenue standpoint, said Kevin F. Israel, a Pittsburgh-based partner at Meyer, Unkovic & Scott LLP.

"The more traditional ways of delivering this kind of content have been going by the wayside," Israel told Bloomberg BNA July 29, "so in that sense the tax base has been shrinking."

The tax is expected to generate as much as \$46.9 million annually, according to a summary of the revenue package from Pennsylvania's House of Representatives. The impact of the tax is likely to fall more on individuals than on businesses, Israel said.

Going forward, licensees in Pennsylvania must collect tax on videos, photographs, books, apps, games, music, audio services, canned software and any other taxable printed material that is streamed or delivered digitally or electronically, according to a July 21 bulletin from the Department of Revenue.

Amazon, Netflix, iTunes. "Transferred electronically," a key term of the new law, means the product is accessed or obtained in a way other than by USB drive, DVD disk or other physical storage device, according to a new post on the department's website.

Taxable products now include e-books from Amazon Kindle and e-book subscriptions such as Scribd, apps and games or add-ons to apps and games; e-greeting

cards; streaming services such as Netflix or Hulu; and digital audio downloaded or streamed from services such as iTunes or Google Play. Free digital downloads will not be taxed.

Backed by Courts. Pennsylvania has had the authority for many years to tax digital downloads, but the recent legislation "just removes any doubt as to the taxability," according to Jason C. Skrinak, state and local tax practice leader at Reinsel Kuntz Lesher LLP in Harrisburg, Pa.

"Pennsylvania treats canned software as tangible personal property and, in a court case, it was determined that canned software is taxable whether it was purchased on a disc or digitally downloaded," Skrinak told Bloomberg BNA July 29, citing *Graham Packaging Co., LP v. Commonwealth* in 2005. "So the parallel between purchasing canned software and purchasing other electronic content is rather obvious."

Also, in *Dechert LLP v. Commonwealth*, the Pennsylvania Supreme Court held in 2010 that canned software is taxable tangible property.

"Notably, Act 84 also characterizes software maintenance, updates and support for canned software as taxable tangible property," which directly contradicts *Dechert*, Reed Smith LLP noted in a July 14 alert.

Vendor Discount Reduced. Aug. 1 also marks a major change to the sales-tax vendor discount, a credit created long ago to help businesses offset the costs of collecting sales tax, Skrinak said.

Before Act 84, businesses that remitted sales tax to Pennsylvania were able to discount their sales tax liability by 1 percent of tax collected. The new rule caps the sales tax vendor discount at the lesser of either 1 percent of tax collect or \$300 annually, according to a Department of Revenue summary of Act 84.

"That's big for some taxpayers," Skrinak said.

The change is substantial for large retailers and is expected to generate \$55.5 million annually for the state.

BY LESLIE A. PAPPAS

To contact the reporter on this story: Leslie A. Pappas in Philadelphia at lpappas@bna.com

To contact the editor responsible for this story: Ryan Tuck

The July 21 DOR bulletin is at <http://src.bna.com/hfQ>. Information on Act 84 of 2016 is at <http://src.bna.com/hfV>.