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Multistate Tax Group Needs Expertise to Form Digital Definitions

By Kelvin M. Lawrence 2023-06-13T04:45:10000-04:00

Recent meetings of the Multistate Tax Commission's [work group](#) for state taxation of digital products and its uniformity committee suggest that, despite intentions to the contrary, its efforts may lead to an expansion of state sales tax bases.

The work group appears to be launching into a discussion of legal definitions for products and services in the digital economy before having a strong grasp of the products and services in the marketplace. Those in the taxpayer community with technical expertise should make their voices heard to spare the work group from recommending legal definitions that are unworkable or over-inclusive.

The uniformity committee launched its project on sales taxation of digital products in 2021 in response to a standing subcommittee [recommendation](#) for a white paper on applying sales tax to digital products. The proposed white paper wasn't intended to make prescriptive recommendations about the taxability of products.

The authors of the recommendation said they "expect some political opposition to any expansion of the tax base" and recommended that the uniformity committee "initiate a limited scope project." The recommendation defined the scope of the white paper related to states taxing digital products for general survey, review, and analysis.

From the start, the MTC acknowledged concerns from the taxpayer community and reassured the community that tax base expansion wasn't the project's end goal. "Nothing in the multistate tax compact says our mission here is to maximize state revenue," MTC General Counsel Nancy Prosser [said in November 2021](#).

Work group chair Gil Brewer has acknowledged this concern repeatedly, with reassurances in [March](#) and [April](#) that the work group's efforts aren't intended to broadly expand the tax base. However, the last two meetings suggest the direction of this project may be heading in a direction where that outcome may be difficult to avoid.

Survey Responses

On April 6, MTC staff presented the results of an anonymous 17-question survey, apparently sent to the 26 members of the work group, including 17 states and the Streamlined Sales and Use Tax Board. Responses to questions 3 and 4 suggested work group members want to understand the services and products in the marketplace and want more direct input from industry.

The response to question 7 indicated that only 30% of respondents believed they understand “a lot” about digital products. This suggests the work group should continue a broad framework for analyzing and understanding digital products, including more involvement from industry personnel with technical expertise, before moving on to the narrower task of assigning definitions.

On April 25, MTC’s uniformity committee received three presentations on sales taxation of digital products. The [first](#) responded to questions raised in the work group survey by including an extensive discussion on the definitions for digital products in the streamlined sales and use tax agreement. This was followed by a [review](#) contrasting the breadth of various state tax bases relating to digital products. The third was a [presentation](#) addressing the progress and direction of the work group’s efforts.

The future of the project was somewhat concerning, in that the first three “next steps” listed were: “More definitions of various digital products,” “Move from What? to How?” and “Broad imposition vs. intermediate vs. product-specific.” These three presentations, along with the upcoming meeting’s agenda, suggest the work group’s focus will be the legal definitions used to tax digital products.

Troubling Shift

This shift is troubling in light of the experience of definitions for digital products in the streamlined sales and use tax agreement. In September 2021, Jeffrey Friedman and Charlie Kearns recounted the streamlined agreement’s adoption of its digital products definition and operating rules on Jan. 1, 2008.

It was clear that the agreement wasn’t designed to “influence a member state to impose a tax,” and that no member state was required to adopt the new definitions unless and until the state voted to adopt a tax on such items. Nevertheless, the existence of the new streamlined agreement definitions

made it easier for states that decided to impose the tax to do so legislatively.

My desire is a sales tax system that reflects the marketplace and that can be administered effectively. As the MTC staff presentation from the April 25 uniformity committee meeting points out, most state sales taxes on transactions in the digital economy reflect a decades-old understanding of computer technology. That is why this project is essential, and why the work group's efforts thus far have been commendable.

But I'm concerned that this shift from "what" digital products are in the marketplace to "how" those digital products are taxed is premature. The work to define a common vernacular should start with the technology itself, not with legal terms.

Technical experts from the taxpayer community, who understand the technology and who can describe what is actually happening in the marketplace, should present to the work group. This would further inform the interviews that MTC staff conducted with stakeholders over the last two years. It would seem that if only 30% of work group members believe they have a "strong" understanding of digital products, it's premature to move to the next phase of the project.

That's not to say the work group can't have a shared vocabulary. But developing that vocabulary around legal definitions states use to impose their tax—whether the tax base is broad or narrow—could convert the proposed white paper from being a descriptive document to a prescriptive one. This could lead the work group to adopt overly-broad definitions, borne of an incomplete understanding of what they purport to describe. That would risk subverting the goodwill built over many months on this project and could lead some in the practitioner community to question the value of their contributions to it.

I would like to thank attorney Edward J. Bernert, who helped inform my understanding of approaches to defining digital products.

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