MEETING NOTES

MTC Work Group – Sales Taxation of Digital Products
August 3, 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 –

Note: Unless expressly stated, we assume that those who spoke did so for themselves and not on behalf of their state, employer, or clients.

Brewer invited any initial public comments. Jeff Friedman (Eversheds Sutherland) provided a set of three principles he hopes will guide the work group and that he believes will be beneficial and lead to better business engagement. The three principles are: (1) any definitions of digital products should be specific and clear rather than broad and ambiguous, (2) any sourcing methodology should reflect where the products are actually used, which may require apportionment, and (3) taxation of digital products, if any, should embrace the goal of exempting associated business inputs.

Nancy Prosser (MTC General Counsel) followed up by asking Friedman for more details. Friedman responded that the intent is to have the three principles guide the work group as it develops its recommendations.

John Mollenkamp (Intuit) referred to the efforts to 'untie the sourcing knot' at Streamlined, and noted that it is very challenging. He noted that the business input principle, if followed, may obviate the principle on sourcing and apportionment. Mollenkamp offered the example of an employer buying products for its employees' use, which might be appropriate to be apportioned but that would be exempted by a business input exemption, and the counterexample of a movie downloaded while in one state but watched in another state or while in transit between two states, which might not be appropriate to apportion. Friedman agreed that consumer sales should not be apportioned and offered the classic example of a haircut.

Karl Frieden (COST) agreed with Friedman's three principles and stated that the second and third are interrelated. Frieden stated that if a business-to-business (B2B) exemption is offered it will make sourcing easier as business-to-consumer (B2C) transactions are simpler to source. Friedman agreed that if digital business inputs are excluded then the sourcing is easier.

Diane Yetter (Yetter Tax Consulting) agreed with the need for a B2B exemption and stated it would be helpful to think about a multiple points of use (MPU) exemption that would shift the collection of tax away from someone without the information. She stated that it may be wise to expand the direct pay concept for taxpayers that do not have a classic direct pay method currently. She stated that sellers must get licenses and other documentation updated often, including reassigning licenses when there is staff turnover, and this is a heavy burden for taxpayers. She recommended putting the burden for apportionment on the buyer with an easy methodology and simple forms for how to claim apportioned use, meaning a defined way to tell the seller what apportionment method to use.

Helen Hecht (MTC Uniformity Counsel) noted that some states have a method for sourcing using estimates, under which the tax can be allocated by population or by other methods if the seller chooses. The state then determines which sub-state jurisdiction gets how much revenue, this alleviates the burden of local sourcing in some instances.

Mark Nebergall (Software Finance and Tax Executives Council) stated that the experience of Streamlined as well as the federal digital goods bill may be helpful to look at for guidance on sourcing. He stated there will be much disagreement and input on the sourcing issue. Nebergall quoted the now-repealed section 312 of the Streamlined Sales and Use Tax Act in the chat. It states that a "purchaser delivering an exemption certificate claiming multiple points of use may use any reasonable, but consistent and uniform, method of apportionment that is supported by the purchaser's books are records as they exist at the time the transaction is reported."

Craig Johnson (Streamlined and work group member) asked whether there was a definition of business inputs and whether anyone had one to propose. He suggested it would be very hard to develop and agree on one.

Friedman responded that the current B2B exemptions are not easy to apply to digital products. He stated that current B2B exemptions could be expanded or refreshed or new ones created. He offered an example from Ohio of the Ohio legislature refreshing an exemption to clarify its application and the issue still being litigated.

Frieden stated that it is not simple, and cited to Iowa's exemption. He described it as an entity-based exemption that also requires the product to be purchased for commercial rather than personal use to be exempt. Frieden says this is the easiest way. Frieden again noted that the states should only include B2C if they are going to expand the digital tax base. He also added that if what is being taxed was previously provided as tangible personal property that was subject to a manufacturing exemption or similar exemption, then the digital version should be exempted also. Frieden stated that these exemptions are often lost when an item goes from tangible personal property to digital. Frieden stated that introducing a B2B exemption early on is an opportunity not to make things worse.

Daniel D'Allessandro (Maine) wrote in the chat that whether the final product is subject to tax or not should be a factor in whether a business input is exempted. He wrote that it makes less sense to exempt the business inputs if the product the input goes into is not taxed.

Shannon Brandt (Texas) asked in the chat how Friedman's principle of "specific and clear" would work with changing technology.

III. Review of Notes from the July 6, 2023 meeting –

Brewer moved to a review of the notes. Brewer stated that the notes from the July 6, 2023 work group meeting were available on the project page on the MTC website and invited comments and changes to the notes. There were no comments or changes.

IV. Review of July 2023 MTC meetings in Austin, TX including Panel and Discussion of Tax on Business Inputs and digital product resolution –

Brewer moved back to the discussion that was happening during the initial public comment period.

Michael Hale (Kansas) asked what reasonable apportionment method the business community would propose. He noted that the method would have to be balanced but not perfect. He reiterated that apportionment will not be perfect and the group should not strive for perfection. He stated his opinion that the Streamlined approach is reasonable. Hale also asked whether a B2B exemption should be an exemption from tax or an elimination from the tax base? (This was a follow up to his comment in the chat.) Hale mentioned D'Allessandro's chat comment about exempt outputs undercutting the exemption of the input.

Josh Pens (Colorado) stated that he sees Friedman's principles as the potential for a framework. He stated that the work group could apply this to a set of digital products as a step-by-step framework, from defining it to sourcing it to considering business inputs. He stated that given that the sales tax is a consumption tax, sourcing will require developing proxies for consumption. Pens stated that sales tax already uses proxies for consumption, offering the example of the retail store as a proxy for consumption. Pens also stated that while specific and clear is a good goal, that should not lead to an excess focus on specificity. He stated that states should be able to define broadly as a class to avoid beginning a perpetual exercise of identifying and defining narrow items.

Brad Heller (CDTFA) stated his desire to exclude business inputs based on B2B sales rather than manufacturing activity. He stated that manufacturing exemptions have been a difficult issue. Heller replied to Hale's question whether business inputs should be exempted or removed from the tax base by stating that exemption is easier in California than removing portions of the base. Taxing only purchases by non-business consumers would solve both problems in a smoother way. Brewer responded that if you are going to introduce exemptions, it is best to do it before the tax revenue money begins being collected.

Prosser asked a question given to her by Deborah Bierbaum with Multistate Associates. The question was whether ITFA requires digital business inputs to be afforded the same treatment as non-digital business inputs. Brewer responded that it was an issue that will come up if the digital product is similar to the non-digital product. Hecht stated that the anti-discrimination provision of ITFA turns on "electronic commerce" and that "electronic commerce" is defined as involving the Internet. Hecht stated that this means the appropriate question is whether the difference in tax treatment being analyzed under the ITFA antidiscrimination provision turns on the involvement of the Internet; the appropriate question is not whether the product is merely "digital."

Johnson responded to Bierbaum's question regarding ITFA and B2B exemptions by stating that when he was still working for the Wisconsin Department of Revenue and Wisconsin joined Streamlined, they added an exemption for digital products if the tangible equivalent receives an exemption. Craig stated this was done to address ITFA concerns.

Nebergall reminded the work group that ITFA includes the full prohibition on taxation of internet access tax. He stated that the definition of Internet access is broader than you might think, and that some of the items we are discussing may be prohibited by that prong of ITFA.

Michael Hale asked in the chat whether the work group should consider whether *Wayfair* and *Murphy v. NCAA*, when read in tandem, affect the application of ITFA.

Frieden said Bierbaum's question may eventually be answered by courts and stated that it might violate the spirit of ITFA. Frieden returned to the B2B exemption. He again recommended excluding B2B transactions from the tax base if they are purchased by a business purchaser for commercial purposes. He also stated that states with a clean slate, like CA, should only add B2C transactions to the tax base, if they add anything at all.

Tim Jennrich (Washington) said he agrees with exempting business inputs to a certain extent. He asked what "clear and specific" means compared to "broad and ambiguous." He pointed out that states have different policy priorities, and the goal may be to develop recommendations that are relevant to many states given their own priorities.

Brewer responded that Washington's Digital Automated Services definition is specific and clear but that it is also broad and that he is unsure if that satisfies Friedman's meaning of clear and specific. He mentioned that a business inputs exemption would affect the imposition and that the final product would depend on the mix of imposition and exemption.

V. Next steps –

Brewer mentioned the next meeting is September 7 and suggested that MTC staff work this discussion into the issue matrix and present the latest version of that at the September meeting. Prosser stated that MTC staff would keep working on the issue matrix toward using it during the September meeting. Brewer mentioned that anyone that did not get their comments in today should send those to Prosser.

VI. Adjourn –

Brewer then adjourned the meeting.