Proposed Uniform Definitions for the Tax Base

Presented to the MTC Digital Products Workgroup
January 23, 2025

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Initial Thoughts

- Uniformity Committee charge regarding the scope of the project: ...
  - "Analysis of the ways that digital products might be defined, categorized, exempted and sourced."

- Langenberg suggestions to partially fulfill the charge:
  - The Work Group should identify criteria that states could use to include or exclude digital products in the tax base.
  - The Work Group should identify factors that states should consider in evaluating the criteria.

The Need

- The distinction between software and services is becoming blurred. Ergo – “software as a service”
  - Application of traditional TTP and service distinctions is hard.
- Digital products tend to be less “tangible.”
  - Tax base is shrinking in states with limited taxation of services.
- Digital products may need a separate classification untethered from traditional notions of TPP and services.

What Are Some Criteria for Inclusion and Exclusion?

- Output – What is produced
- Input – How it is produced
- Who is buying – e.g., nonprofit, business
- Who is selling – e.g., nonprofit
- Intended use – e.g., resale, business, education
- Other

Proposed Solution –
“Automated Digital Product”

“Automated digital product” - an item, including software and service, that is provided for noncommercial use in a binary format, and for which the additional human intervention to produce a similar item for additional customers is minimal.

First Criterion – "Binary Format"

"Automated digital product - an item, including software and service, that is provided ... in a binary format..."

- Criterion is broad – binary format is the basic characteristic of a product that is digital.
- Eliminates distinction between TPP and services – "including software and services."

Second Criterion – "Noncommercial"

"Automated digital product - an item ... provided for noncommercial use..."

- The objective is to prevent the pyramiding of taxes.
- Eliminates the taxation of transactions traditionally treated as the nontaxable sale of intangible rights, such as the sale of digital publishing or performing rights.
- Reduces sourcing difficulties that may result from commercial transactions that involve multiple business users at multiple locations.

Third Criterion –
"Minimal Human Intervention"

"Automated digital product - an item ... for which additional human intervention to produce a similar item for additional customers is minimal."

- The objective is to make the definition more compatible with the selective tax systems of the many states that do not broadly tax professional services.

- Different than Washington exclusion of services that "*primarily* involves the application of human effort."

We would not be starting from scratch

The concepts of “minimal human involvement” and “minimum human intervention” are used in:

- the definition of “automated digital service” in the United Nations Model Double Taxation Convention Between Developed and Developing Countries (2021) ¶ 5.
- the definition of “automated digital service” in the OECD, “Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS”, Box 2.1, and
- the definition of “electronically supplied service” in the Council of the European Union Implementing Regulation No. 282/2011 (2011) Article 7.

Some Comments

- No allowance for Internet Tax Freedom Act preemption.
- No requirement of electronic delivery.
- A state could narrow the application by taxing only specific types of automated digital products, or excluding specific types of automated digital products.
- A state could separately tax some digital products that are not automated.

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