



MULTISTATE TAX COMMISSION

## MEETING NOTES

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

October 5, 2023

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

Gil Brewer, Washington, Chair of the Work Group, called the meeting to order, welcomed the members and other participants and provided introductory information on the work group and its procedures. He noted the meeting would be 90 minutes.

#### 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. There were no initial public comments.

#### III. **Review of Notes from the September 7, 2023 meeting –**

Brewer moved to a review of the notes. Brewer stated the notes from the September 7, 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. **Comments from Marc Nebergall, Software Finance and Tax Executives Council (SoFTEC), to Ray Langenberg’s “Determining the Tax Base” –**

Brewer then turned to Mark Nebergall (Software Finance and Tax Executives Council) for Nebergall’s comments on Ray Langenberg’s submission “Determining the Tax Base.” Nebergall commented that he was struck by the provisions about advertising. He questioned whether website advertising should be subject to sales tax and noted that people access things on the web that require them to watch ads, but so does watching or listening to TV or radio. He asked why these ads would be taxed differently.

Karl Frieden (Council on State Taxation) complimented Langenberg on his work on the principles. He noted that COST believes business inputs should not be taxed where it leads to tax pyramiding—but it doesn’t have a position, otherwise, on how broad or narrow the tax base is. He also noted that Langenberg’s principles touch on how a business-to-business exemption might work. He expressed his belief that the digital economy is fundamentally different in that digital products are used by every business as inputs, whereas the traditional inputs to farming or manufacturing are often specific to those industries. Frieden commended the broad Iowa-style business-to-business exemption for digital products.

Frieden criticized Langenberg's citation of some of certain academics in his submission. For example, Frieden noted that, in particular, Langenberg cites the argument that digital ads are a way of taxing the exchange of access for data or information—a kind of tax on data mining. Frieden emphasized that this is still pyramiding. He noted that digital platforms do pay tax and that the worst thing about taxing digital advertising is that digital advertising is purely a business input—with no consumer sales. Frieden stated he would like Langenberg's principles to be altered or at least qualified. Frieden noted that Langenberg's principles do acknowledge that getting rid of pyramiding is important but hard to do perfectly, and that he agreed with that. Frieden noted that the easiest thing to do is simply eliminate tax on business inputs.

Ray Langenberg (Texas) commented that a news article reporting on his submission referred to him as a "Texas official" and seemed to indicate he was speaking on behalf of Texas, *officially*. He stated that he was not a Texas official and was not speaking on behalf of Texas. He noted that there was disagreement about the points Frieden made and the best thing to do would be to post the articles cited for people to review.

Brewer noted that at every work group meeting there is an express statement that unless participants state otherwise, attendees understand those speaking are merely sharing their expertise and experience at the meetings and only speaking for themselves. He noted that despite noting that participants do not speak on behalf of their state or organization, it is still sometimes reported that way. Brewer thanked the participants for their being willing to speak up—despite any misstatement by the press—and hoped that they would continue to participate without worry that their opinions might be misrepresented, since this is the only way we can do our business.

#### **V. Discussion of draft matrix with three approaches to taxing digital products –**

Brewer then turned the meeting over to Jonathan White (MTC Counsel) to discuss the draft matrix, developed for the work group, showing the three approaches to taxing digital products. White gave background on the matrix and how it was structured. He noted that the idea at this point was to capture as much detail as possible. He noted that state tax agency representatives had agreed to speak about their experiences dealing with the taxation of digital products and how that will help add more information to the draft matrix.

The first person to speak was Alison Jares (South Dakota). Jares explained that in South Dakota, something sold—whether product or service—is taxable unless there is an exemption. So the tax applies broadly unless there is a specific carveout. She noted that this was the case before the growth of digital products. Jares explained that South Dakota simply fit those products into the proper categories in their system.

Jares shared that in her experience digital products are changing all the time and sometimes things seem more like tangibles and sometimes more like services. She noted that South Dakota has an exemption for advertising—provided that it is inserted into media. South Dakota treats the Internet as media for this purpose—so digital advertising is exempt. She also noted that South Dakota is different in that they have no corporate or personal income tax and that their broad tax, which includes business inputs, somewhat takes the place of

these other taxes. Finally, Jares noted South Dakota has been able to keep the sales tax rate lower because the base is so broad.

The next person to speak was Shelley Robinson (Utah). She noted that in the history of the Utah sales tax, there has been some broadening of the base, by including things into the term “tangible personal property.” Currently it includes electronic goods that take the place of tangible personal property. This has changed how they look at tangible property and the application to certain digital products. Utah taxes software and digital goods. But because Utah does not tax services, they do not tax digital products that are similar to services. Robinson noted that this does not necessarily tell Utah what to tax going forward. Finally, Robinson noted that Utah currently does not tax digital advertising. White noted that this differentiation between tangibles and services was something else they could capture in the matrix.

The next person to speak was Brad Heller (CDTFA). He agreed that California was properly characterized as a narrow-base state. He stated that California does not tax services unless associated with tangible personal property. Heller noted that, in his experience, bundling was a potential issue. He stated his opinion that it would be worse to use new taxes to capture digital products rather than the sales tax. He also expected that, because of the Internet Tax Freedom Act (ITFA), there might be a problem taxing some digital products unless the state also taxed other similar non-digital items. Heller would encourage the work group to address ITFA and include information on it in the white paper.

Heller noted that he was in the work group that developed the white paper on marketplace selling. He felt that there were some things about the broad approach described in that paper that were not addressed by the states—and maybe this is because the white paper did not take a position, so that the issues with the broad approach got missed. He therefore encouraged the MTC to clearly highlight critical issues that states will need to consider. White asked about the comment that digital products should be included in the sales tax rather than a separate tax, Heller reiterated that he was merely stating that a separate tax was not a good route if a state wants to expand its base. White noted that both the shareholder interviews and survey of the work group members the MTC had conducted came to that conclusion.

Josh Pens (Colorado) spoke next. Pens agreed that Colorado should be characterized as having a narrow base. Colorado does tax some specifically enumerated services, however. Like most states, Colorado has looked at whether certain digital products are really tangible personal property, and that in 2012, the legislature carved out software unless prepackaged, subject to a non-negotiable license agreement, and conveyed in a tangible medium. Pens explained that as software delivery methods have evolved, these requirements have effectively excluded most software. He also noted that in his experience at the local level, distinguishing between custom and packaged software or services and tangibles, generally, is difficult.

Tim Jennrich (Washington) spoke next. He, like others, thought the matrix was useful and captured important issues. He believed that this was good for states that are doing things differently—to see how their approach affects the taxation of digital products. Jennrich

agreed that Washington should be categorized as a broad state. He also noted that the broad approach is more adaptive to digital products since they are continually changing. He noted there are challenges to the broad approach, noting there is still a need for specific guidance and that exemptions will still need to be updated. However, he noted that the broad approach may not require continual updates to the law.

Jennrich also noted the history of Streamlined and the states' focus on digital products that are similar to tangible products. He noted that Washington did its own study about the tax base and this is what led to their 2009 legislation. Jennrich noted that the exemption for business inputs under this law was narrow and has caused some issues.

Jennrich addressed the principles document accompanying the matrix, noting that some of principles were incompatible with any broad approach. He proposed adding that a broad approach should be clear and administrable. He would like this to be included in any principles adopted, along with simplicity and revenue adequacy. Jennrich highlighted the importance of revenue adequacy, simplicity, and reliability.

Jennrich also noted the complexity created by bundling and product- or use-based exemptions. As for digital advertising, Jennrich stated that Washington exempts it, but that this does not necessarily answer the question of what is digital advertising. He also noted that this is the kind of issue that should be clearly addressed.

Brewer added that there is a lot to learn and that they have been continually adapting to the taxation of digital products. Brewer noted as an example that even with the broad approach, states will have to update exemptions continually. Brewer also mentioned that the effort to adapt to constant changes is something Langenberg has tried to reflect in his document. Brewer continued, saying that states are dealing with a tax that was previously limited to tangible personal property in the best ways they can. He noted that states should try to "do no harm," but that this is difficult based on the history.

Brewer also noted the importance of the business-to-business exemption—and especially the simplicity that a broad business-to-business exemption would provide. There is also the political side of things—which may be facilitated by a business-to-business exemption. Brewer noted that if the base expands first, without a business-to-business exemption, then the revenue may be hard to give up.

Brewer also noted that the idea of "similar" products can be complicated, stating that it makes sense but is hard to apply. He then noted that ITFA is looming over all of this and it has to be considered.

Nebergall provided additional compliments to the work on the matrix. He referred to Streamlined, noting that the definition of tangible personal property includes pre-written software and that the definition of specified digital products provides that states cannot include specified digital products as tangible personal property. Nebergall noted that mismatch between the state tax base and the local tax base can be a problem. Finally, he noted that Streamlined has a definition of a "bundled transaction," suggesting that Streamlined is a source of definitions and classifications.

Frieden also complimented the matrix in terms of capturing issues. He sees it as continuing to be a resource. He would still like to see a column on how states treat business-to-business sales and business inputs, suggesting this may provide detail on how these exemptions are structured. White responded that the plan is to update the spreadsheet and find a way to include this kind of information.

**VI. Adjourn –**

Brewer noted the next work group meeting would be November 2 and that meeting is still on, for now. He thanked the states that provided comments today and adjourned the meeting.