



MULTISTATE TAX COMMISSION

## MEETING NOTES

### MTC Work Group – Sales Taxation of Digital Products November 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. He noted, in particular, that state participants who speak do so from their own experience.

#### II. **Initial Public Comment –**

Gil invited any initial public comments. There were no initial public comments.

#### III. **Review of Notes from the October 5, 2023 meeting –**

Gil asked for if there were any changes to the notes of the October meeting. There were none.

#### IV. **Plans for the November 14, 2023 Uniformity Committee meeting.**

Nancy Prosser (MTC General Counsel) reported that there would be a panel at the upcoming in-person meeting of the Uniformity Committee where the Internet Tax Freedom Act (ITFA) would be discussed. She will moderate the panel in which Andrew Appleby, Assoc. Professor of Law, Stetson University College of Law; Joe Bishop-Henchman, Executive V.P., National Taxpayer's Union; Mark Nebergall, Senior Counsel, McDermott, Will & Emery; and Jonathan White (MTC Counsel) will participate. She noted that there had been a previous panel talking about the legislative history (a recording of which is available on the project page) and this upcoming panel would focus on the statute itself and how it might apply. There will also be opportunities for those attending to participate in the discussion.

#### V. **Upcoming work group meetings.**

Gil raised the question of how the group might use the work group's upcoming meetings, scheduled for December 7, 2023 (tentative), January 11, 2024 (note this is the second Thursday of the month), February 1, 2024 (and the first Thursday of each month thereafter). Anyone interested in what might be good topics of discussion can contact Gil or Nancy and there is also a chance the December 7th meeting may be cancelled if there is no pressing business.

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

Gil turned the discussion over to Jonathan to moderate input from state tax agency representatives about their experiences dealing with the taxation of digital products and how

this information might affect the development of the matrix which the MTC has developed. (This presentation follows a similar one that was held during the last meeting.)

The first presenter was Olufemi Obikoya (District of Columbia) speaking about his opinion as to the approach used by D.C. He noted that D.C. takes the “broad” approach to taxing digital products—in particular, digital advertising. He also acknowledged Ray Langenberg (Texas) and the principles he has suggested for how states might determine what digital products to include in the sales tax base. He noted that it will be hard for states to predict how digital products will develop in the future. This is apparent in the realm of advertising where different media has been used in different ways over time. The way in which business transactions evolve, through innovation, is good, but it may cause erosion of the traditional tax base. Another example is crypto currency, which tax agencies are having to catch up in dealing with. He also mentioned the money that is currently being paid for digital advertising, which is not widely taxed, but which is a legitimate tax base.

But the bigger issue Olufemi noted is that the evolution of products and services is going to keep happening and a broader tax base may be a better approach. He again mentioned the principles proposed by Ray and how they reflect this reality. And he noted that ITFA and the taxation of B2B transactions are important issues that states should be thinking about. But he noted that just because advertising might be considered a business input shouldn’t determine, by itself, whether it is included in the tax base. Another important issue he noted is the need for uniformity and the need for states to work together. But the bottom line is whether the narrow or broad approach to the tax base will work. The narrow approach is going to get smaller over time as products change. And states need to be able to depend on the revenue from their sales tax bases.

Jonathan asked if there were any other aspects of the D.C. tax law that has allowed it to evolve to include new products. Olufemi noted that in addition to the definitions of taxable products being broad, they have been applied to new products over time. He noted that while tangibles are presumed taxable, services are presumed not taxable, unless specifically included. This has had an effect on how these categories have been interpreted and applied. Olufemi also noted that as for B2B transactions or inputs, it should be up to the states to decide whether to grant that exemption—but that there may be better and more uniform approaches to dealing with those exemptions.

Ray Langenberg (Texas), was next (and he used slides for his comments—see those slides available on the project page). He wanted to share what he learned from comparing Texas’s specific taxing provisions to similar provisions of other states. He reminded the work group of the charge from the uniformity committee to consider how digital products may be “defined, categorized, exempted, and sourced.” He noted that the matrix that has been developed is helpful in terms of understanding the state tax bases and whether they are broad, medium, or narrow, but he thinks the group needs to dig deeper into the specific approaches states in each category have used. So he has made a list of criteria that he has observed that states have used for determining what is in the tax base. These criteria include the kind of input or output, who is buying or who is selling, and how is the item used, in addition to other criteria.

He focused first on data processing services, taxed by Texas. So, as for input/output criteria, the base includes services done on data, but also that the process must be computerized. In comparison to Washington’s definition of digitally automated services, Texas does not look to whether the service is something that might represent services predominantly performed by

people. He then noted that the various criteria can be used to either include or exclude items from the tax base.

He also noted the United Nations model convention. Under this convention, they also look to the services performed by people, but use a different threshold for how this criteria is used to categorize the item. This convention also shows how different criteria might be applied to the definition, inclusion, or exclusion of digital products. (And he mentioned similar work of the OECD defining digital products which might be worth considering.) But he also noted that states, like South Dakota, have simply avoided the use of various criteria as far as defining the tax base, by simply applying their tax very broadly.

He noted that this use of criteria in Texas's definition of data processing might be compared to the definitions Texas uses to tax other services. Under those definitions, it doesn't matter whether the service is performed using digital technology. In other cases, the tax might apply only to certain digital products. Ultimately, therefore, Ray believes that the broad/narrow comparison of tax bases is not complete—and the work group should also consider how different criteria can be used under any approach—broad, medium, or narrow. So he advised the work group to consider these different criteria, and others, and how useful they are to states, whether they want to include or exclude digital products or have a narrow or broad base.

Jonathan agreed that Ray's observations about the consideration of specific types of criteria would be useful.

Gil observed that Ray's comment about the inclusion of services, however they are performed, might also avoid potential ITFA problems.

## **VII. Adjourn**

Gil asked if there were any other comments. There were none and the meeting was adjourned.