



MULTISTATE TAX COMMISSION

## **NOTES of MEETING - DRAFT**

### **MTC Work Group – Sales Taxation of Digital Products**

**March 2, 2023**

#### **I. Welcome and Introductions –**

Gil Brewer, Washington, Chair of the Work Group, convened the meeting and provided introductory information on the work group and its procedures.

#### **II. Initial Public Comment –**

Brewer asked if there were any initial comments on the project or the agenda for the call. There were no initial public comments. Steve Kranz (public participant) attempted to make public comments but there were technical difficulties. Kranz spoke later in the meeting.

#### **III. Review of Notes from February 2, 2023 meeting –**

Brewer asked Nancy Prosser (MTC General Counsel) to review the notes from the previous meeting. Prosser mentioned the notes were available on the project page and invited comments and changes to the notes.

Prosser recapped the February 2 meeting and reiterated that the MTC staff are not recommending any specific method or direction for the work group. She then asked if there were any changes or additions to the notes from the previous meeting. There were none.

#### **IV. Review of changes to the detailed white paper outline –**

Prosser summarized the changes to the detailed white paper outline as highlighted and sent with the agenda for the meeting. She noted the inclusion of the proposed purpose of the digital project from the Standing Subcommittee of the Uniformity Committee. Prosser noted Ray Langenberg's (TX) earlier mention of making the Standing Subcommittee's original guidance a more noticeable part of the work group's efforts.

She also mentioned the addition of several additional definitions, including definitions from a withdrawn 2021 Mississippi regulation. She also noted that the report from the Mississippi work group had been added to the project page on the MTC's website. Prosser noted the addition of several international definitions, some from the United Nations and others from European value added tax (VAT) laws. Prosser then asked for comments on the changes.

Karl Frieden (COST) commented on the VAT definitions, stating that broad VAT definitions are backed up by broad business input exemptions built into the structure of a VAT, whether through input credits or otherwise. He contrasted this to the narrow or nonexistent business input exemptions typical in sales taxes. Frieden recommended that VAT business input exemptions be noted in the outline if the broad VAT definitions are included.

Jared Walczak (Tax Foundation) also noted the differences between VATs and sales taxes. He stated that VAT definitions do not matter as much because of the input credits. He stated

that under a VAT it is with cross border activity where the definitions really matter, and that cross-border activity can cause VAT issues similar to cross-state sales tax issues.

**V. MTC staff presentation on digital products state research –**

Jonathan White (MTC staff) presented the staff's research into the current sales taxation of digital products. The MTC will be providing that research to the states for their review before making it available to the public. He explained the way the information is being organized and walked the group through the spreadsheet. He stated the research is focused on the current inclusions of digital products, broadly construed, in the states' sales tax bases. He noted another intention is to identify patterns and trends. He explained that the research began with the definition of tangible personal property and software. White also noted the difficulty with the services category in distinguishing what types of services are "digital" and the overlap between services and cloud products. He noted that for cloud products there is little statutory and regulatory guidance. The guidance on cloud products is primarily in letter rulings. He noted that a survey and digest of these letter rulings could be a worthwhile research project to help the work group members study what is in the marketplace.

Brian Oliner (FTA) asked if there was a test or other objective measure to determine whether a state is labeled a "narrow" state or a "broad" state. White responded that there was not, that it was based on relative consideration between each state's treatment. He also noted that treatment of digital and cloud products was often determinative as many states treat software similarly at this point.

Karl Frieden (COST) asked whether the spreadsheet would be expanded to include products not taxed by the states and business-to-business exemptions. White responded that the goal was not to create a taxability matrix but to survey the pure tax base to give the work group members a general sense of what states have made taxable.

Steve Kranz (public participant) asked if the goal of the research was to develop guidance needed for taxpayer compliance. White stated that this research is more an effort to provide the work group members a general idea of what states are taxing.

**VI. Chair's comments on the project status and background; related discussion –**

Brewer shared his comments and personal experience relevant to the project. He reiterated the goal is not to copy Washington's strategy or to tax everything. He stated the goal of the white paper is to provide valuable information to policymakers so they can make the best decisions. He also mentioned the importance of state sovereignty. Brewer stated his desire for people to keep in mind that the issues go both ways. He explained that tax administrators focus on what is not being taxed, whereas taxpayers and practitioners focus on what is being taxed.

Brewer then provided background on Washington's digital program. He stated that it started with an audit that highlighted some important issues. He stated this led Washington to join Streamlined and adopt their definitions. He stated these did not capture everything, including the financial information behind the audit that started their project. So they defined and began taxing digital automated services.

Brewer noted that it is important to remember that products are changing, and not only from tangible to digital, but from tangible into service and from data into products. He used DVD rentals as an example of something that is not so simple anymore. He noted other features

packaged with movie rentals like algorithmic recommendations and searches, sorting by director or actor, multi-party simultaneous viewing with chat functions, parental controls, and others. Brewer noted that in this way products evolve beyond the definitions in statute, confusing the existing categories of products. He stated this makes it clear that narrow definitions can become outdated as things change.

Brewer stated that Washington's experience is that broad definitions of taxable consumer purchases are easier to administer. He also stated that for business purchases, Washington did not adopt a broad exemption but instead drew a line between digital goods on one hand and services like digital automated services on the other and that this distinction has been more difficult to administer—digital goods have a business exemption, DAS does not.

Brewer also noted that the evolution of products can cause things that were not taxed to become taxed, or vice versa, so it is a challenge for both states and businesses. He stated his belief that technological innovation can render the most well-intentioned policymaking obsolete and counterproductive.

Brewer noted that he has been speaking of definitions but there are many other issues, many listed and addressed in the white paper outline including business-to-business purchases, bundling, preemption, and sourcing.

Brewer next stated that the work group had asked MTC staff to research the way digital products might be described or defined generally—not just for tax purposes—both broadly and narrowly. He asserted that this work is ongoing. He then stated his desire to ensure the work group members are comfortable the group is on the right track. He then asked for feedback and comment from the members.

Steve Kranz stated that he does not exactly see the benefit of the project. He stated he shared others' concern that the project is set up to expand the tax base. He noted that the states have demonstrated they will expand the tax base when they want to and have been all over the map on it. He noted that even if the issue is uniformity, the MTC is different than Streamlined because there are no legislators involved with the MTC project. He stated his belief that Streamlined was successful because there were policymakers involved. He stated that as currently set up there is no similar transparency and accountability for the project.

Jeff Friedman (public participant) stated that his clients are more interested in further development of Streamlined's approach. He favors a more targeted approach to definitions.

Tim Jennrich (WA) stated that the world is moving toward a digital economy and that it is not going to stop. He also stated that practitioners are right in saying that states are doing things in their own way and that it has not created an efficient system. He stated his hopes that a fair and efficient system is a shared goal. He also stated that he does perceive value in the project, both in discussing the universe of digital products and looking at different approaches, broad and narrow. He asked why the white paper could not look at both. He noted that the Streamlined system could be modified to have definitions that go from broad to narrow and used the analogy of a Russian nesting doll. He described a broad approach, with a modular, incremental approach within that.

Jared Walczak (Tax Foundation) raised the issue of whether the definition option becomes more prescriptive once developed. He stated that he sees the different approaches as

prescriptive of what approach to take and he indicated this would go beyond what has been discussed so far.

Brewer summarized the discussion and that the issues are difficult.

**VII. Next steps, including March 28 work group meeting with Avalara representatives –**

Prosser explained that a meeting was scheduled with Scott Peterson and other representatives from Avalara on March 28 at 2PM Eastern time. She stated this would be a special work group meeting and the April 6 regular work group meeting would still take place. The meeting with representatives from Avalara is to hear their experiences in the marketplace and to help the work group members understand how products are described and categorized by CSPs. The meeting will be open to work group members and the public.

**VIII. Adjourn**

Brewer then adjourned the meeting.