



# Discussion Draft of Detailed Outline of a White Paper on Sales Taxation of Digital Products

*Prepared by staff of the Multistate Tax Commission for discussion by the Digital Work Group meeting, January 5, 2023)*

## Introduction

In response to a proposal to prepare a white paper on how states might best adapt their sales tax to include digital products, the MTC Uniformity Committee asked staff to talk to stakeholders, review the relevant research, and identify issues to be included in a detailed outline of that paper. This report provides a first discussion draft of that detailed outline, which is a working document that will change as the project continues.

In the last year, MTC staff conducted 43 separate interviews of individuals or groups representing particular taxpayers, states, or other organizations, as well as practitioners and academics. (See Appendix A). They surveyed other relevant research, including studies done by other groups, much of which also is cited throughout this outline. They also monitored work of the Streamlined Sales and Use Tax Governing Board ("Streamlined") and the New Jersey Division of Taxation's study on the taxation of the digital economy generally, which is being done in conjunction with Rutgers University. See the project page on the MTC website for additional information.

Among stakeholders, administrators, and experts, it appears there is widespread agreement on some issues. For example, there was almost unanimous agreement that the proposed white paper is a good idea. On other issues, as might be expected, viewpoints diverge. Nevertheless, there is no doubt as to the significance of particular issues and those issues have been incorporated into the detailed outline along with the related questions. Also, to aid in review of these issues and questions, this report provides a brief background section.

### Related Actions of the MTC Uniformity Committee:

April 28, 2021 –

Representatives from the Washington Department of Revenue gave a presentation to the MTC Uniformity Committee in which they described their state's experience with imposing sales tax on digital products as well as the alternatives considered. They also proposed that the Committee take up a project to help states develop a simpler and more adaptable approach. The Committee asked the Standing Subcommittee to review the project proposal.

July 28, 2021 –

The Standing Subcommittee recommended that a work group be formed to draft a white paper. The Uniformity Committee asked MTC staff to first solicit input from stakeholders and prepare a detailed outline of the white paper, identifying issues to be addressed.

The project page on the MTC website is here: <https://www.mtc.gov/Uniformity/Project-Teams/Sales-Tax-on-Digital-Products>.  
For questions or other information on this outline, please contact Helen Hecht, Uniformity Counsel, at [hhecht@mtc.gov](mailto:hhecht@mtc.gov).

## State Sales Tax – Background and Terminology

State sales taxes share a common history and there are many similarities across state sales taxes. But there are also important differences worth noting when reviewing the detailed outline.

NOTE on Terminology: The terms used to describe some types of taxes can be confusing. Therefore, this report uses the following terms in the following ways:

- Digital Products – We use this single term to mean digital goods, digital services, or other items.
- Sales Tax – Often referred to as the “retail sales tax,” and which will be referred to here simply as the “sales tax,” these taxes may vary somewhat in the way they are imposed and the breadth of their base. A few are called “gross receipts taxes,” but they should be distinguished from business activity or true gross receipts taxes, as will be further discussed.
- Business Activity or True Gross Receipts Taxes – We refer to taxes on gross receipts or gross income that are distinct from typical sales taxes as “business activity taxes” or “true gross receipts taxes.”
- Excise Tax - The sales tax can also be distinguished from other narrower excise taxes on specific goods and services which may be imposed by states or by local governments.
- “Seller” and “Sale” – The sales tax is typically imposed on customers but is collected by the person or business making the transaction. Various types of transactions may be subject to the tax. We will generally refer to the person or business collecting the tax as the “seller” and the transaction as the “sale.”

### Sales Tax – A Brief History

The history of the sales tax has influenced its development and particular events may have stifled the expansion of the tax base as the economy has changed.

#### Early Years

Most states adopted their sales tax in the 1930s and ‘40s. Mississippi was the first, converting its true gross receipts tax into a tax with features of a modern retail sales tax in 1932. West Virginia was next, enacting a freestanding retail sales tax in 1933 and also a pure gross receipts tax, the business and occupation tax.<sup>1</sup> The states with broad based sales taxes—Hawaii, New Mexico, South Dakota, and Washington—also enacted those taxes in the 1930s. The latest state to adopt a sales tax was Vermont in 1969.<sup>2</sup>

In general, the 20<sup>th</sup> Century saw a trend away from early forms of true gross receipts taxes and toward the sales tax. Most of these sales taxes defined their base to include only sales or transactions involving tangible personal property. To the extent taxes included other items, they typically did so by describing and defining, or “specifically enumerating,” those items. And, over the years, states have generally followed this same specific enumeration approach when expanding their sales tax base, with two exceptions. Florida and Massachusetts attempted to expand their tax to services broadly, but each soon repealed that expansion.<sup>3</sup>

#### NOTABLE EVENTS

1932 –  
Mississippi adopts the first “modern” retail sales tax.

The Great Depression - Spurred other states to also adopt these and other new forms of taxation, including specific excise taxes.

<sup>1</sup> John L. Mikesell and Sharon N. Kioko, “The Retail Sales Tax in a New Economy,” presented at the Municipal Finance Conference, July 16-17, 2018, available here: <https://www.brookings.edu/wp-content/uploads/2018/04/Mikesell-Kioko1.pdf>, (hereafter “Mikesell”), p. 3.

<sup>2</sup> Liz Emanuel and Richard Borean, “When Did Your State Adopt Its Sales Tax?,” July 11, 2014, available here: <https://taxfoundation.org/when-did-your-state-adopt-its-sales-tax/#:~:text=The%20next%20decade%20brought%20twelve,with-out%20a%20statewide%20sales%20tax>, (hereafter “Emanuel”).

<sup>3</sup> Hellerstein, Hellerstein & Appleby, State Taxation, Thomson Reuters/Tax & Accounting, 3rd ed. 2001 & Supp. 2022-1, ¶12.05.

**NOTABLE EVENTS**

**1960s – The Willis Committee expands its study to sales taxes and recommends federal law—states respond.**

**1967 – The U.S. Supreme Court ruled in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967).**

**Also in the 1960s, states began to provide credits for sales taxes paid to other states and clarify acceptance of exemption certificates.**

**1992 – The U.S. Supreme Court ruled in *Quill Corp. v. North Dakota* (91-0194), 504 U.S. 298 (1992).**

**1998 – Congress enacted the Internet Tax Freedom Act – 47 U.S.C § 151 note.**

### Mid-20<sup>th</sup> Century - Federal Restrictions on Sales Taxes

State sales taxes long faced both real and potential federal limits, both from interpretations of the federal constitution and from federal statutory law. In the 1960s, the Willis Committee, best known for its study of multistate income taxes after the U.S. Supreme Court's Ruling in *Northwestern States Portland Cement*,<sup>4</sup> expanded its work to consider state sales taxes as well.

The Willis Committee proposed sweeping federal reforms and limits, which Congress declined to undertake.<sup>5</sup> But it also noted two specific issues that the states responded to—the lack of a uniform credit against sales tax imposed in one state for taxes already paid in another and the failure of states to accept certificates of other states to support exempt transactions. This led directly to the inclusion of provisions to address these issues in Article V of the Multistate Tax Compact,<sup>6</sup> and to widespread adoption by the states of similar and related provisions.

States may impose sales taxes on sellers although most impose them on the customers. But even these states depend on sellers to collect the tax. Therefore, the ability of states to assert taxing jurisdiction over out-of-state sellers, consistent with the U.S. Constitution, has always been a significant consideration for policymakers in considering what to tax.

The U.S. Supreme Court, in its 1967 ruling in *National Bellas Hess*,<sup>7</sup> struck down a sales tax on an out-of-state seller. Then, in 1992, the Court upheld that decision in *Quill*,<sup>8</sup> setting out a physical presence standard for sales tax jurisdiction. This restriction of state tax jurisdiction likely influenced the breadth of the sales tax base.<sup>9</sup>

In addition to these constitutional limits, in 1998, Congress enacted the Internet Tax Freedom Act (ITFA).<sup>10</sup> ITFA had two critical provisions. One imposed a moratorium, now a permanent prohibition, on state taxation of internet access. The other provision, often referred to as the anti-discrimination clause, preempts multiple or discriminatory taxes (not including income taxes) that states might impose on “electronic commerce,” defined to include transactions over the Internet. States seeking to expand their sales tax base to digital products must consider the implications of ITFA, which are further detailed in the outline, below.

<sup>4</sup> 358 U.S. 450.

<sup>5</sup> See Jerome R. Hellerstein, “Federal Legislation on State Taxation of Interstate Commerce: Key Areas of Controversy,” William & Mary Annual Tax Conference, 626 (1966), available here: <https://scholarship.law.wm.edu/cgi/viewcontent.cgi?article=1630&context=tax>.

<sup>6</sup> Article V provides that purchasers liable for a use tax on tangible personal property are entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid with respect to the same property to another state and any subdivision thereof. It further provides that whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate of a state or subdivision taxing author the seller will be relieved of liability for a sales or use tax with respect to that transaction. See the Compact, available here: [https://www.mtc.gov/The-Commission/Multistate-Tax-Compact#Article\\_V](https://www.mtc.gov/The-Commission/Multistate-Tax-Compact#Article_V).

<sup>7</sup> 386 U.S. 753.

<sup>8</sup> 504 U.S. 298.

<sup>9</sup> A number of experts have commented on the influence that the lack of tax jurisdiction over out-of-state sellers had on policy-makers decisions about whether or not to expand the tax base. See, for example, Mikesell, supra FN 1, .

<sup>10</sup> See 47 U.S.C. §151 note.

### Post-*Quill* Years – State and Federal Initiatives

After *Quill*, the states undertook a project to simplify state sales taxes, which led to the formation of the Streamlined Sales and Use Tax Agreement (“SSUTA”) in 2000. The MTC was an early and active proponent of the Streamlined effort.<sup>11</sup> Currently, SSUTA has 23 full and 1 associate members.

Also, in the years following *Quill*, states also began to consider expansion of their sales tax base to digital products. In addition, some states considered, and a handful of states adopted, general business activity taxes including Ohio, Nevada, and Oregon. In part, this may have been to avoid *Quill*'s physical-presence standard and to include in the tax base a much broader range of activities than the traditional sales tax.

Around this time there was another initiative to impose federal limits on states—the Digital Goods and Services Tax Fairness Act (“DGSTFA”). First introduced in Congress in 2010, it would preempt taxes on digital goods and services unless imposed on “similar” items and would require sales be sourced according to uniform rules—often to destination. The bill, however, failed to provide the destination state with jurisdiction over the seller. The Congressional Budget Office found the bill constituted an “unfunded mandate” and imposed costs on the states in the form of forgone revenues “totaling more than \$3 billion in the first full year and at least that amount in each subsequent year.”<sup>12</sup>

### *Wayfair* and Renewed Interest in Digital Products -

In 2018, the Supreme Court in *Wayfair*<sup>13</sup> overturned *Quill* and *Bellas Hess*, allowing states to require that out-of-state sellers with no physical presence in the state collect and pay sales tax. In response, states have now adopted dollar-based thresholds and/or transaction thresholds into law, plus related rules for determining when out-of-state sellers must collect tax on sales into the state. States have also imposed tax collection requirements on intermediaries, including internet marketplaces, for sales made on their platforms.

Even before *Wayfair*, it was common for states to look at taxing software and certain digital products that are similar to traditional goods or services. Since *Wayfair*, interest has grown in taxing other digital products, as well. Two states are conducting studies on taxing the digital economy or digital products—New Jersey and Mississippi—reports to be issued this year. In the last few months, a number of states have considered legislation to expand their sales tax base to include digital products.<sup>14</sup> Also, in 2021, Maryland adopted a tax on digital advertising<sup>15</sup> that has received significant attention and is the subject of litigation. Other states have recently considered similar legislation.<sup>16</sup>

### NOTABLE EVENTS

**1990’s – States, along with the MTC, began the process that would lead to the creation of Streamlined and the SSUTA in 2000.**

**Post-*Quill* – States began to revisit the idea of true gross receipts taxes.**

**2010 – the Digital Goods and Services Tax Fairness Act is first introduced in Congress.**

**2018 – The U.S. Supreme Court overturned *Bellas Hess* and *Quill* in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 585 U.S. \_\_ (2018).**

**2021 – Maryland adopts a tax on digital advertising. Other states file bills on similar subjects in the 2021-22 sessions.**

<sup>11</sup> See MTC Resolution No. 02-01, Improving State Sales Taxes to Achieve Fairness and Simplicity; Resolution No. 01-10, Resolution Supporting the Proposals and Work of the Streamlined Sales Tax Project; and Resolution No. 00-2, and Resolution in Support of the Streamlined Sales Tax Project; available here: <https://www.mtc.gov/The-Commission/Policy-Statements-Resolutions>.

<sup>12</sup> Congressional Budget Office Cost Estimate H.R. 1860, Digital Goods and Service Tax Fairness Act of 2012, Sept. 14, 2012, available here: <https://www.cbo.gov/system/files/112th-congress-2011-2012/costestimate/hr1860.pdf>.

<sup>13</sup> 138 S.Ct. 2080, 585 U.S. \_\_ (2018).

<sup>14</sup> See, for example, Georgia HB 594 and Kansas HB 2230.

<sup>15</sup> Md. Code, Tax-Gen. § 7.5-101 et. seq.

<sup>16</sup> See, for example, Indiana SB 372; Massachusetts bills H. 2894, H. 2928, H. 3081, H. 4042, New York A734, S1124, S302, S4959; and Washington HB 2107.

## Sales Taxes – Important Similarities and Differences

This section provides information about sales taxes that may be useful when reviewing the detailed outline.

### Revenue Generated from the Tax

All but five states—Alaska, Delaware, Montana, New Hampshire, and Oregon—have imposed a state-level sales tax. (In Alaska, the tax is imposed only by local governments.) Even these five states (and their local governments) impose narrower excise taxes on certain goods and services—e.g., fuel taxes, tobacco, and alcohol taxes, lodging taxes, and utility taxes.

The share of tax revenue that each state derives from sales tax varies. A 2020 study found that sales taxes provided 32% of all state tax revenue, slightly less than the revenue provided by state personal income taxes, although, in 16 states, sales taxes are the largest source of tax revenues.<sup>17</sup> According to U.S. census data for more recent quarters, total state sales tax revenue for all states was about 30% of total state tax revenue.<sup>18</sup> This slightly lower percentage may be anomalous, or it may be consistent with the slight but steady relative decline in sales tax revenue that has occurred over the last few decades.<sup>19</sup>

### Tax Rates Imposed

Sales tax rates also vary between jurisdictions and depend on both the state rate imposed and any local rates that may be included. Today, the highest combined state and local rate is slightly less than 10%, and the lowest is around 5%. The overall trend in rates, however, is upward, with median state rates increasing about one percentage point over the last decade.<sup>20</sup>

### Tax Base

As noted above, while some states impose the sales tax on a broad base, others impose it only on sales or transactions involving tangible personal property (however defined) and certain other specifically enumerated items. Therefore, the relative breadth of the tax base (excluding specific excise taxes) varies from state to state and depending on whether it is measured relative to certain consumption data or personal income. One estimate based on personal income shows a variation ranging from 19% (California) to 94% (Hawaii).<sup>21</sup> Because of changes in the economy, one expert estimated that the breadth of the sales tax base across all states has narrowed by as much as 35% since 2000.<sup>22</sup>

### Common Exemptions -

Most states have attempted to reduce what is sometimes called sales tax “pyramiding” or “cascading” on business-to-business (“B2B”) transactions by granting exemptions for purchases made for resale or purchases of manufacturing or processing inputs or other business inputs. In some cases, however, imposing tax on B2B transactions may be considered justified where there is no tax imposed on the ultimate consumption.<sup>23</sup> Most states have also attempted to reduce the regressivity of sales taxes. Methods include exempting certain essential purchases, such as food, tax “holidays,” providing credits tied

<sup>17</sup> “How States Raise Their Tax Dollars,” PEW, May 13, 2021, available here: <https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2021/how-states-raise-their-tax-dollars-fy2020>.

<sup>18</sup> See information available on the U.S. Census Data website, here: <https://www.census.gov/programs-surveys/stc.html>. All state excise taxes generate 13% of total state tax revenues. Common state excise taxes include fuel taxes at around 4% of total taxes and insurance premiums taxes at around 3%. Local governments also impose excise taxes, most notably hotel accommodations and related taxes.

<sup>19</sup> See Vivien Lee and David Wessel, “The history and future of the retail sales tax,” Brookings, July 16, 2018, available here: <https://www.brookings.edu/blog/up-front/2018/07/16/the-history-and-future-of-the-retail-sales-tax/#:~:text=The%20retail%20sales%20tax%20was,than%2032%20percent%20in%201970>, (hereafter, Brookings).

<sup>20</sup> See John L. Mikesell, “State Retail Sales Taxes in 2018,” Tax Notes State, Sept. 30, 2019, p. 1339.

<sup>21</sup> See Jared Walczak, State Sales Tax Breadth and Reliance, Fiscal Year 2021, May 4, 2022, Tax Foundation, available here: <https://tax-foundation.org/state-sales-tax-base-reliance/>.

<sup>22</sup> Id.

<sup>23</sup> See William F. Fox and Leann Luna, “How Broad Should State Sales Tax Bases Be? A Review of the Empirical Literature,” State Tax Notes, Sept. 4, 2006, P. 639.

to income, or expanding the tax base to include certain services purchased by higher-income households.<sup>24</sup>

#### Adaptability (or Lack of It) -

The inability of the state sales taxes to adapt to changes in the economy—reflected in rising tax rates imposed on a narrowing base relative to consumption—is often cited as critical to the tax’s future.<sup>25</sup> Experts have, for decades, noted the failure of sales taxes to keep up with the digital economy, to the point where one noted expert has opined:

“ . . .the tax, as it currently functions, is an anachronism that reflects its origins in the Industrial Age nearly 70 years ago; since the [retail sales tax or RST] was created without a firm conceptual basis and “just grew,” it is not surprising that it is defective—or that e-commerce magnifies its defects. But the problem may be deeper than this; even if reformed, the RST may simply not be suitable to serve as the most important source of tax revenue of state and local governments in the twenty-first century.”<sup>26</sup>

#### Structure and Common Elements -

Sales taxes have a certain structure and common elements, but also some deviations that may affect efforts to develop an approach to taxing digital products.

- Legal Imposition of Sales Tax – In most states, the tax is imposed on the customer but must be collected by the seller (or certain intermediaries). A seller who fails to properly collect the tax typically becomes legally obligated to pay it. A minority of states legally impose tax on the seller.
- Imposition of Use Tax – The sales tax is invariably imposed with a complementary tax called the “compensating use tax,” or “use tax.” This tax is imposed on the customer and may be collected by the seller, or paid directly by the customer. The use tax, which is imposed only on purchases from out-of-state sellers, does not violate the Constitution if it is imposed with an “identifiable and substantially similar tax on intrastate commerce.”<sup>27</sup>
- Tax Rates – Most but not all state sales taxes are imposed by both state and local governments. The tax rate on a particular transaction will be a combination of the state and any local rates applicable.
- State Tax Base - Most sales tax laws provide for general imposition of the tax on all sales or transactions involving tangible personal property, but may also include other specifically enumerated items and specific services. A handful of states impose tax on gross receipts or broad categories of transactions.

#### MAJORITY RULES

**Legal Imposition of the Sales Tax – on the customer unless the seller fails to properly collect.**

**Imposition of Compensating Use Tax – all states**

**Tax Rates – combination of state and local rates.**

**State Tax Base – tangible personal property and specifically enumerated services.**

<sup>24</sup> See, for example, “Who Pays? 6th Edition,” Institute for Taxation and Economic Policy, 2018, available here: <https://itep.sfo2.digital-oceanspaces.com/whopays-ITEP-2018.pdf>; and Michael Mazerov, “Expanding Sales Taxation of Services: Options and Issues,” Aug. 10, 2009; available here: <https://www.cbpp.org/research/state-budget-and-tax/expanding-sales-taxation-of-services-options-and-issues>.

<sup>25</sup> See, for example, Brookings, supra FN 17; and Mikesell, supra FN 1.

<sup>26</sup> Charles E. McClure, Jr., “Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?,” 2000 *BYU Law Rev.* 1, Art. 11, Mar. 1, 2000, available here: <https://digitalcommons.law.byu.edu/cgi/viewcontent.cgi?article=2052&context=lawreview>, (hereafter, McClure).

<sup>27</sup> See *Associated Industries of Mo. v. Lohman*, 511 U.S. 641 (1994).

- **Local Tax Base** - In most states that have tax imposed by local governments, the local tax base is identical to the state tax base. But in a handful of states, local government tax bases may not be identical.
- **Separate Statement of the Tax** – In most but not all states, the seller must separately state the tax being charged to the customer. In part, this facilitates the customer’s determination of whether use tax is due.
- **Exemptions** – As noted above, states typically provide a number of exemptions. Many of these exemptions address B2B transactions to reduce tax pyramiding or address the inherent regressivity of the tax. Others may single out particular industries or activities for tax benefit. There is a wide variation in the types of exemption states offer and even similar exemptions may rely on slightly different defined terms or requirements.
- **Sourcing** – Since rates vary by state or local jurisdiction, it is necessary for transactions to be sourced to particular jurisdictions. In the past, sourcing rules varied considerably. Most states today use destination-based sourcing, although there are some exceptions, and sourcing of certain items, like services and digital products, is more complicated than sourcing transactions involving tangible personal property. States that are members of the SSUTA must conform to uniform sourcing rules.
- **Credit for Tax Paid** – Customers who may owe use tax in a particular state for items acquired outside the state can claim a credit against that tax for sales or use tax properly collected or paid to another state. State credits, however, may not completely eliminate double taxation. A particular transaction may be subject to two (or more) simultaneous sales tax impositions. In some states, the credit for tax paid may not apply in such cases.
- **Documentation** – Sellers and customers must keep proper documentation to show that any exemptions claimed are valid or that tax paid is computed at the proper rate. States typically provide a standard form or certificate for customers to give to sellers, asserting the transaction would meet the exemption criteria, on which the seller can then rely. If the customer fails to qualify, then the use tax may be imposed.
- **Streamlined States** – The members of the SSUTA must conform their laws to that agreement. SSUTA imposes requirements involving definitions, imposition, and sourcing. It contains definitions of certain “specified digital products,” “digital audio-visual works,” “digital audio works,” “digital books,” and “computer software.” SSUTA also provides: “Nothing in this section or the definition of “specified digital products” shall limit a state’s right to impose a sales or use tax or exempt from sales or use tax any products or services that are outside the definition of “specified digital products.” See Section 332 of the SSUTA.

## MAJORITY RULES

**Local Tax Base** – same as for the state.

**Separate Statement of Tax** – required to be properly made to customer.

**Exemptions** – generally provided to reduce pyramiding, regressivity, and provide other tax benefits.

**Sourcing** – destination-based and SSUTA.

**Credit for Tax Paid** – may apply except in certain circumstance.

**Documentation** – typically includes forms of certificates given by customers to sellers

**SSUTA** – provides definitions of certain digital products but does not limit taxation of others.

The detailed outline below relies primarily on the majority rules governing states' sales taxes but will also note when additional consideration might need to be given to how minority-rule states could be affected.

# Detailed Outline

## I. General Purpose or Goal of the White Paper –

*NOTE: In this section of the outline, we would develop the general principles and criteria that will be used to evaluate the information gathered and to compare potential alternatives. The purpose or goals may include:*

- A. Determine the best approach to making existing state sales taxes adaptable and responsive to changes in the digital economy as opposed to creating a new tax or looking at gross receipts taxes.
  - (1) Based on pros and cons of different approaches as determined from the analysis of the issues outlined here.
  - (2) Based on survey of state experience with different approaches.
- B. Determine the approach that is most responsive to issues identified by stakeholders.
  - (1) Addressing the important issues identified by stakeholders and summarized in the outline here.
  - (2) Reducing the compliance and enforcement costs based on best available information.
- B. Determine the approach that will lead to the greatest uniformity.
  - (1) Does the method provide for the ability of states to adopt and apply common definitions?
  - (2) Does the method provide for the ability of states to adopt and apply common requirements for certain exemptions?
- C. Other [may want to note the common criteria used to evaluate taxes – economic equity, revenue reliability, etc.]

## II. Categories and Sub-Categories of Digital Products –

*NOTE: In this section of the outline, we would use both existing tax definitions and industry information to help categorize and describe the types of products that we are focusing on. Definitions pertaining to certain forms of transactions are covered in the next main section of the outline. Also, bundled products or transactions is covered in a separate section of this outline.*

### A. Streamlined Sales and Use Tax Agreement (SSUTA) –

The current version of the SSUTA and related rules are available on the Streamlined website here: <https://www.streamlinedsalestax.org/library?SelectedDocumentType=Agreement+Documents>. These documents define terms that may be relevant. These terms related to both products and transactions. Transaction definitions are discussed in a separate section below. The terms used by SSUTA do not necessarily control what states can tax, or how, but they may impose some limitations and are also used for determining sourcing. This section first summarizes the defined terms and then summarizes how some of these terms are used in the agreement.



## (1) Defined Terms –

SSUTA incorporates some definitions into the specific sections of the agreement (see later subsections here). But most of the definitions are contained in Appendix C. The following summarizes those definitions that are most relevant:

- (a) Tangible Personal Property - SSUTA Appendix C – Part I. Administrative Definitions – contains the agreement’s definition of “tangible personal property.”

“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.

- (b) Computer Related and Digital Products Definitions - SSUTA Appendix C – Part II. Product Definitions contains the following relevant definitions:

- “Computer” means an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions.
- “Computer software” means a set of coded instructions designed to cause a “computer” or automatic data processing equipment to perform a task.
- “Delivered electronically” means delivered to the purchaser by means other than tangible storage media.
- “Electronic” means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.
- “Load and leave” means delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser.
- “Prewritten computer software” means “computer software,” including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more “prewritten computer software” programs or prewritten portions thereof does not cause the combination to be other than “prewritten computer software.” “Prewritten computer software” includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the specific purchaser. Where a person modifies or enhances “computer software” of which the person is not the author or creator, the person shall be deemed to be the author or creator only of such person’s modifications or enhancements. “Prewritten computer software” or a prewritten portion thereof that is modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains “prewritten computer software;” provided, however, that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute “prewritten computer software.”

A member state may exempt “prewritten computer software” “delivered electronically” or by “load and leave.”

- “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, and
- “Digital Books” which means works that are generally recognized in the ordinary and usual sense as “books”.

For purposes of the definition of “digital audio works”, “ringtones” means digitized sound files that are downloaded onto a device and that may be used to alert the customer with respect to a communication.

For purposes of the definitions of “specified digital products”, “transferred electronically” means obtained by the purchaser by means other than tangible storage media.

- (c) SSUTA separately defines telecommunications and a number of related products and services in Section 315: Telecommunication Sourcing Definitions, and these, in turn, may determine sourcing under Section 314. Only one of the terms appears to include digital products:

“M. Prepaid wireless calling service” means a telecommunications service that provides the right to utilize mobile wireless service as well as other non-telecommunications services, including the download of digital products delivered electronically, content and ancillary services, which must be paid for in advance that is sold in predetermined units or dollars of which the number declines with use in a known amount.”

(2) Use of Defined Terms –

- (a) SSUTA Section 332: Specified Digital Products provides limits on the states’ ability to tax “specified digital products.” (See definitions summarized above.) This is a lengthy section with numerous provisions on the extent to which the defined “specified digital products” controls a SSUTA state’s ability to tax. The most relevant provisions are briefly excerpted here:

“A. A member state shall not include ‘specified digital products’, ‘digital audio-visual works’, ‘digital audio works’ or ‘digital books’ within its definition of ‘ancillary services’, ‘computer software’, ‘telecommunication services’ or ‘tangible personal property.’ This restriction shall apply regardless of whether the ‘specified digital product’ is sold to a purchaser who is an end user or with less than the right of permanent use granted by the seller or use which is conditioned upon continued payment from the purchaser. . . .

. . .

“C. If a state imposes a sales or use tax on products “transferred electronically” separately from its imposition of tax on “tangible personal property”, that state will not be required to use the terms “specified digital products”,

“digital audio visual works”, “digital audio works”, or “digital books”, or enact an additional or separate sales or use tax levy on any “specified digital product.

...

“E. Nothing in this section or the definition of “specified digital products” shall limit a state’s right to impose a sales or use tax or exempt from sales or use tax any products or services that are outside the definition of “specified digital products.”

...

“G. The tax treatment of a “digital code” shall be the same as the tax treatment of the “specified digital product” or product “transferred electronically” to which the “digital code” relates. . . .

...

“I. For purposes of this section, the term “transferred electronically” means obtained by the purchaser by means other than tangible storage media.”

- (b) SSUTA Section 333: Use of Specified Digital Products (Effective January 1, 2010) also provides the following limit:

“A member state shall not include any product transferred electronically in its definition of “tangible personal property.” “Ancillary services”, “computer software”, and “telecommunication services” shall be excluded from the term “products transferred electronically.” For purposes of this section, the term “transferred electronically” means obtained by the purchaser by means other than tangible storage media.”

B. Other common state tax definitions

(1) Interpretations of “tangible personal property”

- (a) Cases that have interpreted TPP

(2) Goods versus services distinction

- (a) Traditionally – true object or other tests  
(b) As applied to certain digital products

(3) Examples

- (a) Advertising  
(b) Artificial intelligence  
(c) Data processing services  
(d) Information services  
(e) Software as a Service

C. Common and emerging products – based on the results of internet searches by MTC staff about the use of digital technology in particular industries.

- (1) Examples of agricultural products - apps, artificial intelligence (such as using artificial intelligence for assessing soil quality, plant yield, and plant deficiencies), augmented

and virtual reality (for training and safety), big data (to improve farming operations and reduce food waste), blockchain (for pricing and tracking), cloud computing/storage, computers, data storage, digital advertising, digital controls, digital pasture management, digital seed technology, digital tools/equipment, digital weather forecasting, drones, farm management software, GPS guidance systems, hardware, Internet of Things, machine learning (used to improve crops and identify pests), monitoring technology, networks, precision agriculture, printers – 3D/smart, robotic harvesting, satellites, sensors, smart irrigation, software, software as a service, and variable rate applications (for water, pesticides, and fertilizer).

- (2) *Examples of consumer products* - Alexa, Astro, Siri, apps, augmented/virtual reality (immersive experiences), ChatGPT, cloud computing/storage, computers, data storage equipment, digital art, digital books/newspapers, digital cameras, digital education, digital movies, digital music, digital television, digital voice assistants, drones, electric vehicles, e-toys, e-readers, facial recognition products, fitness wearables, hardware, home automation, home robots, Internet of Things, machine learning, networks, PC peripherals, portable audio, printers – 3D/smart, predictive text, self-driving cars, smart home devices, smart security systems, software, software as a service, smart phones, stable diffusion text-to-image, streaming services, text editors, video games and consoles, virtual reality accessories, wireless communications, and wireless speakers.
- (3) *Examples of products in the construction industry* – apps, artificial intelligence (used in architecture and engineering), building modelling (3D), cloud computing/storage, computers, connected hardhats, data storage equipment, digital cameras, digital equipment and tools, GPS tracking, humanoid robots, Internet of Things, laser technology, machine learning (to estimate completion time), networks, PC peripherals, printers – 3D/smart, robot swarms for mundane tasks, sensors, software, smart infrastructure, smartphones, software as a service, supply chain management products, virtual construction site visits, virtual reality equipment simulations, and virtual training technology to train workers.
- (4) *Examples of educational products* - apps, artificial intelligence (used for creating courses, tutoring, and personalized learning), augmented/virtual reality (used for immersive content/experiences and interaction with virtual 3D objects), class response systems, cloud computing/storage, computers, data storage, digital advertising, digital payment, hardware, Internet of Things, machine learning (used for analytics, classroom management, and tracking student performance), online collaboration tools, online courses, networks, printers – 3D/smart, robots, software, software as a service, virtual classrooms, and virtual field trips.
- (5) *Examples of products in the energy industry* - apps, artificial intelligence (used for detecting anomalies in generation, consumption, and transmission), augmented/virtual reality (used for training and to see underground infrastructure), blockchain (tracking the generation, distribution, and consumption of renewable energy), cloud computing/storage, computers, controls for fusion magnets, data storage, digital controls, digital payment, digital equipment/tools, hardware, intelligent networking of consumers and generators, Internet of Things, machine learning (determining energy demand), networks, printers – 3D/smart (for parts and prototypes), smart grids, smart meters, smart power consumption tools, robots, software, and software as a service.

- (6) *Examples of products in the healthcare industry* - apps, artificial intelligence (used for tracking disease spread, interpreting images, and preventative care), augmented and virtual reality (3D views of anatomy), big data, blockchain storage of medical records, chatbot consultations, cloud computing/storage, computers, data storage, digital advertising, digital controls, digital payment, hardware, Internet of Things, machine learning (for diagnostics and imaging), networks, predictive analytics, printers – 3D/smart, robot assisted surgery, software, software as a service, virtual appointments, virtual biopsies, virtual reality headsets for pain, and wearable devices.
- (7) *Examples of products in the manufacturing industry* - apps, artificial intelligence (assists with failure prediction and maintenance planning and provides 360 degree visibility), augmented/virtual reality (used for training, inventory management, modelling, simulations, and to identify safety hazards), automated production line, big data (used for tracking and analytics), blockchain (used for quality checks and for digital twins of physical assets), cloud computing/storage, cobots (collaborative robots), computers, data storage, digital advertising, digital controls, digital machines, digital payment, digital processing, digital tools, hardware, Internet of Things, machine learning, networks, printers – 3D/smart (to create prototypes and final products), robots, sensors, software, and software as a service.
- (8) *Examples of office products* – apps, artificial intelligence (assists with research, document tracking, predictive modelling, diagramming transactions, and repetitive tasks in offices such as legal and accounting offices), augmented/virtual reality (for training), computers, cloud computing/storage, data storage, digital advertising, digital job applications, GPT-3, hardware, Internet of Things, machine learning, networks, printers – 3D/smart, robotic coauthors, software, software as a service, virtual reality onboarding, and videoconferencing.
- (9) *Examples of products in the restaurant industry* – apps, artificial intelligence (used for supply chain management and to predict inventory and staffing needs), augmented/virtual reality (used for virtual tours, virtual interactive menus, and for training), big data (used for analytics), Bluetooth temperature sensors, blockchain (used for tracking and loyalty programs), cloud storage/computing, cloud-based point of service, computers, data storage, delivery apps, digital advertising, digital inventory tracking, digital kiosks, digital payment, digital table manager, digital tools/equipment, hardware, Internet of Things, machine learning, networks, printers – 3D/smart, purchasing apps, restaurant robots (used for anything from prepping food to serving/delivering food), scheduling software, smart appliances, software, software as a service, tabletop tablets, and virtual onboarding.
- (10) *Examples of products in the retail industry* - apps, augmented/virtual reality (used for interactive and 3D shopping experiences), artificial intelligence (used to analyze data and send recommendations to customers), big data (used for price optimization and strategic decisions), blockchain (for tracking inventory), chatbots, cloud storage/computing, cloud-based POS, computers, data storage, digital advertising, digital inventory tracking, digital payment, digital twin technology (used to model supply chain), facial recognition, hardware, Internet of Things, machine learning, networks, omnichannel retail, printers – 3D/smart, robots (used to help customers find products and to manage stores), scheduling software, sensor data, software, software as a service, staff less shops, and virtual onboarding.

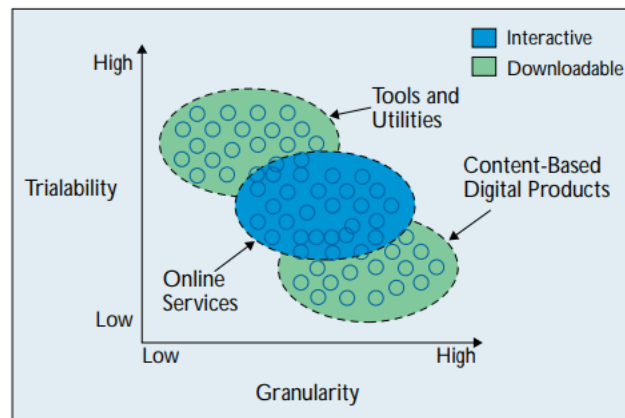
- (11) *Examples of products in the science industry* – apps, artificial intelligence (interpreting results of trials and experiments), augmented/virtual reality (used for visualization), big data, cloud storage/computing, computers, data storage, data analysis, digital controls, digital simulations and modelling, digital tools/instruments, hardware, Internet of Things, machine learning (used for data analysis), networks, printers – 3D/smart, quantum computing, sensor data, software, software as a service, and supercomputers.
- (12) *Examples of telecommunication and information technology products* – apps, artificial intelligence (used to detect network anomalies), augmented/virtual reality (assists field technicians with repair estimates and troubleshooting), big data (predictive analytics), blockchain (for payments and tracking), chatbots, cloud storage/computing, computers, data centers, data storage, data warehouses, digital controls, digital payment, fiber optic cables, hardware, Internet of Things, machine learning (assists with network optimization), networks, process mining, printers – 3D/smart, quantum computing, robotic automation, satellite technology, server centers, software, software as a service, supercomputers, and virtual assistants.
- (13) *Examples of products in the travel industry* – apps, artificial intelligence (used to evaluate prices and for client assistance), augmented/virtual reality (virtual and guided tours), automatic train control, big data (targeted marketing), blockchain (for payments), chatbots, cloud storage/computing, computers, data storage, digital ads, digital keys, digital gas pumps, digital payment, digital reservations, digital road signs, digital tickets, facial recognition technology, hardware, in-flight entertainment systems, Internet of Things, language translation products, machine learning (to learn more about customers), networks, printers – 3D/smart, robot concierges, satellite technology, software, software as a service, transportation rentals, and virtual assistants.
- (14) Non-Fungible Tokens (“NFTs”) (e.g., PA DOR REV-717, p.12 (05-22) adds NFTs to the list of taxable digital products without definition; WADOR issues “Interim Statement Regarding the Taxability of Non-Fungible Tokens (NFTs) 7/1/22)
- (15) Digital currency
- (16) Data gathered from online activity and sold
- D. Digital Goods and Services Tax Fairness Act Definitions (DGSTFA) –
- (1) The DGSTFA is proposed federal legislation that was put forward in the past to provide sourcing limitations on states. See S. 765 (2019). In the legislation, certain terms were defined, including:
- (a) “Digital Code” means a code that conveys only the right to obtain a covered electronic good or service without making further payment.
  - (b) “Digital Good” means any software or other good that is delivered or transferred electronically, including sounds, images, data, facts, or combinations thereof, maintained in digital format, where such software or other good is the true object of the transaction, rather than the activity or service performed to create such software or other good, that results in the delivery to the customer of a complete copy of such software or other good, with the right to use permanently or for a specified period, and includes, as an incidental component, charges for the delivery or transfer of such software or other good.

- (c) “Digital service” means any service that is provided electronically, including the provision of remote access to or use of a digital good, and includes, as an incidental component, charges for the electronic provision of the digital service to the customer.
- (d) “Digital service” does not include a service that is predominantly attributable to the direct, contemporaneous expenditure of live human effort, skill, or expertise, a telecommunications service, an ancillary service, Internet access, audio or video programming service, or a hotel intermediary service.
- (e) “Covered electronic good or service” means a digital good, digital service, audio or video programming service or VoIP service.
- (f) “Delivered or transferred electronically” means the delivery or transfer of a digital good by means other than tangible storage media, and the term provided electronically means the provision of a digital service, audio or video programming service, or VoIP service remotely via electronic means.
- (g) “Separate and discrete transaction” means a sale of a covered electronic good or service or digital code sold in a single transaction that does not involve any additional charges or continued payment in order to maintain possession of the digital good or access to or usage of the digital service, audio or video programming service, or VoIP service.

E. Academic definitions –

- (1) Claudia Loebbecke, Digital Goods: An Economic Perspective (2003), <http://www.mm.uni-koeln.de/team-loebbecke-publications-book-chapters/Chapt-024-2002-%20Digital%20Goods%20An%20Economic%20Perspective-scan.pdf>
  - (a) Digital goods are goods that can be fully expressed in bits so that the complete commercial business cycle can be executed based on an electronic infrastructure such as the Internet.
  - (b) To distinguish within the group of digital goods, we use the following criteria: transfer mode, timeliness, usage frequency, usage mode, external effects, and customizability
    - (i) When we talk about *transfer mode*, we distinguish between delivered and interactive goods
    - (ii) *Timeliness* covers the constancy and dependence of the value of digital goods over time. (Products like news, weather forecasts, or stock prices normally lose value as time goes by.)
    - (iii) *Usage frequency*. Some goods are intended for single use. They lose their customer value after or through use. For instance, the query on a search engine has no recurring value. Other products are designed for multiple uses; examples include software and games.
    - (iv) When we look at *usage mode*, we can distinguish between fixed and executable goods. Fixed documents allow handling and manipulation in different ways and by different means than executable goods. With executable goods such as software, suppliers define the form by which the good can be used.

- (v) Products with positive *external effects* raise the value for customers with increasing numbers of users. For instance, the more participants who agree on a common standard, the more potential partners for exchange exist.
  - (vi) *Customizability* reflects the extent to which goods can be customized to specific customer needs. An electronic newspaper has a high degree of customizability in that an average customer is able to design a personal version through combinations of articles. But the articles themselves – being equal for all customers – show low customizability.
- (2) Kai Lung Hui and Patrick Y.K. Chau, *Classifying Digital Products* (2003), <http://klhui.people.usf.edu/research/2002-CACM.pdf>
- (a) “Broadly speaking, digital products refer to any goods or services that can be digitized (converted into a binary format)”
  - (b) Classify based on two dimensions: product category and product characteristic
    - (i) Product category
      - ◆ Tools and Utilities (assist users to accomplish specific goals or tasks)
      - ◆ Content-based Digital Products (newspapers, journals, books, etc.)
      - ◆ Online services
    - (ii) Characteristic
      - ◆ Delivery Mode
      - ◆ Granularity
      - ◆ Trialability



F. General industry definitions outside the SALT world

G. What is being offered for sale in the market?

H. Federal “digital assets” definitions

- (1) Internal Revenue Code § 6045(g)(3)(D) provides that “except as otherwise provided by the Secretary, the term ‘digital asset’ means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.” Pub. L. 117-58, § 80603(c), 135 Stat. 1341 (2021).



This definition is effective for returns required to be filed, and statements required to be furnished, after December 31, 2023.

- (2) The IRS website states that digital assets “are broadly defined as any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.” According to the IRS, digital assets include, but are not limited to, convertible virtual currency and cryptocurrency, stablecoins, and non-fungible tokens. <https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets>. The 2022 draft instructions for Form 1040 use this “digital asserts” definition, and further indicate that “if a particular asset has the characteristics of a digital asset, it will be treated as a digital asset for federal income tax purposes.”
  - (3) The White House’s March 9, 2022, Executive Order on Ensuring Responsible Development of Digital Assets provides that the term “digital assets” refers to “all CBDCs [central bank digital currency], regardless of the technology used, and to other representations of value, financial assets and instruments, or claims that are used to make payments or investments, or to transmit or exchange funds or the equivalent thereof, that are issued or represented in digital form through the use of distributed ledger technology. For example, digital assets include cryptocurrencies, stablecoins, and CBDCs. Regardless of the label used, a digital asset may be, among other things, a security, a commodity, a derivative, or other financial product. Digital assets may be exchanged across digital asset trading platforms, including centralized and decentralized finance platforms, or through peer-to-peer technologies.”
  - (4) S. 4356, the Lummis-Gillibrand Responsible Financial Innovation Act (introduced 6/7/2022), provides that “digital asset”
    - (a) means a natively electronic asset that—
      - (i) confers economic, proprietary, or access rights or powers; and
      - (ii) is recorded using cryptographically secured distributed ledger technology, or any similar analogue; and
    - (b) includes—
      - (i) virtual currency and ancillary assets in accordance with section 2(c)(2)(F) of the Commodity Exchange Act;
      - (ii) payment stablecoins in accordance with section 403 of the Commodity Futures Modernization Act of 2000 (7 U.S.C. 27a); and
      - (iii) any other security or commodity that meets the requirements of subparagraph (A).
- I. MTC Auditors / June 2022 Legal Staff Presentation – will be added to the website
- J. ITFA
- (1) Permanent Internet Tax Freedom Act 47 U.S. § 151 note
    - (a) “Electronic commerce” (Sec. 1105(3)) means any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or

delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access.

- (b) "Internet" (Sec. 1105(4)) means collectively the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected world-wide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio.

(2) Anti-discrimination language – Sec. 1105(2):

Discriminatory tax.—The term 'discriminatory tax' means—

“(A)any tax imposed by a State or political subdivision thereof on electronic commerce that—

“(i)is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means;

“(ii)is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period;

“(iii)imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means;

“(iv)establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means; or

“(B)any tax imposed by a State or political subdivision thereof, if—

“(i)the sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation; or

“(ii)a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of—

“(I)the display of a remote seller's information or content on the out-of-State computer server of a provider of Internet access service or online services; or

“(II)the processing of orders through the out-of-State computer server of a provider of Internet access service or online services.

- (3) Comment received by staff - Some in the business community consider the IFTA definition of "electronic commerce" to establish a boundary between digital services that are provided over the internet versus those that are commonly referred to as "facility-

based," such as telecommunications services. These services are typically subject to robust non-tax regulations. This boundary should be preserved so that facility-based digital services are taxed according to existing laws and not subject to potentially broader definitions of digital products, including, for example, the SST definition for digital audio-visual work.

K. Council On State Taxation

L. NJ / MS legislative research / reports

M. Any other legal definitions / body of law outside SALT that might give insight (e.g., copyright, contracts)

(1) According to ChatGPT, an open AI platform ([chat.openai.com](https://chat.openai.com)), when asked how to define digital products replied as follows:

(a) Digital products are products that are delivered and accessed electronically, rather than physically. They can take many different forms, including software, ebooks, music and video files, online courses, and more. Some characteristics of digital products include:

(i) They are delivered electronically: Digital products are typically delivered to the customer via the internet, often through a download or streaming service.

(ii) They are not physical: Digital products do not have a physical form and are not tangible objects that can be held or touched.

(iii) They can be accessed from any device: Digital products can be accessed from any device with an internet connection, such as a computer, smartphone, or tablet.

(iv) They can be easily copied and shared: Digital products can be easily copied and shared, which can pose challenges for creators and sellers in terms of protecting their intellectual property and generating revenue.

(v) They can be updated and improved: Digital products can be updated and improved over time, allowing creators to continue to add value to their products and customers to access the latest versions.

(b) Overall, digital products are a convenient and flexible way for consumers to access and consume a wide range of products and services, and they have become increasingly popular in recent years with the widespread adoption of the internet and digital devices.

(c) Digital technologies are technologies that use digital information and data for various purposes. Some examples of digital technologies include:

(i) Computers: Desktop computers, laptops, tablets, and smartphones are all examples of digital technologies that allow users to communicate, create, and access information.

(ii) Internet: The internet is a global network of interconnected computers and servers that allows people to access and share information and communicate with each other.

(iii) Social media: Social media platforms such as Facebook, Twitter, and Instagram are digital technologies that allow users to create and share content, connect with others, and engage in online communities.

- (iv) Online storage: Cloud storage services such as Google Drive and Dropbox are digital technologies that allow users to store and access their files and documents online.
- (v) Mobile apps: Mobile apps are software programs that can be downloaded and installed on smartphones and tablets, and they allow users to perform a variety of tasks such as checking their email, ordering food, and tracking their fitness.
- (vi) Virtual reality: Virtual reality (VR) technology allows users to experience immersive, computer-generated environments and interact with them in real-time.
- (vii) Artificial intelligence: Artificial intelligence (AI) is a branch of computer science that focuses on the development of intelligent systems that can learn, adapt, and make decisions on their own.
- (viii) Blockchain: Blockchain is a decentralized, digital ledger that uses cryptographic techniques to record and verify transactions and provide a secure and transparent way to store and transfer data.

#### N. CSP websites

#### O. National Conference of Commissioners on Uniform State Laws Revised Uniform Fiduciary Access to Digital Assets Act (2015) – adopted by most states:

- (1) Section 2. (10) “Digital asset” means an electronic record in which an individual has a right or interest. The term does not include an underlying asset or liability unless the asset or liability is itself an electronic record.
- (2) Section 2. (11) “Electronic” means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.
- (3) Section 2. (22) “Record” means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

#### P. Proposed definitions:

- (1) Ray Langenberg – Texas (Nov. 2022): A digital product is a product, including images, sounds, or other data, that is delivered in a computer-readable format.
  - (a) MTC Staff edit: Digital product means anything readable in a binary format.
- (2) Ray Langenberg – Texas (Dec. 8, 2022): Digital product means an item that is received by the consumer in a binary form.
  - (a) MC Staff edit: Digital product means anything that is received by the consumer in a binary format or other similar format now in existence or that may be devised.
    - (i) Binary form relates to musical theory; binary format relates to computing technology.
    - (ii) Quantum computing: processing an infinite number of things at the same time in qubits rather than bits.
- (3) Ray Langenberg – Texas (Dec. 30, 2022): An item that is received by the consumer in a binary form intended to be used by an electronic device.
  - (a) MTC Staff response: See prior comment on the definition of binary form vs. binary format. And, do we need to define what is meant by electronic device? Does the Uniform Laws definition of “electronic” add clarity? (see Section II.O.(2) of this outline).

## Q. Comments on Proposed Definitions

- (1) Charlie Kearns (Eversheds Sutherland) – received via email: There is a well-established boundary between digital services that are provided over the Internet versus those services that are commonly referred to as “facilities-based,” such as telecommunications services, where the service provider owns and operates the underlying infrastructure to deliver such services. The distinction between the treatment of these two categories relates to the fact that facilities-based services are typically subject to robust tax treatment and extensive non-tax regulation. This distinction should be acknowledged so that facilities-based services are characterized according to existing laws and not subject to an additional layer of taxation applicable to digital products, including, for example, the SST definitions for products transferred electronically, digital audio-visual works, digital audio works, and other concepts. Some in the business community recommend that these considerations would be furthered by adopting a definition of “digital products” based on the ITFA definition of “electronic commerce,” which states in relevant part “any transaction conducted over the Internet or through Internet access...” However, the business community also notes that such characterization and/or taxability should be analyzed in the context of (i) ITFA’s prohibition on discriminatory taxes on electronic commerce and (ii) overall policy goals of horizontal equity among competing services.
- (2) Jan. 3, 2023 written comments from Charlie Kearns and Jeff Friedman of Eversheds Sutherland (attached to the Jan. 5, 2023 meeting notice).

## III. Typical Forms of Digital Product Transactions – (new outline section for 12/8/22 discussion)

*NOTE: In addition to the definitions of items that are relevant, above, some states and the SSUTA distinguish different types of transactions when taxing various products. Therefore, this section summarizes the types of transactions that are commonly defined or used in the imposition of sales tax. Bundled products or transactions are covered in a separate section below.*

### A. Sale –

- (1) General meaning – this term is used throughout state law but may also be defined specifically for sales tax purposes and often refers to a transaction in which the customer obtains the unlimited use of or title to whatever is conveyed by the seller.
- (2) SSUTA – SSUTA does not define “sale” as a distinct term. It does define “retail sale and “sale at retail” broadly to mean “any sale, lease, or rental for any purpose other than for resale, sublease, or subrent.” See Appendix C.

### B. Lease or rental –

- (1) General meaning – this term is also used throughout state law but can be specifically defined for sales tax purposes. In general, a lease is a transfer of the right to possession and use of some item for a period of time.
- (2) SSUTA – The SSUTA defines lease or rental “as any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. A lease or rental may include future options to purchase or extend.” The definition then goes on to distinguish things that are not leases, which it appears are presumably sales—although, again, the agreement does not define a “sale.”

### C. License or license to use –

- (1) General meaning – this term is used generally to describe a transfer of the right of possession and use of some item for a period of time where the rights conveyed are less than would be granted under a lease. Also, the term license is generally used when conveying the right to use an intangible.
- (2) SSUTA – The SSUTA does not define “license” or “license to use.” It does use the term “license” in the context of software. See Rule 309.5 –

“Sourcing Software Term License and Subscriptions (1) Definitions: As used in this section (a) the term ‘software subscription’ means a transaction requiring additional payments for updates to prewritten computer software and (b) the term ‘software term license’ means a transaction where the purchaser’s right to continue to use prewritten software is dependent on periodic payment.”

D. Subscriptions or access charges –

- (1) General meaning – this term may describe a way of conveying information or data or other times in exchange for periodic or per-use charges.
- (2) SSUTA – The SSUTA does not generally define “subscription” but does provide, in Sec. 332, that:

“A state may treat a subscription to products ‘transferred electronically’ differently than a non-subscription purchase of such product. For purposes of this section, ‘subscription’ means an agreement with a seller that grants a consumer the right to obtain products transferred electronically from within one or more product categories having the same tax treatment, in a fixed quantity or for a fixed period of time, or both.”

E. Service Contract –

- (1) General Meaning – a service contract is a type of transaction that is generally used when the seller agrees to provide a service which may have no tangible or other product. For example—a repair service.
- (2) SSUTA – The SSUTA does not define “service” or “service contract.”

F. Exchange of user data for certain products and sales of that data (see also products below)

G. Non-Fungible Tokens (“NFTs”) as transactions (see also products above)

#### IV. Important Limitations Facing States that Must be Considered –

In this section we would focus on certain practical realities of making an adaptable tax on digital products work including enforcement and ITFA limits.

A. Enforcement generally

- (1) International sellers
- (2) Other enforcement issues

B. Dormant Commerce Clause

- (1) Potential issues with respect to multiple points of use
- (2) Other potential double-taxation

C. ITFA’s non-discrimination provision and its interpretation and application [which would include survey of litigation and case law as well as other information]

- (1) “Electronic commerce”
- (2) “Similar property, goods, services, or information”
- (3) “Internet access”

## V. Important Issues Raised by Stakeholders –

In this section we would focus primarily on the biggest issues cited by stakeholders that are creating challenges or problems—describing the issues and potential solutions generally.

- A. Continually changing products
  - (1) Description of the problem
  - (2) Possible solutions
- B. Lack of certainty and areas needing more guidance generally and process for obtaining specific, timely guidance
  - (1) Description of the problem
  - (2) Possible solutions
- C. Concern for equity/parity between digital products and other items
  - (1) Description of the problem.
  - (2) Possible solutions.
- D. Need for some flexibility
  - (1) Description of the problem
  - (2) Possible solutions
- E. General mechanics of the sales and use taxes – especially exemptions and sourcing
  - (1) Sales tax versus use tax and whether difference in the nature of the taxes might justify additional rules
    - (a) Multiple points of use
      - (i) Description of the problem
      - (ii) Adoption and repeal of rule by Streamlined
      - (iii) Possible solutions
  - (2) Possible limit on the period after first use during which a subsequent use in a state may give rise to tax
  - (3) Application of general B2B exemptions to digital products when the purchaser is a business
    - (a) Description of the problem
    - (b) Possible solutions
  - (4) Application of exemptions based on the nature of the item or use, e.g., fabrication, processing, etc.
    - (a) Description of the problem
    - (b) Possible solutions

- (5) Application of typical exemptions related to services, e.g., educational services, entertainment, etc.
  - (a) Description of the problem
  - (b) Possible solutions
- (6) Treatment of bundled or mixed transactions – where digital products that are or may be taxable are sold in combination with or integrated with other items, including services, which are not taxable
  - (a) Description of the problem – including ITFA bundling rule
  - (b) Possible solutions
    - (i) SSUTA, Appendix C, Part I – Administrative Definitions provides a lengthy definition of a bundled transaction which also contain substantive rules. Some of these rules apply specifically to traditional services or tangible personal property. The portions of the definition most relevant is excerpted here:

A “bundled transaction” is the retail sale of two or more products, except real property and services to real property, where (1) the products are otherwise distinct and identifiable, and (2) the products are sold for one non-itemized price. A “bundled transaction” does not include the sale of any products in which the “sales price” varies, or is negotiable, based on the selection by the purchaser of the products included in the transaction.

(A) “Distinct and identifiable products” does not include:

...

2. A product provided free of charge with the required purchase of another product. A product is “provided free of charge” if the “sales price” of the product purchased does not vary depending on the inclusion of the product “provided free of charge.”

3. Items included in the member state’s definition of “sales price,” pursuant to Appendix C of the Agreement. [See that definition discussed above.]

(B) The term “one non-itemized price” does not include a price that is separately identified by product on binding sales or other supporting sales-related documentation made available to the customer in paper or electronic form including, but not limited to an invoice, bill of sale, receipt, contract, service agreement, lease agreement, periodic notice of rates and services, rate card, or price list.

(C) A transaction that otherwise meets the definition of a “bundled transaction” as defined above, is not a “bundled transaction” if it is:

...

(3) A transaction that includes taxable products and nontaxable products and the “purchase price” or “sales price” of the taxable products is de minimis.



(a) De minimis means the seller's "purchase price" or "sales price" of the taxable products is ten percent (10%) or less of the total "purchase price" or "sales price" of the bundled products.

(b) Sellers shall use either the "purchase price" or the "sales price" of the products to determine if the taxable products are de minimis. Sellers may not use a combination of the "purchase price" and "sales price" of the products to determine if the taxable products are de minimis.

(c) Sellers shall use the full term of a service contract to determine if the taxable products are de minimis; or

...

(7) Application of special tax treatment of communications, especially when bundled with other digital products – e.g., enterprise software.

(a) Description of the problem

(b) Possible solutions

(8) Application of tax to data and information and whether public information can be "sold" or whether the product is the mechanism for transmitting or using that data

(a) Description of the problem

(b) Possible solutions

(9) SSUTA sourcing rules and gaps in the rules

(a) Description of the problem

(b) Possible solutions

(10) Consideration of federal DGSTFA sourcing provisions

(11) Consideration of direct pay by customers

F. Related issues

(1) Threat of qui tam and class action suits [see the MTC resolution on this subject]

(2) Expansion of the tax base through administrative interpretation

(3) Effect on existing marketplace facilitator laws

G. Provide time for taxpayers to implement changes and for agency to issue necessary guidance

## VI. Survey of the Main Approaches to Including Digital Products in the Tax Base

A. General SSUTA framework – definitions and other requirements

(1) Examples of SSUTA states taxing digital products

(2) How do SSUTA definitions affect application of the tax? When are state rules in conflict with SSUTA.

(3) How the taxes have adapted generally

(4) Key issues

- B. States with broad tax bases – generally
  - (1) Description of the approach – categories defined only broadly
  - (2) Durability of the taxes
  - (3) How the taxes have adapted generally
  - (4) Challenges faced – including exemptions, sourcing, etc.
- C. States that have specifically enumerated certain digital products – survey
  - (1) Different products included [see the work done by Arizona and Louisiana, as well as others]
  - (2) How the taxes have adapted generally
  - (3) Challenges faced – including exemptions, sourcing, etc.
- D. States that have interpreted “tangible personal property” to include digital products – survey
  - (1) Examples of states using definition of TPP [again, see the work done by Arizona and Louisiana.]
  - (2) How the taxes have adapted generally
  - (3) Challenges faced – including exemptions, sourcing, etc.
- E. Example – contrasting approaches – taxation of software [staff research]

## VII. Pros and Cons of Applying an Alternative Tax

- A. True gross receipts taxes [see research done by various groups.]
  - (1) Possible Pros – May be simpler.
  - (2) Possible Cons – Pyramiding and need for different rates.
  - (3) Other
- B. Digital advertising taxes [summarizing the discussion of Maryland’s tax.]
  - (1) Possible Pros – Can be tailored to the industry.
  - (2) Possible Cons – ITFA limitations and failure to address other products; OECD Pillar 1 discussions to eliminate digital taxes at the international level.
  - (3) Other
- C. “Data mining” taxes [summarizing Plattner’s proposal and discussion.]
  - (1) Possible Pros – Recognizes value in “free” services provided in exchange for data.
  - (2) Possible Cons – Untested.
  - (3) Other
- D. Alteration of sales tax mechanics – simplifying the sales tax
  - (1) Ability to vary the typical mechanics including separate statement of the tax so as to allow estimated amounts sourced to particular jurisdictions.
  - (2) Elective use of a single state tax rate (i.e., the Texas approach).

## VIII. Conclusions



## I. APPENDIX A

This is a list of the stakeholders that MTC staff talked to, the questions we asked, and a summary of the responses we received.

### Digital Products Stakeholder Discussions as of July 1, 2022

- Departments of Revenue (12)
  - Arizona
  - New Jersey
  - Hawaii
  - Colorado
  - Maryland
  - New Jersey
  - New Mexico
  - Texas
  - South Dakota
  - California Department of Tax and Fee Administration
  - Utah
  - Iowa
  
- Taxpayers (7)
  - Amazon
  - AT&T
  - Meta
  - Verizon
  - Microsoft
  - Charter Communications
  - Apple
  
- Practitioners (8)
  - Kranz & Associates
  - Eversheds Sutherland
  - BakerHostetler
  - EY
  - KPMG
  - Deloitte
  - McDermott Will & Emery

- MultiState Associates
  
- Industry (2)
  - Avalara
  - Tax Cloud
  
- Organizations (10)
  - Council On State Taxation
  - Electronic Transactions Association
  - Center on Budget Policy and Priorities
  - American Bar Association – written comments submitted
  - Tax Foundation
  - Motion Picture Association
  - Streamlined Sales Tax Governing Board (staff)
  - AICPA – State & Local Tax TRP
  - National Taxpayers Union Foundation
  - National Conference of State Legislatures (informal)
  
- Academics (4)
  - Bill Fox, Univ. of Tennessee
  - Orly Mazur, Southern Methodist University Dedman School of Law
  - Adam Thimmesch, Nebraska College of Law
  - Hayes Holderness, University of Richmond School of Law

### **Stakeholder Questions**

These are the basic questions we asked all stakeholders, with some modifications for states and the “Big Four” accounting firms that agreed to talk with MTC staff.

1. Which states have the best / worst approach to taxation of digital items and why?
2. Which states have the best guidance for taxpayers/CSPs?
3. Which states have the best systems for taxation of digital products?
4. How much of a problem is the fear of qui tam or other suits for sourcing/charging the wrong rate?
5. Would it make things simpler if states would allow taxpayers to “build in” the cost of the tax, rather than charging it on the bill or invoice, so that the tax would work more like a gross receipts tax?

6. In addition to the concerns that states' taxation of digital products lacks uniformity (definitions, sourcing, etc.) and likely may be over-reliant on "B to B" transactions, please identify any other major concerns states' taxation of digital products and be as specific as possible.
7. How would you approach the taxation of digital products irrespective of what states are currently doing? What are your specific suggestions on how such taxes should be structured, imposed, and administered?
8. What issues relating to the taxation of digital products should the MTC be focusing on and in what priority?
9. How should the MTC approach this uniformity project in order to get maximum positive input from interested parties (in particular private sector/industry participants) to produce the best possible end result that states can use for sound policy guidance?
10. What would you like to see as the end result for this project?
11. Any other thoughts for us / the Uniformity Committee?
12. Who else should we be talking to?

### **Summary of Stakeholder Responses**

As reported at the April 20, 2022 Uniformity Committee meeting, here are some general takeaways from the interviews in no particular order.

1. **There is general support for the project:** The majority of people are supportive of this project and can see value from the MTC proceeding to help provide information and guidance to policymakers, taxpayers, and tax administrators. In only one interview were we told not to move forward.
2. **Be mindful of the Streamlined states:** We are mindful of what the Streamlined states are doing with respect to taxation of digital products, particularly their current project on sourcing. Richard Cram is monitoring their activities.
3. **B to B transactions:** Attention is needed to bundling, multiple points of use, and related issues; eliminating "B to B" transactions could simplify taxation issues. Iowa has statutory language.
4. **Definitions needed:** Some are concerned that clear definitions will lead to more taxation of digital goods and services, but many people said clear definitions were important.
5. **Broad versus piecemeal approach:** Washington state is a good model among the states as to how to tax digital items given the broad definitions and clear guidance. In contrast, and for example, trying to navigate how to tax software depending on how it is sold (TPP vs. SaaS vs. downloaded) is a burden and leads to greater risk of getting it wrong.
6. **Sales and use versus other tax type:** Taxing digital goods and services through a sales and use tax is the best way to proceed; creating a new or separate tax, such as a gross receipts tax, adds complexity to the overall tax system and has its own problems / doesn't solve other problems, such as not allowing for exemptions based on purchaser status and requiring sellers to still determine proper tax rates.
7. **Legislation versus administrative guidance:** There is a preference for state legislatures to address taxation of digital items rather than through administrative guidance.

8. Whitepaper versus model statute: Most people liked the idea of developing a whitepaper / best practices for policymakers to use as guidance. Fewer people asked for model statutory language.
9. Focus on today versus the future: Stakeholders recommended focusing on the digital goods that exist now (instead of trying to look ahead) and making rules that are broad enough to cover future innovation.