

Definitions Study Group – Primer for Potential Volunteers

(Note – this primer references materials available on the project webpage – [Here](#))

Concept:

Two study groups are being proposed: one to consider the narrow approach and one to consider the broad approach. The distinction between the narrow and broad approaches has been discussed, mainly in connection with the multistate research on the tax base.

The two proposed study groups would consider definitions that fit within each approach. The study group being formed currently by the project work group is to consider definitions under the broad approach. A group to consider definitions under the narrow approach may be conducted by Streamlined.

The current proposal:

There is a proposal on the table to get the study group started. It was presented to the work group at their meeting on January 23, 2025. (A PDF document and Powerpoint slides describing it are available on the project webpage.) It is important to note that it is but one potential proposal and the study group may consider other broad definitions.

The proposal defines the term “automated digital product” as:

“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.”

The proposal relies on three criteria: (1) binary format; (2) noncommercial use; and (3) minimal human intervention. These three criteria each serve a purpose. The first, binary format, ensures a broad inclusion as the starting point. The second, non-commercial use, narrows the broad inclusion by excluding any automated digital product provided for commercial use. The third, minimal human intervention, ensures some compatibility with existing sales tax systems by excluding the service transactions that are typically not subject to sales tax. (A summary of the factors and criteria for “determining the tax base” is available on the project webpage.)

The proposed definition is not an exclusive one. An “automated digital product” may include things that fall into other sales tax categories like tangible personal property (TPP) and services. For example, a compact disc—considered TPP under typical sales tax regimes—would qualify as an “automated digital product” under the proposal.

Outline of possible issues for discussion:

The following is a list of potential issues the study group may address in considering the current proposal or an alternative proposal under the broad approach.

- The trade-off between definitions of digital products that provide immediate certainty (narrow, incremental approach) and definitions of digital products that provide some adaptability into the future (broad approach).
- A definition of digital products that is not dependent on the current classifications of tangible personal property and services.

- The factors and criteria relevant to developing a tax base. (See document on project webpage.)
- Issues created by overlapping definitions – these are questions as to how products that fall into two definitions or categories—i.e., both digital products and tangible property or digital products and services—will be treated under existing rules, including exemptions and sourcing rules.
- The effect of the broad definition on the treatment of items commonly not taxed, whether exempted or excluded –
 - Commonly exempted items:
 - Professional services
 - Nonprofit entity’s income
 - Groceries
 - Business inputs – mostly sale for resale
 - Educational materials
 - Machinery and equipment used in manufacturing
 - Farming materials
 - Streaming – based on lack of download
- Potential effects on existing categories of exemptions:
 - Exemptions based on the item itself:
 - Groceries – if exempted, then exempt regardless of who sells it
 - Professional services – exemption based on the service, but if defined properly, must be provided by the professional
 - sales by the same professional of TPP are taxable
 - Exemptions based on the activity:
 - Sales by a nonprofit organization
 - all sales or sales that further the tax exempt purpose (the activity)?
 - Inputs purchased by a farming operation
 - The same inputs purchased by other businesses are taxed
 - Inputs purchased by business – Iowa is the only broad example,
 - also included in the exemptions based on the buyer’s identity below
 - Exemptions based on the identity of the buyer:
 - Charities
 - Educational institutions
 - Religious institutions
 - Business inputs—if based on the identity of the buyer being a business with or without any other criteria
- Pyramiding and treatment of business inputs.
- Effect on tax administration and tax compliance – (see research done on the effect of broad definitions generally on the project webpage.)
 - Bundling
 - Sourcing
 - True object test
 - Existing exemptions
- Federal preemption -

- Is there any need to reference the potential preemption of the Internet Tax Freedom Act?
- If so, how can that be done effectively given that the extent of that preemption is uncertain.

Possible Agenda of First Study Group Session:

- Determine timeline and leadership
- Schedule future sessions
- Determine output of the study group
 - Development of the current proposal.
 - Development of alternative(s).
 - Consider the feasibility of a definition under the broad approach compared to multiple definitions developed under the narrow approach
 - Develop a definition describing the missing part(s) of the current sales tax base, i.e. digital products
 - Resolve or lessen the dilemma of distinguishing between digital products and services