TEXAS TAXPAYERS
TTARA
AND RESEARCH ASSOCIATION

October 12, 2024

Ms. Jenny Burleson
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Texas Comptroller of Public Accounts
P. O. Box 13528
Austin, Texas 78711

Via email: jennifer.burleson@cpa.texas.gov
cc: tp.rule.comments@cpa.texas.gov

Re: Comments to proposed rule §3.330.

Dear Ms. Burleson:

On behalf of the Texas Taxpayers and Research Association (TTARA), I submit the following comments to the draft administrative rule 3.330 published in the *Texas Register* on September 13, 2024. TTARA is grateful for the opportunity to submit comments regarding the draft rules.

Pursuant to Tex. Gov't Code § 2001.029(b), TTARA, a membership association with over 200 members, requests a public hearing on the proposed rule. Applying sales and use tax to data processing services is an issue of great importance for TTARA and its members. Draft Rule 3.330 presents several issues that we believe would lead to a prolonged period of controversy between the Comptroller's office and taxpayers.

Our comments on the draft rule are as follows:

1. **Proposed subsection (a)(1)(C) should not be adopted because it wrongly rejects the essence of the transaction test for determining whether a service is a data processing service.**

The definition of "data processing service" in current Rule 3.330(a)(1) provides: "Data processing does not include the use of a computer by a provider of other services when the computer is used to *facilitate the performance of the [other] service*… (emphasis added)." This provision reflects the essence of the transaction test approved in 1977 by the Texas Supreme Court in *Bullock v. Statistical Tabulating Corp.*, 549 S.W.2d 166 (Tex. 1977).

The draft rule would delete the current (a)(1) and adopt a new test in (a)(1)(C) for determining whether a service is a taxable data processing service. The Comptroller lacks authority to promulgate the new test in (a)(1)(C) because the new test would conflict with the essence of the transaction test under *Bullock, supra*.

a. The Comptroller asserts in the preamble and in new (a)(1)(C) that the new test is promulgated under the agency's "exclusive jurisdiction to interpret taxable services." This exclusive jurisdiction to interpret "taxable services," including "data processing services," does not permit the Comptroller to interpret the terms in a manner contrary to the Tax Code. *Hegar v. CheckFree Servs. Corp*., No. 14-15-00027-CV, 2016 WL 1576414, at *2 (Tex. App.—Houston [14th Dist.] Apr. 19, 2016, no pet.). The Comptroller's interpretation must be consistent with the Tax Code, and the Tax Code offers no support for the proposition that using a computer to perform an otherwise nontaxable service transforms the nontaxable service into a taxable data processing service. The Comptroller does not have the authority to expand the scope of data processing as this draft rule purports to do.

Moreover, while the Comptroller is the only agency in the executive branch vested by the legislature with authority to adopt rules to enforce the Tax Code, those rules may not "conflict with the laws of this state." Tax Code § 111.002(a). The pronouncements of the judicial branch are laws of this state. Under constitutional principles, the legislature does not have the power to preclude the judicial branch from interpreting a statute. Therefore, the Comptroller's jurisdiction to interpret the definition of "taxable services" is not exclusive of the courts, and neither Rule 3.330 nor any other rule of the Comptroller may conflict with the decisions of the judicial branch, including *Bullock, supra.*

b. According to the preamble, the new test in (a)(1)(C) would provide that "data processing will not be taxable if it is sold for a single charge with another service, the data processing service does not have a separate value, and the data processing service is ancillary to the other service." The preamble expressly rejects the nearly half-century-old essence of the transaction test with respect to sales that include taxable data processing services. Presumably, the legislature was aware of the essence of the transaction test when it adopted the tax on data processing services in 1987. Although the legislature could exclude data processing services from the essence of the transaction test, it did not do so in 1987 and has not done so since then. The Comptroller does not have the authority to reject the essence of the transaction test in the absence of a legislative mandate.

c. The preamble states that because "[t]he essence of the transaction test attempts to determine what the buyer ultimately wants," and "[t]he buyer will never want the manipulation of data for its own sake," the essence of the transaction test "is not the appropriate test for data processing." In fact, the Comptroller is wrong that a buyer will never want the manipulation of data for its own sake. One of the original purposes and uses of the Internet was to network computers around the world so that one scientist could utilize the processing capacity of multiple computers at one time and process large amounts of data faster than the scientist's own computer could process the data. Scientists used to (and perhaps still do) reserve time on a distant server for the purpose of processing a data set, often overnight. Cloud computing serves a similar function today,

allowing a scientist or other user to purchase the processing capacity or storage capacity of other, larger computers for the sole purpose of processing or storing large amounts of data. The assertion that a buyer will never want the manipulation of data for its own sake is factually inaccurate and cannot be the basis for rejecting the essence of the transaction test.

d. The preamble cites Hellerstein & Hellerstein's *State Taxation* for the proposition that "the primary purpose test is 'folly.'" However, that treatise makes such a claim only in the context of distinguishing between sales of tangible personal property and sales of services or intangibles. It makes no such statement in the context of distinguishing between taxable and nontaxable services. Moreover, the Hellerstein treatise is not the law in Texas. The law in Texas is the essence of the transaction test under *Bullock, supra,* and its progeny.

e. Even if the Comptroller had the authority to adopt the new "ancillary" requirement in (a)(1)(C), the requirement incorporates a separate factor having no legal support. According to the preamble:

> The repetitive or routine manipulation of data by the seller is a factor suggesting that the activity is not ancillary and should be taxable as a data processing service, while the manipulation of data that depends on the external knowledge and discretionary judgment of the service provider suggests that the activity is ancillary and should not be taxable as a data processing service.

The new "repetitive or routine manipulation of data" test is made from whole cloth. It is not present in the Tax Code, has no support in any case decided by the Texas courts, and does not flow from the *Black, Mann & Graham* case cited in the preamble. Under this new test, "data processing services," which inherently result from the "repetitive or routine manipulation of data," could never be "ancillary" to a nontaxable service.

f. The repeal of current subsection (a)(1) and the adoption of proposed subsection (a)(1)(C) would change longstanding Comptroller policy without support in law. Current Rule 3.330(a)(1) excludes the "use of a computer by a provider of other services when the computer is used to *facilitate the performance of the service* (emphasis added)" from the definition of data processing services. This exclusion reflects the essence of the transaction test and is the longstanding policy of the agency. The Comptroller adopted the exclusion in 1988 as part of the original Rule 3.330. *See* 13 Tex. Reg. 2753 (eff. June 16, 1988), *adopting* 13 Tex. Reg. 1179. The repeal of the exclusion in (a)(1) in favor of the new "ancillary," "separate value," and "repetitive or routine manipulation of data" tests in (a)(1)(C) would supplant the exclusion in current (a)(1). This change in longstanding Comptroller policy is not supported by any action of the legislature or decision of Texas courts.

g. Focusing on the "ancillary" test rather than the "essence of the transaction" may sometimes violate the Internet Tax Freedom Act ("ITFA").

One component of ITFA is that it prevents multiple or discriminatory taxes on electronic commerce. ITFA defines a discriminatory tax as a tax "not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means." The ancillary test may ultimately tax services with non-digital analogs that are not taxed in Texas because it focuses on how the service is performed rather than the nature of the service itself.

h. The preamble improperly relies on *Rylander v. San Antonio SMSA Ltd. P'ship.*, 11 S.W.3d 484 (Tex. App.--Austin 2000, no pet.), in support of the separate value test in (a)(1)(C). According to the preamble, "the [*San Antonio SMSA*] opinion uses the "separate value" concept in evaluating whether services could be segregated for taxation purposes." While it is true that the *San Antonio SMSA* court narrowly applied the separate value test to the transactions at issue there, the holding of *San Antonio SMSA* is inapposite to what the proposed rule attempts to do via (a)(1)(C).

The court in *San Antonio SMSA* only applied the separate value test *after* reviewing the underlying transactions and determining that the longstanding essence of the transaction test did not apply. *San Antonio SMSA*, 11 S.W.3d at 487-488. In contrast, proposed subparagraph (a)(1)(C) would apply the separate value test *in lieu of* the essence of the transaction test anytime data processing services and other services are sold for a single charge. This substitution of the separate value test for the essence of the transaction test finds no support in any case decided by the Texas courts and does not flow from the *San Antonio SMSA* case cited in the preamble. Such an interpretation of *San Antonio SMSA* is also inconsistent with Comptroller guidance and decisions, which cite *San Antonio SMSA* as standing for the proposition that the essence of the transaction test applies to the bundled sale of a nontaxable service and a taxable item. *See e.g.,* Comptroller's Decision No. 118,163 (2024).

Moreover, by relying on *San Antonio SMSA* to broadly apply the separate value test to all sales of services that include data processing services under proposed (a)(1)(C), the Comptroller ignores key aspects of the *San Antonio SMSA* case that led to the application of the separate value test. In *San Antonio SMSA,* the taxpayers purchased services and property at **two separate times** as part of **two separate transactions**. The seller also separately stated the charges for the services and property to the taxpayer; however, the charges for the two transactions were later included on a single invoice as a byproduct of the seller's integrated invoicing system. *San Antonio SMSA*, 11 S.W.3d at 486 ("The taxpayers first purchased line-engineering services from AT&T's engineering

divisions in Chicago and St. Louis. After this assessment was done, they purchased new equipment from the manufacturing division of AT&T in Columbus, Ohio."). On the facts of the case the taxpayers had separate prices for the components of the bundle. However, the Comptroller argued that because the two transactions were comingled on a single invoice, the nontaxable services were "part of the sale" of the equipment and were subject to sales tax. *Id.* at 486. Upon review, the court disagreed and dismissed the Comptroller's single invoice theory. Because the "transaction" at issue was actually comprised of two separate transactions that occurred at different times, it was clear that the taxpayers sought both the provision of services and receipt of tangible personal property. *Id.* at 488. On these facts, the court explained "it cannot be said that there is but one "essence" to this transaction." *Id.* Accordingly, the court applied the separate value test. *Id.*

Proposed (a)(1)(C) essentially assumes that data processing services have a separate value from other services so frequently that a *presumption* of taxability is warranted when data processing and other services are sold together. While it is possible for data processing services and other services sold for a single charge to have separate values in some instances, we believe a presumption, if any, should go the other way. In today's economy, the use of a computer is, most often, the means of performing a different service or function altogether, and the data storage and manipulation that occurs is simply implicit to the use of a computer to perform the service or function. Yet, as proposed, (a)(1)(C) would permit the Comptroller to skip undertaking this critical "essence" analysis and would instead apply the separate value test at the outset as a presumption. Such an application of the separate value test is not supported by *San Antonio SMSA* or any other authority. Further, because the essence of the transaction test applies in all other instances in which nontaxable services are sold with taxable services or products for a single charge, by automatically applying the separate value test to sales involving data processing services, proposed (a)(1)(C) also frustrates the legislature's decision to tax only specifically enumerated services.

Given that the seller in *San Antonio SMSA* separately stated the charges for the services and property sold to each taxpayer, it is disingenuous for the Comptroller to rely on that case to propose automatic application of the separate value test to transactions where the components of a bundle are sold for a single charge simply because the sale includes data processing. Given the fact patterns prevailing in today's economy, the Comptroller's proposal to put the burden on taxpayers to "demonstrate that the data processing service does not have a separate value and is ancillary to the other service" is also perplexing.

For example, in marketplace transactions, the price for taxable and nontaxable components of the marketplace service is a commission based on the price the seller in the marketplace charges its customer. Marketplaces, thus, do not set any price for any component of the service they provide; the seller in the marketplace does. There is no

"separate value" for any service within the marketplace service. The services of storing product listings and photographs, maintaining records of transactions, and compiling data analytics are inseparable from other non-data processing components of marketplace services like seller support, seller training, in-marketplace promotions/coupons, dynamic pricing, prioritization in search results, in-marketplace customer support for their own buyers, and access to warehousing, packing, shipping, and other logistical services. All of these are only meaningful to sellers who list products on the marketplace. To the extent that these services are included and billed as a single charge, the seller is paying for far more than just data storage and manipulation. When services are bundled together inseparably—as marketplace services—and are sold for a single charge, the essence of the transaction test should make the entire amount nontaxable.

2. **Proposed subsection (a)(1)(C) should be rephrased to clarify that the taxpayer's burden is only to rebut the Comptroller's prima facie case that a service is a taxable data processing service.**

While all items of tangible personal property are taxable items under Chapter 151 of the Tax Code, a service is a taxable item only if it is among the services enumerated in Section 151.0101 and defined in Sections 151.0025 et seq. See Tax Code § 151.009. Thus, while all items of tangible personal property are presumed to be taxable items, the Comptroller must make a prima facie case showing that a service is a taxable service.

Proposed subsection (a)(1)(C) creates an exclusion from the definition of data processing service and then purports to burden the taxpayer with proving that a service falls within the exclusion. This could be interpreted to shift the Comptroller's prima facie burden to the taxpayer.

Proposed subsection (a)(1)(C) should be rephrased to state that if the Comptroller makes a prima facie showing that a service is a taxable data processing service because it is not ancillary to the other service and has a separate value, then the taxpayer has the burden to prove that the data processing is ancillary and has no separate value.

3. **Proposed subsection (a)(1)(C)(iii) should be revised to clarify that the phrase "commonly provided" is to be applied in the context of the seller's industry.**

In determining whether a data processing service has a "separate value," proposed (a)(1)(C)(iii) provides that the Comptroller is to consider "… whether each service is of a type that is commonly provided on a stand-alone basis or commonly provided as an additional service for a greater single charge."

Because industry-specific practices and procedures often dictate whether a service is "commonly" provided on a stand-alone basis, additional language should be added to proposed (a)(1)(C)(iii) to clarify that the phrase "commonly provided" is to be applied within the seller's industry.

4. **Proposed subsection (b)(5) should not be adopted because it wrongly rejects the essence of the transaction test for services of marketplace providers.**

The proposed rule would add a new subsection (b)(5) classifying marketplace provider services as taxable data processing services without applying the essence of the transaction test. In doing so, new subsection (b)(5) would wrongly convert many charges for services akin to a nontaxable auctioneer or broker service into a taxable data processing service.

As provided in Tax Code § 151.0242(a)(2), a marketplace provider "owns or operates a marketplace and directly or indirectly processes sales or payments for marketplace sellers." A marketplace provider's defining activities are operating a marketplace and processing sales or payments. Thus, the essence of the transaction between a marketplace provider and a marketplace seller, by statute, is the operation of a marketplace and the processing of sales or payments.

While marketplace providers perform some services that may fall within the definition of data processing if offered on a stand-alone basis, those services are performed in conjunction with other nontaxable, unrelated services that represent the essence of the transaction, namely the operation of a marketplace and the processing of sales or payments. Accordingly, the data processing services provided by marketplace providers to their marketplace sellers generally are not taxable under the essence of the transaction test and the exclusion in current (a)(1) for the "use of a computer by a provider of other services when the computer is used to facilitate the performance of the service."

The pricing scheme of marketplace providers demonstrates that data processing is not the essence of the transaction. Marketplace providers typically charge their marketplace sellers a commission that is a percentage of the selling price of an item sold in the marketplace. The prices charged by the marketplace providers do not vary or depend in any way on the amount of data processing required to facilitate a sale or payment.

Marketplace providers sometimes provide services on a stand-alone basis for a separate charge that may qualify as taxable data processing services, such as referral fees and professional seller subscription fees. The proposed rule should distinguish between taxable services such as these and nontaxable marketplace provider services.

5. **Subsection (a)(4) of the proposed rule should clarify that the exclusion of charges by marketplace providers from the definition of "settling of an electronic payment transaction" does not mean the charges are taxable data processing services.**

Section 151.0035(c) of the Tax Code excludes charges by a marketplace provider from the definition of "settling of an electronic payment transaction." Subsection (b)(3) excludes the settling of an electronic payment transaction by certain persons from the definition of "data processing service." However, these two exclusions do not constitute the inclusion of charges by a marketplace provider for settling transactions in the definition of data processing service in

Section 151.0035(a). Nor do the exclusions transform those charges into taxable data processing services absent further analysis.

Charges by a marketplace provider for settling transactions must be evaluated to determine whether they are data processing services and, if so, whether they are taxable data processing services under the essence of the transaction test.

Instead of merely reiterating the text of Tax Code § 151.0035(c)(3), proposed subsection (a)(4) should outline the proper analysis for determining the taxability of charges by a marketplace provider for settling transactions.

6. **Proposed subsection (b)(12) should define the terms "search engine optimization," "social media marketing," and "lead generation" and consider the nature of the services when determining taxability.**

In proposed subsection (b)(12) the Comptroller would deem "search engine optimization," "social media marketing," and "lead generation" to be taxable data processing services when data storage, manipulation, entry, or compilation is involved, without defining those terms, considering what is involved in the services, or considering the exclusion for online advertising in Tax Code § 151.0035(d).

a. Proposed Rule 3.330 should define the terms "search engine optimization," "social media marketing," and "lead generation" and should consider the nature of the services in determining taxability. Each term can refer to several different services or components, including nontaxable advertising and other nontaxable services. It is inconsistent with statute and prior Comptroller guidance and decisions to treat all services carrying those labels as taxable data processing instead of examining the nature of each service. For instance, social media marketing may involve sharing a website link, which is expressly excluded from tax under Tax Code § 151.0035(d) and proposed subsection (a)(1)(B)(iii) of the proposed rule, and lead generation services could be nontaxable information services. See, e.g., Tex. Comptroller Hearing No. 104,366, STAR Doc. No. 201107196H (July 21, 2011) (determining the online lead generation services at issue were a nontaxable proprietary information service); see also Private Letter Ruling No. PLR20201012121830, STAR Doc. No. 202109061L (concluding the online lead-generating services at issue were information services).

b. Especially in the data processing context, a label attached to a service is often insufficient to make a taxability determination, and a deeper understanding of what is involved in the service is typically required. When the Comptroller has addressed the tax treatment of "search engine optimization" or "social media marketing" on a standalone basis, the agency has typically described what was entailed in the service at issue before making a determination. See, e.g., Private

Letter Ruling No. 20180314160029, STAR Doc. No. 201903015L (Mar. 22, 2019) (describing the "search engine optimization" service at issue as altering a customer's website); Private Letter Ruling No. 20200225084219, STAR Doc. No. 202010013L (Oct. 22, 2020) (indicating the "search engine optimization" service at issue that involves "maintenance on [a] customer's website, setting up tools, and adding metatags" is taxable, describing the "social media marketing" service at issue as the "creation of a strategy, profile, and photo designs for a customer's social media webpage" without determining if it would be taxable data processing if offered on a standalone basis, but confirming online advertising links and add placements are not taxable).

c. The preamble to proposed Rule 3.330 cites Comptroller's Decision No. 116,834 to support adding new paragraph (b)(12), but that decision provides no such support. In Comptroller Hearing No. 116,834, STAR Doc. No. 202206024H (June 28, 2022), the Comptroller addressed services that included website design, search engine optimization, social media marketing, three-dimensional rendering, and lead generation, without separately analyzing which are taxable data processing because the taxpayer did not dispute the issue. The hearing cannot be used to support the correctness of a legal proposition that was not in dispute.

d. Prior decisions of the Comptroller do not support treating each "search engine optimization," "social media marketing," and "lead generation" as taxable data processing services on a stand-alone basis. When the Comptroller has addressed "search engine optimization," "social media marketing," and "lead generation" in prior published guidance, the services have often been included with other services that the Comptroller considers taxable data processing, such as website development, and were often not independently analyzed in the guidance. See, e.g., Tex. Comptroller Hearing No. 119,232, STAR Doc. No. 202401030H (Jan. 30, 2024) (addressing a monthly fee that pertained to website development, hosting, search engine optimization, etc., without analyzing what is involved in each component); Private Letter Ruling No. 20221108103742, STAR Doc. No. 202402020L (Feb. 20, 2024) (addressing a service that involved website building, including search engine optimization, without separately analyzing the search engine optimization component, but concluding that a separate, standalone website-related "blueprinting service" that did not involve changes to a website was not taxable); Tex. Comptroller Hearing No. 116,834, STAR Doc. No. 202206024H (June 28, 2022) (addressing services that included website design, search engine optimization, social media marketing, three-dimensional rendering, and lead generation, without separately analyzing which are taxable data processing because the taxpayer did not dispute them); Tex. Comptroller Hearing No. 110,022, STAR Doc. No. 201712013H (Dec. 27, 2017) (addressing multiple

services, including website development and search engine optimization services, without explicitly analyzing the search engine optimization component).

7. **The term "unrelated services" should not be changed to "nontaxable related services."**

Subsection (e) of the proposed rule changes the term "unrelated services" to "nontaxable related services." This change takes the definition out of alignment with "unrelated services" definitions in other sections in Chapter 3, Subchapter O, of the Texas Administrative Code (TAC) but still uses substantially the same content found in the other sections of the TAC. The below three rules relating to taxable services similar to data processing have identical definitions of "unrelated services." The Comptroller should not create a different term ("nontaxable related services") for data processing alone with nearly the same definition as the "unrelated services" in the other sections. See the following rules for the parallel definitions:

a. RULE §3.313 Cable Television Service and Bundle Cable Service
b. RULE §3.342 Information Services
c. RULE §3.343 Credit Reporting Services

This variance in definitions introduces ambiguity, which should be interpreted in favor of the taxpayer.

8. **The sourcing rules in proposed Rule 3.330 should promote more clarity.**

The proposed rule's sourcing rules are unclear in several instances. When the consumer is responsible for sales/use tax, the seller is the state's agent for collecting the tax. Sourcing rules must be clear to allow the seller to administer the tax correctly.

a. The sourcing rules in 3.330(g) are not clear. Taken together, Sections 3.330(g)(2), (3), and (4) give sourcing rules based on where the service was delivered *and* where the service was performed, but the rule should not allow the Comptroller to "have it both ways." Section (2) covers when the service was <u>delivered</u> in Texas; Section (3) covers when the service was <u>performed</u> in Texas; and Section (4) covers when it was <u>performed</u> outside Texas. The rule should make clear whether the incidence of the tax is at the customer's location (delivery) or the seller's location (performance).

The focus on place of performance is not supported in the original statutory language upon which the rule is based. The preamble says that the language is being added to incorporate Tax Code Section 151.330, which reads, in relevant part:

> **(e)** Services <u>performed for use</u> outside this state are exempt from the tax imposed by Subchapter C of this chapter.

> **(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.
>
> **(g)** The exemption provided by Subsections (e) and (f) of this section do not apply to services performed outside this state for use within this state.

The sourcing provisions in proposed Rule 3.330(g) do not follow from Section 151.330. Sections 151.330(e) and (f) do not specify place of performance within Texas but instead relate to place of use. Even (g), which references performance outside Texas, ultimately relates to services used in Texas. The place of performance language in the draft rule should be removed or modified to be more consistent with the original.

Read together proposed Rule 3.330(g)(3) and (4) seem to say, "when the services are *performed* in Texas, they are taxable to the extent *used* in Texas," but "when the services are *performed* outside Texas, they are taxable to the extent *used* in Texas." The outcome is the same regardless of where the services were performed.

The definition of "use" itself is unclear. In proposed Rule 3.330(g)(1), "use" is defined as "the derivation in Texas of direct or indirect benefit from the service." The old rule said the benefit was received at the buyer's primary place of business, or at the business location most related to the data processing. It is unclear whether, with the introduction of "indirect benefit," if businesses also benefit from data processing in the places where the data processing enables them to serve their own customers.

For example, when a business purchases marketplace services, it could be seen to benefit from reaching a much broader market than it could independently. Should marketplace services, then, be sourced to the location of the purchaser's end customer? This would place an exceedingly high a burden on the seller of data processing. From a system perspective, a requirement to subdivide marketplace fees by state to charge tax appropriately does not make sense. Moreover, it is not clear if this type of division is supported by any tax compliance software solutions today (e.g., Avalara, Vertex).

The proposed rule does include a multiple points of use exemption in 3.330(g)(6), but the exemption does not go far enough to mitigate this burden. The exemption in 3.330(g)(6) currently leaves the seller responsible for collecting tax on services to the extent that they are used within Texas. By contrast, the multiple points of use exemption offered through the Streamlined Sales and Use Tax Agreement (SSUTA) is a full exemption that shifts the tax remittance obligation to the buyer and releases the seller entirely. The SSUTA model prevents an unrealistic burden on the seller to keep track of where its buyer uses products after purchasing them.

At a minimum, the definition of "use" would need to be accompanied by additional detail or guidance to clarify the impact of "indirect benefit" on sourcing for data processing.

b. The sourcing rules in 3.330(h) create inconsistency. The local sourcing in proposed Rule 3.330(h) is different from state-level sourcing in 3.330(g), which could lead to inconsistent outcomes, especially if the "indirect benefit" language only applies at the state level. Section 3.330(h) does not include the concept of "direct or indirect benefit" and instead sources data processing to where the order was received, where the order was fulfilled, or where the service was delivered. It is unclear whether the Comptroller's intent is to treat local sourcing differently than state sourcing or to have local sourcing follow state rules more closely.

Example A: Austin-based MARKETPLACE SELLER sells a product to someone in Dallas, TX

- **STATE**: The seller is taxed on data processing fees at the state rate due to the direct benefit received in Texas.
- **LOCAL**: The seller is taxed on data processing at the Austin local rate/s as the service was delivered to their business location in Austin. There is no Dallas tax.

Example B: California-based MARKETPLACE SELLER sells a product to someone in Dallas, TX

- **STATE**: Is there no tax on the seller as the services were delivered outside Texas? Is the seller taxed at the state rate due to the indirect benefit of reaching a customer within Texas? (State-level rules are unclear.)**LOCAL**: There will be no local tax (Dallas, Austin, or other) as the seller's business location is outside Texas, and there is no indirect benefit concept at the city level.

If we assume state-level sourcing could apply to a California buyer with a Dallas customer, should Dallas be able to tax that transaction as well? Should Dallas receive tax on the Example C transaction while Austin receives tax on the Example B transaction?

Regardless of the final changes to the proposed rule or any associated guidance, the outcome should at least be internally consistent.

c. These sourcing issues may also affect the franchise tax. They could result in confusion on how receipts are sourced under Tax Code § 171.106 for online data processing services that fall under the definition of "Internet hosting" under Tax Code § 151.108. This is because online data processing services falling under the definition of "internet hosting" in Section 151.108 will be taxed using market-based

sourcing, while information services are sourced based on the cost of performance method.

9. **Inconsistent sourcing rules across jurisdictions will lead to double taxation and drive up costs for businesses.**

If data processing is digitally delivered to a business location in Texas, but the "business address" for the company's account is in an SSUTA state like Oklahoma, the transaction could be sourced to both locations and taxed twice. Though it is not a member, Texas should model its sourcing rules on SSUTA rules for consistency and clarity.

> **Example C**: A MARKETPLACE SELLER signs up to sell products on a NATIONWIDE MARKETPLACE, where the products are made available to customers across the US. The MARKETPLACE SELLER pays fees to the marketplace to maintain their seller account.
>
> - **Texas MARKETPLACE SELLER**: 100% taxable. If the marketplace fees are characterized as data processing, then the services are delivered to the seller in Texas. The seller receives a direct benefit at their Texas business location from their ability to list products, conduct business, and analyze their operations.
> - **California MARKETPLACE SELLER**: Under the proposed Rule 3.330, the sourcing outcome is unclear. The services are delivered in California where the seller accesses the user interface and receives the benefit of conducting their business. Should the analysis stop there?

When the service is delivered outside Texas, should we look next to where the service was performed (3.330(g)(3) and (4))? If so, does the NATIONWIDE MARKETPLACE need to pinpoint the business location where the seller's data was processed? As the information is handled in the cloud, and not by a particular employee in a specific office location, how would the NATIONWIDE MARKETPLACE determine the performance location?

Further, is there an indirect benefit to the California seller if they use the NATIONWIDE MARKETPLACE to reach their own customers within Texas? In this case, would the Texas-based MARKETPLACE SELLER get any adjustment to acknowledge their market outside the state? Would the indirect benefit require the single marketplace fee to be subdivided into Texas/non-Texas components before tax could be applied?

Regardless of the changes to proposed Rule 3.330, the result must be fully supported within the associated statutes, and the rule must be internally consistent.

A well-designed consumption tax will not raise the price of goods and services for consumers. Taxation of digital services without a broad business use exemption is counter to this premise. As shown in Example C, a Texas-based MARKETPLACE SELLER will pay sales tax on all marketplace fees, even those that relate to their sales to customers outside the state. This will drive up business costs for Texas businesses and reduce competitiveness. This framework is

not business-friendly and should not be implemented through rulemaking and interpretation by the Comptroller.

Thank you for your consideration of TTARA's comments to proposed Rule 3.330. Please do not hesitate to contact me if you would like any clarification or additional information about our comments.

Sincerely,

Helen Brantley
Legal Analyst
Texas Taxpayers and Research Association