

January 3, 2023

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Dear Nancy:

We submit the following comments on behalf of the undersigned, and not on behalf of our clients, colleagues, or law firm. The “digital product” definition discussed during the Multistate Tax Commission’s most recent Sales Tax on Digital Products Project Work Group meeting on December 8th included a discussion of how best to define digital products. While some participants were careful to note that their proposed definitions of digital products were not intended to include a proposal as to what is and what is not taxable, we remain skeptical that the two can be kept separate.

For instance, Mr. Ray Langenberg offered the following definition for consideration: “A ‘digital product’ is an item received by the consumer in binary form.” This proposed definition is broad in scope – although other participants questioned whether it should be made broader. The proposed definition – and the reactions to it – offer an example as to why definitions should not be offered in the abstract. Rather, a definition should be offered for whatever purpose it is intended to serve, including as a product that a state should consider to tax or, alternatively, to exempt. Offering proposed digital product definitions in context will lead to a more efficient process and also increase the likelihood that Work Group participants will understand the ramifications of their discussions. We also appreciate the fact that some Work Group participants do not share our concerns associated with purpose and objective. It is with this in mind that we offer the following comments for consideration at the upcoming January 5th meeting. We first comment on the “digital product” definition before the Work Group, then provide additional comments for general consideration.

“An Item Received by the Consumer in Binary Form.” We agree in principle that “form” – and not “delivery method” – should control taxability.¹ Yet, the method by which a person obtains a “digital product” is inextricable from the product itself. In other words, defining a digital product requires consideration of delivery method. Under the proposed definition discussed above, a

¹ See Amy Hamilton, “MTC Work Group Begins Defining ‘Digital Product,’” [Tax Notes Today State](https://www.taxnotes.com/tax-notes-today-state/digital-economy/mtc-work-group-begins-defining-digital-product/2022/12/09/7ffxm), Dec. 9, 2022, available at <https://www.taxnotes.com/tax-notes-today-state/digital-economy/mtc-work-group-begins-defining-digital-product/2022/12/09/7ffxm>.

lawyer’s email with a tax opinion attached as a PDF would be a “digital product”² even though the vast majority of state sales tax systems would treat the PDF attachment as the provision of a professional service, and not a digital product. A definition of digital products based solely on the presence of “1’s and 0’s” will turn our sales tax systems on their head. If that is what is in scope for this Work Group, perhaps it should be renamed “Revamping US Sales and Use Taxes.”

Further, defining a “digital product” based on whether software, data, or the Internet “touch” a transaction leads to incongruous results. Nearly every transaction “touches” software and the Internet, including the sale of milk at the corner grocery store using a point-of-sale system resident in the cloud. Registering for an MTC meeting on the Internet (and paying the registration fee) would be recast as a digital product. This approach sweeps in nearly every transaction and renders the proposed definition meaningless (unless its objective is to form the basis to tax every transaction, including a MTC registration fee).

Whatever terminology the Work Group uses to limit its scope, the white paper should include clear – yet technology-neutral – distinctions between “digital products” and services that are facilitated by software, data, or the Internet. For example, most jurisdictions provide a well-established boundary between (i) digital services that are provided over the Internet, and (ii) services that transmit, route, convey, or distribute data, where the provider owns and operates the underlying infrastructure to deliver their services. The latter category of “facilitates-based” services includes telecommunications service, broadcast television and multichannel video programming services, and Internet access services. This distinction is important because facilities-based services are subject to sales tax rules and regimes that, while not perfect, have created predictability.

Finally, we note that the proposed definition raises issues about how one determines a “digital product” is “received” by the purchaser or user. Does *receipt* only include *delivery* of a digital product (which is intangible in nature)? How would the proposed definition interact with the Streamlined Sales and Use Tax Agreement’s definition of “receipt” used to source a transaction, where “‘receive’ and ‘receipt’ mean ... [t]aking possession or making first use of digital goods, whichever comes first”?³

Well-Established, Alternative Options. We suggest that the Work Group not reinvent the wheel when there are viable constructs to reference, including the Streamlined Sales and Use Tax Agreement’s digital products definitions and operating rules.⁴ We urge the Work Group to focus its consideration and proposals on regimes that have been applied and tested in practice. Recognizing the context of how taxpayers, practitioners, and states will use the Work Group’s definition and eventual work product will avoid complexities and possible confusion as this project progresses.

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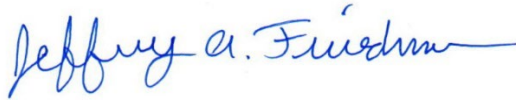
² *Id.*

³ SSUTA § 311.C.

⁴ SSUTA §§ 332, 333, and Appendix C, Part II (“Digital Products Definitions”).

We appreciate the Work Group's continued efforts to set the scope of its white paper. The digital product definition should be furthered with a well understood objective. Due consideration should be given to long-standing regimes. This is especially true given the likelihood that states may look to the Work Group's white paper for tax policy decisions.

Respectfully,



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