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The Model City Tax Code, Municipal Tax Code Commission, and Digital Goods

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**Ad Hoc Joint Committee on the Tax Treatment
of Digital Goods and Services
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The Model City Tax Code...



... was designed to allow each city and town the ability to adapt the local sales tax to its unique economic conditions, and also assist the business community in identifying which items are taxed by each city and town.

History

Sales Tax Origins:

- Great Depression devastated state and local finances, leading to the widespread imposition of taxes on the sales of goods
- At least 13 states adopted a sales tax by 1933 including Arizona; 45 states have this tax today
- Arizona and Phoenix were early adopters; all other AZ cities and towns followed suit over the years

History

Before 1984:

Each city and town created and maintained its own tax code, making multi-jurisdictional business increasingly complex.

1984:

- State and Phoenix Chambers attempt preemption of local sales tax authority.
- Legislature creates the **Municipal Sales Tax Study Commission**, includes policy makers and business leaders.

History Continued

Municipal Sales Tax Study Commission:

- Joint Licensing
- Joint Auditing
- Coordinate State & Local Sales Tax Regulations
- Model Tax Reporting Form
- Model City Sales Tax Code

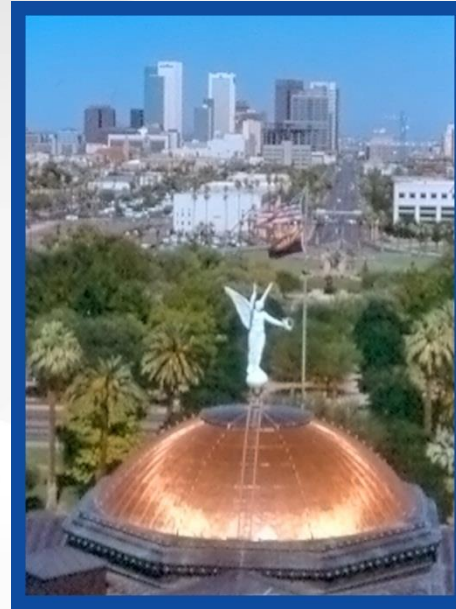
1985:

- First draft of MCTC completed.
- Business community rejects draft.
- Second draft completed.

History Continued

1986:

- State Chamber drafts bill to mandate a uniform tax base through preemption legislation
- Third Draft distributed to cities and business community



1987:

- Preemption bill fails
- All cities and towns adopt the **Model City Tax Code (MCTC)**

History Continued

1988:

- Legislature creates **Municipal Tax Code Commission (MTCC)**; includes city representatives, business leaders, and the Director of DOR as an ex-officio member.
- Business community agrees to 4 years of peace

1993:

- Tucson Chamber creates bill to place Model City Tax Code in statute. Bill fails.
- ATRA and business community pursue preemptive legislation for 1994 session.

History Continued

1994:

- ATRA preemption bill fails, but negotiations produce compromise
- Cities adopt amendments for certain manufacturing exemptions and additional taxpayer rights

1999:

- Municipal authority to go outside the Model City Tax Code is limited by requiring prior MTCC approval
- Joint Legislative Study Committee formed to examine elimination of the Model City Tax Code

History Continued

2000:

- Study Committee provides no substantially new recommendations
- Cities agree to numerous administrative changes:
 - Joint auditing, at the taxpayer's option (MJAC)
 - Increased consistency of interpretations
 - Creation of Municipal Tax Hearing Office (MTHO) to hear all MCTC Appeals.

Continuing Themes:

- Business community dislikes complexity
- Cities want to maintain local authority

History Continued

2001 to 2013:

- Unified Audit Committee gains strength
- Cities proactively work together to make auditing as consistent as possible, with varied success
- Greater interaction with DOR on audits and state and local tax code interpretations
- MJAC and MTHO provide for greater uniformity amongst cities and towns
- Cities restrict changes that create new exceptions; work to eliminate existing differences and options

2013 to today:

- Focus on TPT Simplification with DOR
- State administration began January 2017



Model City Tax Code

WWW.MODEL CITY TAX CODE.AZ.GOV

- Index
- Article I – General Conditions and Definitions
- Article II – Determination of Gross Income
- Article III – Licensing & Recordkeeping
- Article IV – Privilege Taxes
- Article V – Administration
- Article VI – Use Tax
- Regulations
- Appendices
- “Green Pages”

Model City Tax Code

Appendices

- **Appendix I** – Modifications to Model City Code for Cities and Towns in the State Collection System
- **Appendix II** – Model Options
- **Appendix III** – Local Options
- **Appendix IV** – Modifications to the Model City Tax Code for Cities and Towns in State Collection System Performing Supplementary Local Audits

Model City Tax Code

Appendix II & III: The Options

Model Options

Allows Cities and Towns to omit language from the Model City Tax Code.

Local Options

Allows Cities and Towns to add or substitute language to the Model City Tax Code.

Option Charts

Displays every option that each city has chosen in a concise and comprehensible way.

LOCAL OPTIONS																																					
Rev. 11/2011																																					
CITIES & TOWNS	A	B	C	D	E	F	G	H	J	K	M	N	P	Q	R	S	T	U	V	W	X	Z	AA	BB	CC	DD	EE	FF	GG	HH	JJ	KK	LL	MM	NN	OO	
Apache Junction								H					P	Q				V								DD											
Avondale					F								Q			T		V								DD			GG								
Benson*																		V								DD			GG								
Bisbee*									J				P	Q							X		AA			DD											
Buckeye*	A				E			H					P	Q									AA						GG								
Bullhead City					E			H				N				S																	LL				
Camp Verde*								H				N																		HH							
Carefree*																							AA														
Casa Grande*	A																	V	W																		

Model City Tax Code

Revision of the MCTC

Cities are currently engaged in a long-term process to update the Model City Tax Code

- Catching up to changes in A.R.S. 42-6004
- Adopting certain policy-based exemptions
- Removing Appendices I and IV
- Combining the Options (App. II and III) into a single list
- Continue eliminating Green Pages wherever possible
- Separating Residential Rental from Commercial Lease
- Separating MMJ from Retail

Target: In time for November 2018 elections, to be effective Jan-2019



Municipal Tax Code Commission

Summary

- The MTCC reviews, comments on, and is ultimately responsible for approving any proposed code language change to the MCTC submitted by any taxpayer, city or town, or the Department of Revenue.
- MTCC approval is required prior to enacting any change to the MCTC or an individual city tax code, except in the case of tax rates and Option selections.
- Meets on the 2nd Friday of every other month unless the Chair determines there is no business.
- The MTCC also creates an annual report for the Governor and legislative leadership.

Municipal Tax Code Commission

Membership

The MTCC consists of 10 members who must be Mayors or Councilmembers of a city that adopted the MCTC:

- 5 appointed by the Governor
 - 2 appointed by the President of the Senate
 - 2 appointed by the Speaker of the House
 - Director of DOR or his designee, who serves as an ex-officio member; also, DOR provides staffing
-
- Each appointee serves a term of 3 years
 - No more than two may be from the same city or town
 - Commission annually elects a Chair

Municipal Tax Code Commission

Activity

In the early years, the MTCC would often hear testimony from taxpayers and municipalities on open disputes, then either recommend compromises on code language or direct the parties to settle the dispute and return.

Since at least 1999, taxpayers and cities have found it productive to meet and work out potential code changes prior to ever taking an issue to the MTCC.

The MTCC has essentially become the final step in making a code change, since controversial issues are no longer being presented.

Recently it has taken the role with DOR of being official recorder of local ordinance adoption.



Digital Goods

Overview

- Interpretations of taxability on this topic are essentially identical for the cities and the State
- “Digital goods” is a modern phrase – MCTC uses 1986 nomenclature – but still clearly addressed in the code
- MCTC is more explicit in both its definitions and regulations regarding taxability of software products
 - Section 115, Definitions: computer software; custom computer programming
 - Regulation 115.1, Computer hardware, software, and data services

Digital Goods

Streamline Definitions

DIGITAL GOODS

- SST definition of “specified digital products” means electronically transferred:
 - **“Digital Audio-Visual Works”** which means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.
 - **“Digital Audio Works”** which means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones.

Digital Goods

Streamline Definitions

DIGITAL GOODS

- SST definition of “specified digital products” means electronically transferred:
 - “**Digital Books**” which means works that are generally recognized in the ordinary and usual sense as “books.”
 - For purposes of the definitions of specified digital products, “transferred electronically” means obtained by the purchaser by means other than tangible storage media.

Digital Goods

Streamline Definitions

CHARACTERIZATION (CONT.)

- Emerging trend to tax digital goods and various bills have been proposed to tax digital services.
 - “‘Tangible personal property’ means personal property that can be seen, weighed, measured, felt, or touched, or that is *in any other manner perceptible to the senses*. ‘Tangible personal property’ includes electricity, water, gas, steam, and prewritten computer software.” SSUTA, Appendix C.

Digital Goods

Retail sales

Section 460. Retail sales: measure of tax; burden of proof; exclusions.

(a) The tax rate shall be at an amount equal to _____ percent (____%) of the gross income from the business activity upon every person engaging or continuing in the business of selling tangible personal property at retail.

"Tangible personal property" means personal property which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses.

Digital Goods

Rental, leasing and licensing for use

Section 450. Rental, leasing, and licensing for use of tangible personal property.

(a) The tax rate shall be at an amount equal to _____ percent (____%) of the gross income from the business activity upon every person engaging or continuing in the business of leasing, licensing for use, or renting tangible personal property for a consideration...

Digital Goods

Section 115, Definitions: computer software; custom computer programming

(a) "Computer Software" means any computer program, part of such a program, or any sequence of instructions for automatic data processing equipment. **Computer software which is not "custom computer programming" is deemed to be tangible personal property for the purposes of this Chapter, regardless of the method by which title, possession, or right to use the software is transferred to the user.**

Digital Goods

Section 115, Definitions: computer software; custom computer programming

(b) "Custom Computer Programming" means any computer software which is written or prepared exclusively for a customer and includes those services represented by separately stated charges for the modification of existing prewritten programs when the modifications are written or prepared exclusively for a customer.

Digital Goods

Section 115, Definitions: computer software; custom computer programming

(b)(1) The term does not include a prewritten program which is held or existing for general or repeated sale, lease, or license, even if the program was initially developed on a custom basis for in-house, or for a single customer's, use.

(b)(2) Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification, and only to the extent that the actual amount charged for the modification is separately stated on invoices, statements, and other billing documents supplied to the customer.

Digital Goods

Regulation 115.1, Computer hardware, software, and data services

(a) Definitions.

(1) "Computer hardware"...

(2) "Computer Software" (also called "computer program") is tangible personal property, and includes:

(A) "Operating Program (Software)" (also called "executive program (software)")...

(B) "Applied Program (Software)", which is the programming system or technical language (including the tape, disk, cards, or other medium upon which such language or program is recorded)...

Digital Goods

Regulation 115.1, Computer hardware, software, and data services

(a) Definitions.

(3) "Storage Medium" is any hard disk, compact disk, floppy disk, diskette, diskpack, magnetic tape, cards, or other medium used for storage of information in a form readable by a computer, but not including the memory of the computer itself.

(4) A "Terminal Arrangement" (also called "'on-line' arrangement") is any agreement allowing access to a remote central processing unit through telecommunications via hardware.

(5) A "Computer Services Agreement" (also called "data services agreement") is an agreement allowing access to a computer through a third-party operator.

Digital Goods

Regulation 115.1, Computer hardware, software, and data services

(b) For the purposes of this Chapter, transfer of title and possession of the following are deemed sales of tangible personal property and any other transfer of title, possession, or right to use for a consideration of the following is deemed rental, leasing, or licensing of tangible personal property:

(1) Computer hardware or storage media. Rental, leasing, or licensing for use of computer hardware or storage media includes the lessee's use of such hardware or storage media on the lessor's premises.

Digital Goods

Regulation 115.1, Computer hardware, software, and data services

(b) For the purposes of this Chapter, transfer of title and possession of the following are deemed sales of tangible personal property and any other transfer of title, possession, or right to use for a consideration of the following is deemed rental, leasing, or licensing of tangible personal property:

(2) Computer software which is not custom computer programming. Such prewritten ("canned") programs may be transferred to a customer in the form of punched cards, magnetic tape, or other storage medium, or by listing the program instructions on coding sheets. Transfer is deemed to have occurred whether title to the storage medium upon which the program is recorded, coded, or punched passes to the customer or the program is recorded, coded, or punched on storage medium furnished by the customer.

Digital Goods

- “Digital Goods” are software files containing things like movies, audio recordings or books; software programs are also available digitally, such as Quicken, TurboTax, Excel, Word, Office, etc.
- Since these products are available for mass consumption, they are considered “canned” software and are taxable regardless of the manner of transfer
- All of these can purchased in a store on physical storage media, purchased for download as files from the Internet, or one can purchase access to use the software online without a download for the SaaS model
- In each case, the consumer receives the same product:
the method of transfer is the only difference

Digital Goods

When considering the potential fiscal impact of creating a new exemption for “Digital Goods”, please keep two things in mind:

- There is no accurate way to quantify the value of revenue currently collected from sales of goods delivered electronically
- As technology advances, more goods will transition to electronic delivery. Today most digital sales are movies, music, books and other software. What happens to State and local revenues when 3D printers become commonplace if electronic delivery is the basis for exemption?

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