

TTARA ANNUAL MEETING

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Taxation of Digital Products

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Where's ~~Waldo~~ Clarity?



- B2B
- Cryptocurrency
- Data processing
- Digital advertising
- Input/Output
- Internet Tax Freedom Act
- Marketplace Facilitators
- Multistate approach?
- P.L. 86-272
- Sourcing
- Tangible Personal Property
- Texas Rangers



Lawyerly Caveats

This outline is designed to present a summary of selected issues and interpretations and to provide a springboard for discussion. Some statements (maybe even some entire pages) do not reflect agreed views of the panel or of taxing authorities. After all, if taxpayers and taxing authorities always agreed with one another, there would be no need for litigation or interpretive rules, and the tax world would be far less interesting.

This outline does not constitute legal advice.

Agenda*

- Tax Base & Definitions
- Sourcing
- Prospects for the Future

** With an emphasis on Texas law and Streamlined Sales Tax*

The Digital Products Tax Base – Texas

- Computer programs are TPP
- Data processing service
- Information service
- Cable television service
- Amusement service
- Certain services on computer programs

Tangible Personal Property – Texas

Tex. Tax Code § 151.009. "Tangible personal property" means personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner, and, for the purposes of this chapter, the term includes a computer program and a telephone prepaid calling card.

Data Processing Service – Texas

Tex. Tax Code § 151.0035.

(a) "Data processing service" includes:

(1) word processing, data entry, data retrieval, data search, information compilation, payroll and business accounting data production, and other computerized data and information storage or manipulation; ...

Data Processing Service & The Legislature

The Texas legislature has considered several data processing-related bills in last few legislative sessions, including Senate Bill 153 enacted in 2021.

“Data processing service” does not include certain payment services, including those generally described below:

- services exclusively to encrypt certain electronic payment information for acceptance onto certain payment card networks
- settling of an electronic payment transaction by certain payment processors and other specified entities

Amusement & Cable TV Services – Texas

Tex. Tax Code § 151.0028. (a) "Amusement services" means the provision of amusement, entertainment, or recreation, but does not include the provision of educational or health services if prescribed by a licensed practitioner of the healing arts for the primary purpose of education or health maintenance or improvement.

Tex. Tax Code § 151.0033. "Cable television service" means the distribution of video programming with or without use of wires to subscribing or paying customers.

Information Service – Texas

Tex. Tax Code § 151.0038.

(a) "Information service" means:

- (1) furnishing general or specialized news or other current information, including financial information, unless furnished to: (A) a newspaper or to a radio or television station ... or (B) a member of a homeowners association...; or
- (2) electronic data retrieval or research.

Services on Computer Programs – Texas

Tex. Tax Code § 151.0101.

(a) "Taxable services" means: ...

(5) the repair, remodeling, maintenance, and restoration of tangible personal property, except: ...

(D) the repair, maintenance, creation, and restoration of a computer program, including its development and modification, not sold by the person performing the repair, maintenance, creation, or restoration service; ...

The Digital Products Tax Base – SSUTA*

- Prewritten Computer software is TPP.
- Products transferred electronically are not TPP.
- States can elect to tax defined “specified digital products.”
- States are free to tax products or services that are outside the definitions of “specified digital products.”

** Streamlined Sales & Use Tax Agreement*

Tangible Personal Property – SSUTA

Library of Definitions:

“Tangible personal property” means personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses.

“Tangible personal property” includes electricity, water, gas, steam, and prewritten computer software.

Digital Goods: Developing Definitions

Incrementalist Approach – SSUTA

- Existing state definitions
- Federal definitions
- Industry standard definitions
- Business community experts

Current Definitions for Digital Goods – SSUTA

Definitions: Not included in “ancillary services,” “computer software,” “telecommunications services,” or “tangible personal property”

Specific Digital Products:

Digital Audio-Visual Works

Digital Audio Works

Digital Books

Digital Codes

Other Products Transferred Electronically:

“If a state imposes a sales or use tax on products “transferred electronically” separately from its imposition of tax on “tangible personal property”, that state will not be required to use” any specific Streamlined digital products definition.

Specific Criteria for Digital Goods – SSUTA

End Users:

Only imposed on “end users” unless the statute specifically imposes and separately enumerates the tax on someone who is not an end user

Permanent or less than permanent use:

Only on permanent use unless statute specifically imposes and separately enumerates on less than permanent use

Continued payments:

Only on sales that are not conditioned on continued payment unless statute specifically imposes and separately enumerates on sales conditioned on continued payments

Specific Criteria for Digital Goods – SSUTA (cont'd)

Digital codes:

Same treatment of product to which code relates

Code can be obtained by any means (i.e., email, tangible form (song code))

Other products transferred electronically:

Products outside “specified digital goods”

“Additional digital goods” – as defined by state

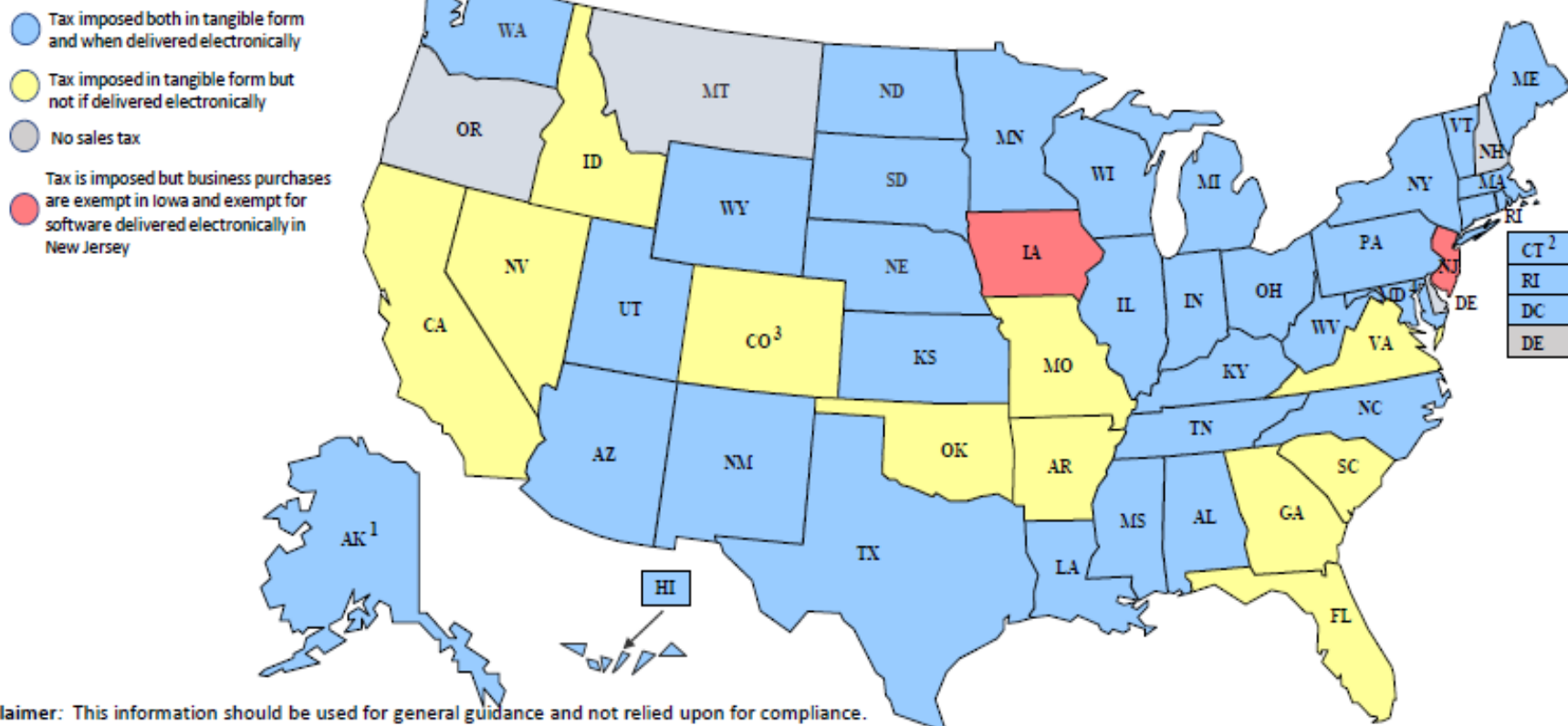
(a) “Additional digital goods” means all of the following, if they are transferred electronically:

1. Greeting cards.
2. Finished artwork.
3. Periodicals.
4. Video or electronic games.
5. Newspapers or other news or information products.

(b) For purposes of this subchapter, the sale, license, lease, or rental of or the storage, use, or other consumption of a digital code is treated the same as the sale, license, lease, or rental of or the storage, use, or other consumption of any additional digital goods for which the digital code relates.

Subscription to products: Can treat differently than products with no subscription.

Prewritten Software (Including Electronic Delivery)



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation (COST)

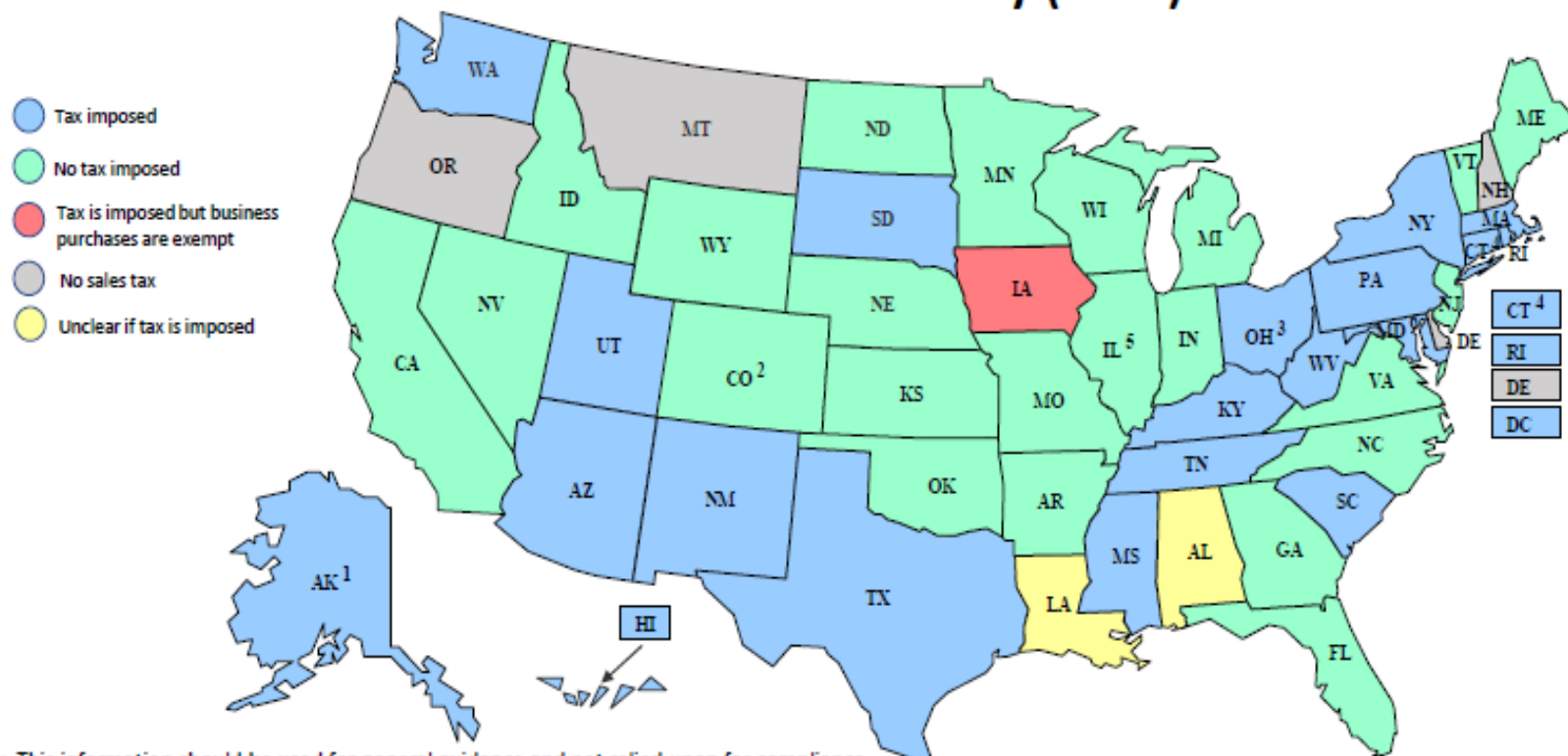
¹ Data is based on local municipalities since Alaska does not have a state-wide sales tax

² Software delivered electronically is taxed at a 1% rate for businesses

³ Tax may be imposed by some localities on electronic delivery

⁴ Maryland has a limited exemption for enterprise software.

Software Accessed Remotely (SaaS)



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation (COST)

¹Data is based on local municipalities since Alaska does not have a state-wide sales tax

²Tax may be imposed by some localities

³Tax only applies to businesses

⁴Electronically accessed software is taxed at a 1% rate for businesses

⁵Taxed in Chicago

⁶Maryland has a limited exemption for enterprise software

Digital Information Services

The map displays the following states categorized by color:

- Blue (Tax imposed):** WA, OR, MT, ND, MN, WI, MI, NY, PA, OH, WV, VA, NC, SC, GA, FL, TX⁴, NM, AZ, HI, AK¹.
- Green (No tax imposed):** ID, WY, UT, CO², KS, MO, IL⁵, IN, KY, TN, MS, AL, LA.
- Red (Tax is imposed but business purchases are exempt):** IA.
- Grey (No sales tax):** DE, CT³, RI, VT, NH, MA, CT³, RI, DE, DC.

Legend:

- Tax imposed
- No tax imposed
- Tax is imposed but business purchases are exempt
- No sales tax

Disclaimer: This information should be used for general guidance and not relied upon for compliance.
Source: Council On State Taxation (COST)

¹Data is based on local municipalities since Alaska does not have a state-wide sales tax
²Localities may impose tax
³Taxed at a reduced rate of 1%
⁴Tax imposed at 80% the standard rate
⁵Taxed in Chicago
⁶Maryland exempts some types of digital information services

Source: Council On State Taxation (COST)

¹Data is based on local municipalities since Alaska does not have a state-wide sales tax

²Localities may impose tax

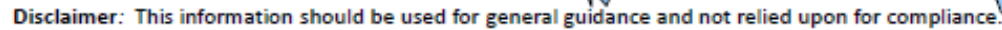
³ Taxed at a reduced rate of 1%

⁴Tax imposed at 80% the standard rate

⁵Taxed in Chicago

⁶ Maryland exempts some types of digital information services

Audio, video, and books



¹ Data is based on local municipalities since Alaska does not have a state-wide sales tax

² Some products may be picked up by the tax on general services

³Taxed under communications services tax

⁴Tax not based on clear statutory authority

⁵Taxed in Chicago

The Future of Digital Goods – SSUTA

- SST currently has a State and Local Advisory Council workgroup in response to a request from the Business Advisory Council to expand the use of the “digital codes” look-through rule beyond specified digital goods.
- The MTC whitepaper represents a unique opportunity for Streamlined to participate and share its experience in this area and to work with the larger tax community in promoting continued sound tax policy development. For example...
 - Contributing material on Streamlined’s digital products framework for consideration as part of the MTC whitepaper
 - Exploring opportunities to develop additional voluntary definitions consistent with the Streamlined incrementalist approach
- Benefits
 - Time-tested digital products framework
 - Compliments the broader imposition approach discussed at the MTC, providing state policy makers more option to make informed decisions
 - Streamlined participation entails collaboration with additional state administrators, legislators, and members of the business community

Sourcing – Texas

Results can vary:

- Sale of TPP (computer programs) in Texas.
 - “transfer of title or possession of tangible personal property.” Tex. Tax Code § 151.005.
- Use of TPP (computer programs) in Texas.
 - “the exercise of a right or power incidental to the ownership of tangible personal property over tangible personal property.” Tex. Tax Code § 151.011.
- Sale of taxable digital services in Texas.
 - “the performance of a taxable service” in Texas. Tex. Tax Code § 151.005.
- Use of taxable digital services in Texas.
 - “the derivation in this state of direct or indirect benefit from the service.” Tex. Tax Code § 151.011(b).

Sourcing Sales Tax on TPP – Texas

- “transfer of title or possession of tangible personal property” Tex. Tax Code § 151.005.
- Downloaded software – Where does the sale occur?

Letter Ruling 9802118L (1998):

“In reviewing this issue, we realized that because a web page can be moved from one server to another anywhere in the world by a thirteen year old child in a matter of a few minutes, it is questionable whether a tax situs should be determined based on the location of the server. Consequently, last November the policy decision was made to disregard the location of the server as determining the tax situs of a transaction...”

Sourcing Sales Tax on TPP

Multiple Points of Use – Texas

- Verizon Business Network Services, Inc., v. Combs, No. 07-11-0025-CV, 2013 WL 1343530 (Tex. App.—Amarillo 2013, pet. dism'd).
 - Verizon contracted with vendors to periodically provide “feature enhancements” for the software used by Verizon switches located throughout the nation.
 - The vendors first shipped the feature enhancement software to the Verizon “testbed” in Texas, where Verizon tested the software offline before installation.
 - After testing, the vendors installed copies of the feature enhancements in Verizon switches nationwide.
 - Verizon paid a lump sum for the feature enhancements.

Sourcing Sales Tax on TPP

Multiple Points of Use – Texas (cont'd)

- Verizon Business Network Services, Inc., v. Combs, No. 07-11-0025-CV, 2013 WL 1343530 (Tex. App.—Amarillo 2013, pet. dism'd).
 - Subject to Texas sales tax because Verizon purchased and used (tested) the software in Texas.
 - Furthermore, the statutes did not allow for the apportionment of the tax, and the exclusion for property transported outside the state only applied to property used “solely” outside the state. See Tex. Tax Code § 151.011(f)(1).
 - Fair or not, Verizon had to pay Texas tax on the entire purchase price of software that was ultimately installed on switches throughout the country.

Sourcing Use Tax on TPP

Multiple Points of Use – Texas

- “the exercise of a right or power incidental to the ownership of tangible personal property over tangible personal property.” Tex. Tax Code § 151.011.

Hearing No. 44,040 (2005):

“In light of the relevant statutes and Comptroller precedent, it is concluded that use in Texas may occur even though no physical media has entered into the state.”

Use Tax Credit

Multiple Points of Use – Texas

- No MPU statutory authority for sale or use of TPP.
- Use tax credit for tax paid in another state:
 - (c) A taxpayer is entitled to a credit against the use tax imposed by Subchapter D of this chapter on a taxable item in an amount equal to the amount of any similar tax paid by the taxpayer in another state on the sale, purchase, or use of the taxable item if the state in which the tax was paid provides a similar credit for a taxpayer of this state.
- But no sales tax credit for tax paid in another state.

Sourcing Sales Tax on Services

Multiple Points of Use – Texas

- “the performance of a taxable service” in Texas. Tex. Tax Code § 151.005.
- Exemptions in Tex. Tax Code § 151.330:
 - (e) Services performed for use outside this state are exempt from the tax imposed by Subchapter C of this chapter [sales tax].
 - (f) Services performed for use both within and outside this state are exempt to the extent the services are for use outside this state and made taxable on or after September 1, 1987.

Sourcing Use Tax on Services – Texas

Comptroller Rule 3.330(f) Service benefit location--multi-state customer. ...

(2) If that part of the business is conducted at locations both within and outside the state, the service is not taxable to the extent it is used outside Texas. A multi-state customer may use any reasonable method for allocation which is supported by business records.

(3) A multi-state customer purchasing data processing services for the benefit of both in-state and out-of-state locations is responsible for issuing to the data processing service provider an exemption certificate asserting a multi-state benefit, and for reporting and paying the tax on that portion of the data processing charge which will benefit the Texas location...

Taxpayer Advocate Interlude

State taxation of digital goods is complex, and how and whether sales tax statutes apply to them in many states is often open to debate and interpretation. Taxing authority guidance on such issues can be helpful, including to understand the authority's positions, but may not reflect what the law actually requires.

- *Sirius XM Radio, Inc. v. Hegar*, 643 S.W.3d 402 (Tex. 2022) (rejecting Comptroller “receipt-producing, end-product act” test for sourcing receipts for franchise tax purposes and noting the Comptroller’s application of “the test is not consistent with the statute”).
- *Combs v. Rourk Amusement & Vending, L.P.*, 422 S.W.3d 632 (Tex. 2013) (rejecting Comptroller disallowance of resale exemption and noting “the Comptroller cannot through rulemaking impose taxes that are not due under the Tax Code; the question of statutory construction ... ultimately is one left to the courts.”).

Uniform Sourcing – SSUTA

Section 309: APPLICATION OF GENERAL SOURCING RULES AND EXCLUSIONS FROM THE RULES

A. Each member state shall agree to require sellers to source the retail sale of a product in accordance with Section 310 or Section 310.1. Except as provided in Section 310.1, the provisions of Section 310 apply to all sales regardless of the characterization of a product as tangible personal property, a digital good, or a service. Except as otherwise provided in this Agreement, the provisions of Section 310 and Section 310.1 only apply to determine a seller's obligation to pay or collect and remit a sales or use tax with respect to the seller's retail sale of a product. These provisions do not affect the obligation of a purchaser or lessee to remit tax on the use of the product to the taxing jurisdictions of that use.

Cascading Sourcing – SSUTA

Section 310: GENERAL SOURCING RULES

A. Except as provided in Section 310.1, the retail sale, excluding lease or rental, of a product shall be sourced as follows:

1. When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

2. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.

Cascading Sourcing – SSUTA (cont'd)

3. When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.

4. When subsections (A)(1), (A)(2), and (A)(3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.

Cascading Sourcing – SSUTA (cont'd)

5. When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A)(4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

Pending Sourcing Issue – SSUTA

- Current project on sourcing of sales when the seller does not need a complete street address from the customer to transfer or deliver the product (such as a digital goods transaction with electronic delivery/access to the product) and has only a 5-digit zip code from the customer (if that).
- <https://www.streamlinedsalestax.org/committees/state-and-local-advisory-council/slac---workgroups>
- Business Advisory Committee (BAC) and State and Local advisory Committee (SLAC) continue to discuss possible ways forward.

Multiple Points of Use – Repealed – SSUTA

Section 312 of the SSUTA – Repealed December 2006

Notwithstanding the provisions of Section 310, a business purchaser that is not a holder of a direct pay permit that knows at the time of its purchase of a **digital good, computer software, or a service** that the digital good, computer software, or service will be **concurrently available for use in more than one jurisdiction** shall deliver to the seller in conjunction with its purchase an exemption certificate claiming multiple points of use...

Upon receipt of an exemption certificate claiming multiple points of use, **the seller is relieved of all obligation to collect**, pay, or remit the applicable tax and the **purchaser shall be obligated to collect, pay, or remit** the applicable tax on a direct pay basis...

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 and records** as they exist at the time the transaction is reported for sales or use tax purposes...

Multiple Points of Use – Repealed – SSUTA (cont'd)

Section 312 of the SSUTA – Repealed December 2006

- Developed and adopted as a compromise
- At time of repeal – various specific rules adopted:
 - Rule 309.2 – Sourcing Prewritten Computer Software
 - Rule 309.3 – Sourcing Computer-Related Services
 - Rule 309.4 – Sourcing Computer Software Maintenance Contracts
 - Rule 309.5 – Sourcing Software Term License Subscriptions



MTC Digital Products Project Scope

The MTC Uniformity Committee requested a whitepaper with this information:

1. A general survey and description of the kinds of digital products currently offered in the marketplace and the nature of the transactions through which those digital products may be provided to customers;
2. A general survey of academic research or other analysis on policy reasons for including digital products in (or excluding them from) the sales tax base;
3. A review and summary of general information on the specific types of digital products that states currently tax (which information is available from different sources, including Streamlined);
4. Analysis of the extent to which mixed or bundled products (including nondigital services and intangibles) may create issues for taxing digital products;
5. A summary of sourcing issues and common approaches to sourcing digital products, including multiple points of use; and
6. Analysis of the ways that digital products might be defined, categorized, exempted, and sourced.

What We Have Studied So Far - 1

1. Definitions for digital products.
2. Identification of what items exist in the marketplace, including a presentation by SST certified service provider Avalara representatives.
3. Presentation by Streamlined representatives (watch via the MTC project page).
4. Survey of state treatment of digital products (website has spreadsheet and details)
 - Jurisdictions have a variety of digital product tax bases – broad to narrow and in-between.
 - At a macro-level, no clear patterns in taxation approaches across the states.
 - Cloud product characterizations vary wildly; same item can be TPP or service depending on the jurisdiction's definition and things like prior case interpretations.
 - Characterizations impact sourcing, exemptions, ITFA analysis, and other outcomes.



What We Have Studied So Far - 2

5. Panel discussion on digital products and business inputs at July 2023 Uniformity Committee meeting (watch via the MTC project page). Staff is working on a summary of information presented and otherwise compiled about state experiences with different approaches and policy considerations relating to taxing / exempting business inputs.
6. Developing a matrix with “three approaches” to taxing digital products used by the states today and possible guiding principles for policy makers.
7. Internet Tax Freedom Act – presentation on what states and taxpayers need to know about definitions and the anti-discrimination provision at the Nov. 14, 2023 Uniformity Committee (taped and will be posted to the website).

MTC slides courtesy of Nancy Prosser, MTC General Counsel, nprosser@mtc.gov

Prospects for the Future

- Texas & Other States & Federal?
- Streamlined Sales and Use Tax
- Taxing Authorities?
- Legislatures?
- Taxpayers

QUESTIONS or INSIGHTS?

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