



MULTISTATE TAX COMMISSION

## **NOTES of MEETING**

### **MTC Work Group – Avalara Presentation**

**March 28, 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 the meeting. He introduced Avalara representatives Scott Peterson, David Lingerfelt, and Toby Bargar. Brewer stated he would be using prepared questions but invited questions from others.

#### **II. Initial Public Comment –**

Brewer asked if there were any initial comments on the project or the agenda for this call. There were no initial public comments.

#### **III. Digital Products in the marketplace – Discussion with Avalara representatives Scott Peterson, David Lingerfelt, and Toby Bargar –**

Brewer began by thanking the Avalara representatives and asked them to introduce Avalara and themselves.

Scott Peterson (Avalara) introduced the company as a multinational and multitax compliance company with the goal of eliminating businesses' burdens in complying with their tax obligations. Peterson introduced Toby Bargar, from Avalara's communication excise tax business unit, and David Lingerfelt, a senior director of indirect tax content with Avalara who previously worked at the North Carolina Department of Revenue.

Brewer asked about fact patterns or situations in which they have dealt with digital products. Bargar stated they have dealt with streaming products and a lot of software that touches around the edges of that. He stated that the streaming video companies are a large and diverse client base, ranging from Netflix-type clients to clients that make direct sales of streamed videos. He also mentioned cloud products.

Lingerfelt reiterated that they see a lot of streaming clients. He also mentioned software and particularly the bundling of software with other services like implementation. He stated that online education has grown due to Covid. He stated the traditional items like photography, movie clips, mp3 files, and other things you can traditionally purchase in tangible form are still relevant. Lingerfelt listed NFTs and the metaverse, blockchain, and cryptography as emerging areas.

Brewer asked them to speak to specific state tax compliance challenges. Bargar responded that they focus on billing and invoicing correctly. He also mentioned that they focus on the compliant filing of taxes for clients. He stated that 'digital goods' includes a lot of use cases that touch different areas of the tax code. Bargar further stated that asking 'how does a jurisdiction tax digital goods?' is asking the wrong question. He stated that the type of digital

good is often the initial question. Finding good definitions across jurisdictions is a big challenge.

Lingerfelt stated their initial task is always to determine what the client is selling and to classify that product or service. After this determination, the challenge is due to the variation of how a client's product is treated in different jurisdictions.

Brewer followed up asking about how they handle the variation, interplay, and confusion across so many jurisdictions. Lingerfelt explained they always start by abstracting the product itself and they avoid addressing the question one jurisdiction at a time. He said they first determine what the product is. They gather all aspects of the product, including the business model, the end customer, billing method, delivery method, and more. He stated they do this full abstraction without reference to any existing definition. Lingerfelt stated they do this because if they did not, they would inevitably get to a jurisdiction and find they do not have the detail they need on the product for that jurisdiction. He stated the full abstraction exercise ensures they have everything they need for any jurisdiction's law and rules.

Brewer asked how they describe every possible attribute and if they notice patterns. Lingerfelt said they do see patterns given their scale of operation. He explained that they keep a list of comparisons based on things they have seen before.

Peterson stated the procedures described apply throughout their business and not just for digital products.

Brewer asked about the scale of digital products and whether there is anything they have learned that will help the work group.

Bargar said one challenge is that across jurisdictions, the types of variables that matter can change from place to place, delivery can be important in one jurisdiction, access point in another, and the monetization model (subscription or single purchase) in another. Also, live versus on-demand content can be a distinction point. Bargar stated that anything and everything can be bundled as well, so there are infinite permutations. Bargar stated that the inconsistency with which variable is the key variable is a major challenge.

Lingerfelt added that Avalara's role is to get the tax right and not to tell the states how to tax. For the states, and the work group members, he encouraged thought leadership exercises, focusing on the bigger picture of what is happening in the economy and around them. He stated his belief that this exercise and outlook can inform what should be taxed. He reiterated that this should be the starting point rather than the definition of a term like digital products. He stated that many of these things come up through audit, and that states should try to think in a way that will have them addressing as many things as possible before they come up on audit.

Nancy Prosser (MTC General Counsel) asked about the tax issues they encounter in the metaverse. Bargar noted that the metaverse is a new and novel concept but that nearly all metaverse concepts act as platforms for marketplaces, at least in part, and that people sell items within that marketplace just as they do in the usual marketplaces. He noted that many are monetized by offering a platform-specific token that can be used within the platform's marketplace. He stated the question is whether to tax them at all, but also whether they should be taxed at purchase or at the time the token is exchanged for something else.

Peterson stated that the metaverse may ultimately impact other tax types, even property tax. He stated that people buy space in the metaverse and rent it out. He recalled a recent conversation about potential property tax obligations in the metaverse.

Lingerfelt stated he compares the metaverse to the real world when thinking through taxability determinations. He likened it to real world shopping malls with items for sale just as in malls. He stated that you can buy name brand clothing for your avatar in the metaverse. He offered this as a rapidly growing area where states are not fully informed and likely have no authority to impose tax.

Prosser followed up by asking how they would code their systems given these facts. Lingerfelt responded that the Avalara policy is to be conservative and apply the tax when in doubt.

Brewer asked about verification of what is taxable and what sources they look at. He wondered whether they have problems finding clear answers.

Lingerfelt walked through the basic order of authorities and said they are relying on every source there is, from statutes to informal guidance issued by states. He stated that some states have a habit of providing detailed guidance while others deal in broader strokes. He reiterated that Avalara's role is to get the tax right.

Bargar said they have issues establishing standing for letter rulings because they are not a taxpayer. Peterson followed up by stating that the private letter ruling process, across states, is painful, and in some states, it is expensive. He reiterated the standing issues. He stated that it does no one any good to struggle to get answers out of states.

Brewer agreed generally with this and stated that it would help to get answers quickly.

Jonathan White (MTC staff) asked whether any processes are specific to digital products. Lingerfelt responded there is not much difference for digital. He explained they will attack every product the same way but that it is more difficult to define with digital. He explained that with digital they may need to piece together multiple pieces of authority, or they may find there is no authority. In these cases, they will abstract to other jurisdictions and look for any patterns. He stated that in that pattern finding exercise digital might be a bit different.

Another participant asked how Avalara defines digital products or digital services.

Bargar stated that 'digital products' or 'digital services' is an umbrella term under which there is so much variation and volume. He recommended not even approaching the question. He stated that the exercise should be determining how to tax different items. Bargar stated it is a lost cause to try to bring 'digital good' or 'digital product' under one definition.

Lingerfelt agreed that the exercise is to determine what should be taxed to raise revenue. He recommended determining that and then breaking down the ways those things are delivered. He recommended this over trying to define 'digital product' first.

Peterson stated they are not in the business of telling the states what to tax.

Marc Pfeiffer (New Jersey) asked what recommendations they have to the MTC going forward on the digital products project. He also asked for their outlook on sales taxation in five years given the challenges.

Peterson stated the issue is not just digital, it is a bigger issue than digital. He stated that legislators need to ask what type of tax structure they want to have. He stated that

government will never be able to keep up with the business community's creativity. He recommended taking a broader look when addressing sales tax and not just focus on digital.

Bargar stated he recalls no point in his career where communications technology has not been ahead of the statutes and rules in a jurisdiction. Proactively creating a tax system that will be robust for ten years is not practical.

Lingerfelt stated that whatever the result, it must be revisited every few years. He stated that a whitepaper is a potent idea but that even that will have a limited time scope and will require revisitation. Peterson followed up by saying that states have to react more quickly.

Richard Cram (MTC) noted increased activity in the NFT field and asked about types of NFTs and if Avalara has detected any patterns there.

Lingerfelt says they are seeing things like artwork, admissions, videography, digital fashion by fashion houses, and even yachts in the metaverse. He stated that everything in the real world is showing up in the metaverse.

Bargar stated that admission to events is a big category and could include a streaming concert with an NFT issued as the admission ticket. He stated that one struggle is determining which category this belongs in. One option is legacy cable entertainment, another is admission to an in-person concert. Lingerfelt mentioned a recent Ariana Grande concert held in the metaverse, admission to which was bundled with a real world t-shirt purchase. He stated that this highlights the volume of possible combinations and questions to answer.

Another participant asked about issues with sourcing, particularly regarding new digital products and services.

Lingerfelt stated that the sourcing issue should be front and center. He explained that many of the "new" digital products are based on cryptography. The issue with sourcing these product sales arises out of the very idea behind cryptography, which is that it is anonymous. He stated this means there is no sound way to source the products, at least not using the typical methods of tracking delivery location or billing address.

Bargar followed up by saying that many companies want to maintain as little customer information as possible, for data security reasons and other reasons, so the sourcing issues here will be difficult. Peterson followed up that they want clarity nonetheless.

#### **IV. Adjourn –**

Brewer then thanked the Avalara representatives, mentioned the upcoming work group meeting, and adjourned the meeting.