

State Tax Review®

By CCH Tax Law Editors



Economic Reality Created Maryland Nexus for Intellectual Property Sub

The Maryland Court of Special Appeals has affirmed an October 2008 decision of the Circuit Court holding that an out-of-state subsidiary that held the intellectual property of a parent corporation that maintains a physical presence in Maryland has constitutional nexus with Maryland and is therefore subject to Maryland corporate income tax. The basis of nexus sufficient to justify taxation was the economic reality of the fact that the parent's business in the taxing state was what produced the income of the subsidiary. The fact that a transaction may not be motivated subjectively by a desire to save taxes does not necessarily mean that the transaction is not subject to state taxation. *The Classics Chicago, Inc. v. Comptroller of the Treasury*, Maryland Court of Special Appeals, No. 2047, September Term, 2008, January 4, 2010

North Carolina Taxation of Digital Property Discussed

The North Carolina Department of Revenue has issued guidance on the sales and use tax applied to digital property that goes into effect on January 1, 2010. The tax, which is equal to the general 5.75% state rate and applicable local rates, is imposed on the purchase or use of the following items: (1) an audio work; (2) an audiovisual work; (3) a book, a magazine, a newspaper, a newsletter, a report, or another publication; and (4) a photograph or a greeting card. The notice provides detailed definitions concerning these terms and clarifies that the general sales and use tax rate applies to digital property that is delivered or accessed electronically, is not considered tangible personal property, and would be subject to sales and use tax if sold in a tangible medium. The tax applies regardless of whether the purchaser has the right to use it permanently or to use it without making continued payments but does not apply to an information service or to a service that is taxed under the general state privilege tax applied to retailers. For example, receipts from pay-per-view movies in conjunction with cable service or direct-to-home satellite service continue to be taxed as video programming at the combined general rate and would not be subject to the tax as digital property.

The notice also specifies that the general sourcing rules apply to purchases of digital property and outlines the applicable reporting and payment requirements. *Important Notice: Certain Digital Property Subject to Sales and Use Tax*, North Carolina Department of Revenue, December 9, 2009

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An income tax chart on withholding returns and deposits begins on page 14. The chart is reprinted from a *Multistate Quick Answer Chart* available to online subscribers.

North Carolina Department of Revenue
Post Office Box 25000
Raleigh, North Carolina 27640-0001

IMPORTANT NOTICE: Certain Digital Property Subject to Sales and Use Tax

The 2009 General Assembly enacted G.S. 105-164.4(a)(6b), **effective January 1, 2010**, which imposes a privilege tax at the general 5.75% State and applicable local rates on the net taxable sales or gross receipts derived from certain digital property. The combined State and local rate is 7.75% in ninety-one counties, 8% in Alexander, Catawba, Cumberland, Haywood, Martin, Pitt, Sampson, and Surry Counties and 8.25% in Mecklenburg County.

G.S. 105-164.4(a)(6b) levies tax on the following items: (1) an audio work; (2) an audiovisual work; (3) a book, a magazine, a newspaper, a newsletter, a report, or another publication; (4) a photograph or a greeting card. The general sales and use tax rate applies to digital property that is delivered or accessed electronically, is not considered tangible personal property, and would be taxable under Article 5, Sales and Use Tax, if sold in a tangible medium. The tax applies regardless of whether the purchaser has the right to use it permanently or to use it without making continued payments.

An **audio work** as defined pursuant to G.S. 105-164.3(1e) is a series of musical, spoken, or other sounds, including a ringtone. Pursuant to G.S. 105-164.3(35c), a **ringtone** is defined as a digitized sound file that is downloaded onto a device and may be used to alert the user of the device with respect to communication. A ringtone does not include ringback tones or other digital audio files that are not stored on the purchaser's communications device. In addition to ringtones, examples of an audio work include, but are not limited to, recorded or live songs, music, readings of books or other written materials, speeches, and other sound recordings.

An **audiovisual work** as defined pursuant to G.S. 105-164.3(1g) is a series of related images and any sounds accompanying the images that impart an impression of motion when shown in succession. Examples include, but are not limited to, movies, motion pictures, musical videos, news and entertainment programs and live events. An audiovisual work does not include video greeting cards or video or electronic games.

A **book, a magazine, a newspaper, a newsletter, a report, or another publication** will be generally recognized as such in the ordinary and usual sense.

A **photograph** is an image captured by a camera.

A **greeting card** is an imprint with a greeting and often with a suitable moving or still image with or without music.

Digital code as defined pursuant to G.S. 105-164.3(7a) is a code that gives a purchaser of the code a right to receive an item by electronic delivery or electronic access. A digital code may be obtained by an electronic means or by a tangible means. A digital code does not include a gift certificate or a gift card.

Delivered or accessed electronically means delivered to, received by or obtained by the purchaser by means other than tangible storage media. **Delivered electronically** is delivery by download, email or other method while **accessed electronically** is delivery by online access generally accompanied by a password or digital code. For example, a movie downloaded or accessed via the internet for consideration is subject to the general State and applicable local rate of tax as digital property.

The tax on certain digital property does not apply to a service that is taxed under another subdivision of G.S. 105-164.4(a). For example, receipts from pay-per-view movies in conjunction with cable service or direct-to-home satellite service continue to be taxed as video programming at the combined general rate and would not be subject to the tax as digital property.

The tax on certain digital property does not apply to an information service. Pursuant to G.S. 105-164.3(14a), an **information service** is defined as a service that generates, acquires, stores, processes, or retrieves data and information and delivers it electronically to or allows electronic access by a consumer whose primary purpose for using the service is to obtain processed data or information.

Digital property is sourced pursuant to G.S. 105-164.4B as follows: (1) When a purchaser receives digital property at a business location of the seller, the sale is sourced to that business location (2) When a purchaser receives digital property at a location specified by the purchaser and the location is not a business location of the seller, the sale is sourced to the location where the purchaser receives the digital property (3) When a seller of the digital property does not know the address where the digital property is received, the sale is sourced to the first address listed that is known to the seller: (a.) The business or home address of the purchaser (b.) The billing address of the purchaser (c.) The address from which the digital property was provided.

A person who purchases digital property upon which the tax has not been fully paid is liable for use tax due on such purchases. Persons making such purchases for business purposes must register with the Department to report and remit the tax due on Form E-500, Sales and Use Tax return. Persons making such purchases for personal use must report and remit tax due on Line 19 of Form D-400, North Carolina Individual Income Tax Return. Persons making such purchases for personal use who are not required to file Form D-400 must report and remit tax due on Form E-554, Consumer Use Tax Return.

Questions about this notice can be directed to the Taxpayer Assistance and Collection Center at telephone number 1-877-252-3052 (toll-free) or in writing to the Taxpayer Assistance Division, North Carolina Department of Revenue, P. O. Box 25000, Raleigh, N.C. 27640-0001.