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March 25, 2025

Ray Langenberg
Chair, MTC Digital Products Definitions Study Group

Re: Digital Products Business to Business Exclusion Proposal

Dear Mr. Langenberg

We commend the MTC Digital Products Definitions Study Group for including an exclusion for business-to-business (B2B) purchases in the initial proposed definition of digital products. We believe this exclusion is advisable both for: (1) conceptual reasons to conform any recommended definition to sound sales tax policy principles that avoid sales tax pyramiding¹ and (2) to allay business concerns that an expansion of the digital sales tax base to business-to-consumer purchases will also encompass B2B purchases.

Per your request for submissions relating to a workable B2B exclusion from the digital products sales tax base, we have included a proposal modeled on the current Iowa statute.² We understand from your recent comments that you are concerned that the Iowa digital products B2B exemption approach has two limitations: (1) the Iowa B2B exemption is tied to specific statutory and regulatory provisions unique to Iowa and (2) that the statute has no provision that requires the purchaser to inform the seller of the purchaser's exempt status and use.

We believe our proposal adequately modifies the Iowa B2B digital products exemption to make it adaptable for use in other states. We also think it can be used in connection with either a broad or narrow definition of taxable digital products. Of course, we are open to any edits or modifications, as long as they reinforce the goal of providing a broad digital product B2B exclusion.

In addition, as we were about to send the Study Group our proposed B2B exclusion, we received from Helen Hecht today Ray's revised "Proposed Model Digital Product Definition and Related Exemption". We are also supportive of the B2B exemption included in Ray's March 24, 2025 revised definitions.

¹ See K. Frieden & F. Nicely, "Digital-Business Input Exemptions: Lessons From Sales Tax History," Tax Notes State, January 29, 2024; available at: www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/frieden-and-nicely.-tns.-digital-business-input-exemptions.-lessons-from-sales-tax-history.pdf.

² See Iowa Code section 423.3(104), available at: www.legis.iowa.gov/docs/ico/section/423.3.pdf; and Rule ARC 4679C, available at: rules.iowa.gov/Notice/Details/4679C#:~:text=Iowa%20Code%20section%20423.3%20%28104%29%20exempts%20from%20sales,enterprise%20when%20used%20exclusively%20by%20the%20commercial%20enterprise.

The Proposed B2B Exclusion Provision:

The sale of a “[Insert digital products definition (DP)]” to a qualified business that is the exclusive user of the [DP], including sharing the use of the [DP] with other qualified business users, is not subject to the [insert state SUT definition]; provided, however, that this exclusion shall not apply to non-business use of a [DP] by a qualified business unless the non-business use is inconsequential.

“Inconsequential” is based on consideration of the [DP] value and the frequency of which it is used for a non-business purpose, which is based on the non-business use being so small as to make accounting for that use unreasonable and/or impractical.

Qualified Business” means all for profit [and non-profit] entities including sole proprietorships, partnerships, LLCs, corporations and other similar entities.”

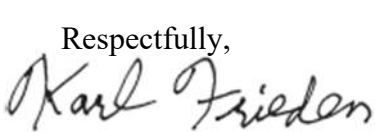
[Optional - The Department of Revenue will provide an “exclusion” certificate for the purchaser to provide to the seller indicating the purchaser is a “qualified business” and is claiming the “exclusion” for the purchase of the [DP]. The Department of Revenue may issue a regulation defining “inconsequential” and any other terms used in relation to the application of the [SUT] to [DP].

SSUTA Must Be Considered in Development of a Digital Product Definition

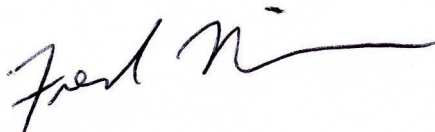
An additional issue with how a digital product is defined is the interplay with those states that have expanded their sales tax base to incorporate digital products. Specifically, the Streamlined Sales Tax (SSUTA) states, 23 of which are full member states, already have definitions for software, specified digital products (*i.e.*, “electronically transferred” products),³ and the ability for the SSUTA to tax other products (*e.g.*, Software as a Service)⁴ as a service. We believe any proposed definition should take the SSUTA methodology into consideration.

We appreciate your consideration of the above and we look forward to working with you and others on this Study Group.

Respectfully,



Karl A. Frieden



Fredrick J. Nicely

cc: COST Board of Directors
Patrick J. Reynolds, COST President & Executive Director

³ See Computer related definitions in Part II, of the SSUTA definitions. For “prewritten software,” a state is allowed to exclude prewritten software “delivered electronically” or by “load and leave.”

⁴ See Section 332 of the SSUTA.