This Week in State Tax (TWIST)

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Colorado: District Court Determines that Streaming Service Does Not Constitute "Tangible Personal Property" Subject to Sales Tax

Netflix and the Colorado Department of Revenue have had a long-running dispute over whether Netflix's streaming service falls within the definition of "tangible personal property" for state sales tax purposes. In May 2020, the Department sought to address this issue by proposing an amendment to a rule that clarified that sales tax applied to tangible personal property regardless of the "method of delivery," and included an example providing that streaming service subscriptions are subject to tax. The proposed rule became effective in 2021. Later that year, the Colorado legislature enacted a Digital Goods Law that purported to codify the Department's treatment of digital goods, as reflected in its rule. The Digital Goods Law stated that "tangible personal property" included "digital goods," which is defined as "any item of tangible personal property that is delivered or stored by digital means," and that "the method of delivery does not impact the taxability of a sale of tangible personal property."

Following enactment of the Digital Goods Law, Netflix periodically remitted sales tax to Colorado for sales of its streaming service, but later submitted a refund claim for the tax that was remitted, which the Department denied. Netflix appealed the denial of its refund claim to the Colorado district court, and as part of that action filed a motion for summary judgment.

Netflix made three arguments. First, it asserted that the streaming service was not a physical object, and therefore was not subject to tax as tangible personal property; second, that the terms of use with its subscribers did not grant anything that could be construed as tangible personal property; and third, because its streaming service was billed monthly, it did not constitute a "sale." The court agreed with Netflix that its streaming service was not a sale of tangible personal property, so the court did not address the last two arguments.

As part of its analysis, the court noted that Colorado's sales tax law was originally enacted in 1935 and imposed sales tax on tangible personal property. The law defines "tangible personal property" as "corporeal personal property," and to find a definition of "corporeal personal property" that was contemporaneous with enactment of the Colorado tax, both parties turned to the 1933 edition of Black's Law Dictionary. There, the term "corporeal property" was defined as "such as affects the senses, and may be seen and handled, as opposed to incorporeal property, which cannot be seen or handled, and exists only in contemplation." (Emphasis added). The notes to the definition also provided that "in modern law, all things which may be perceived by any of the bodily senses are termed corporeal, although a common definition of the word includes merely that which can be touched and seen." In reviewing this definition and other contemporaneous regulations, the court stated that it found "little evidence to support the Department's argument that the clear import of the 1935 tax code was to tax items that have no physical body and cannot be touched."

The court also rejected the Department hearing officer's reliance on State v. Jones, an Arizona Supreme Court case from 1943 that has recently been cited by the Arizona Court of Appeals in finding that a SaaS application constituted the sale of tangible personal property subject to transaction privilege tax. The Jones case involved a taxpayer's revenues earned from jukeboxes, and the Arizona Supreme Court held that the "playing of a record is perceptible to the sense of hearing, and hence, constitutes what the statute terms tangible personal property." The Colorado court found that the Jones case was of limited value, however, because the definition of "tangible personal property" in the Arizona statute was broader than the Colorado statute, and included "property which may be seen, weighed, measured, felt, touched, or is in any other manner perceptible to the senses."

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The court reviewed several other court cases cited by the Department but found them unpersuasive. The court also considered the state's taxation of electricity and telecommunications but noted that these items are taxable under separate provisions of the tax code rather than as sales of "tangible personal property." Finally, the court noted that software in Colorado is taxable only if a purchaser obtains possession of the software via a tangible medium, such as a CD, and that software hosted over the internet is not subject to tax.

In conclusion, the court held that it could not find that in 1935 the Colorado legislature intended to tax something "as ephemeral" as streaming services, and that its use of the term "corporeal" to define "tangible personal property" instead showed that the legislature intended to limit the scope of taxation to items that could be seen and touched. Because the Netflix streaming service can be seen, but is not capable of being touched, the court held that it was not subject to tax. For questions on Netflix v. Department of Revenue, please contact **Steve Metz**.

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