

June 30, 2025

Via E-Mail @ Ray.Langenberg@cpa.texas.gov

Ray Langenberg
Chair, MTC Digital Products Definitions Study Group
444 North Capitol Street NW, Suite 425
Washington, DC 20002

Re: Proposed Model Digital Product Definition and Related Provisions

Dear Ray:

We are writing in response to the feedback provided to our May 8, 2025, letter addressing the concerns we have with the proposed draft of the “automated digital product” definition (“Proposed Definition”) and related interpretative provisions intended for inclusion in the MTC Digital Products Work Group’s forthcoming Whitepaper.

During the Study Group call on May 9, 2025, feedback was provided on the four areas addressed in our comments as follows:

- First, it was noted that, in response to our comment that most states already include prewritten computer software in their definitions of “tangible personal property,” that there is no uniform definition of “prewritten computer software.”
- Second, in response to our concern that the “minimal human intervention” concept in the automated digital product definition is unworkable, it was stated that there is no brightline standard for what constitutes “minimal” that may be incorporated into the Proposed Definition.
- Third, there was disagreement with our suggestion that the Proposed Definition should take into account the purchaser’s perspective.
- Finally, there was concern that use of the term “transferred electronically,” as an alternative to “binary format,” might conflict with the Internet Tax Freedom Act’s (“ITFA”) prohibition on discriminatory taxes on electronic commerce.

We address each of these points below.

1. There are Uniform Definitions for Computer Software

In our previous letter, we expressed concern about including “software” in the Proposed Definition of an “automated digital product.” Our concern stems from the fact that most states already characterize prewritten computer software as tangible personal property.

A majority of states that impose a sales tax have adopted—more or less—uniform definitions of “prewritten computer software.” Because the Streamlined Sales and Use Tax Agreement (the “Agreement”) includes “prewritten computer software” in its definition of “tangible personal property,” the Agreement includes a number of computer-related definitions, including “computer,” “computer software,” and “prewritten computer software,” among others.¹

For example, “computer software” means “a set of coded instructions designed to cause a ‘computer’ or automatic data processing equipment to perform a task” and “prewritten computer software” means, in relevant part, “‘computer software,’ including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser.”² Streamlined member states adopt these definitions.³

States that are not Streamlined members adopt similar “computer software” definitions. Colorado, for instance, defines “computer software” as “a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task.”⁴ Louisiana similarly defines “computer software” as “a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed, regardless of whether the statements, data, or instructions are capable of being perceived by or communicated to humans.”⁵

Given these consistent computer software definitions—even among states that are not “Streamlined,” like Colorado and Louisiana—we remain concerned that the inclusion of the term “software” may, in fact, cause an unintended tax base expansion or result in a conflict with existing defined terms.

¹ See generally, Streamlined Sales and Use Tax Agreement, Appendix C, Part I - Administrative Definitions (Rev’d Dec. 20, 2024) (requiring member states to define “tangible personal property” as including “prewritten computer software”) and Appendix C, Part II - Product Definitions (Computer Related) (defining “prewritten computer software” and other computer related terms, but permitting member states to exempt “prewritten computer software” “delivered electronically” or by “load and leave”).

² Streamlined Sales and Use Tax Agreement, Appendix C, Part II - Product Definitions (Computer Related).

³ Streamlined Sales and Use Tax Agreement Section 104; see also Streamlined Certificates of Compliance for Member States, including references to the Computer Related Product Definitions, available at <https://sst.streamlinedsalestax.org/coc>.

⁴ C.R.S. § 39-26-102(15)(c)(II)(B).

⁵ La. R.S. § 47:301(22).

2. There Are Workable Tests to Determine if “Human Intervention” is Minimal

In our last letter, we also noted that the Proposed Definition does not have a workable definition of the term “minimal” when it comes to measuring “additional human intervention.” In response, it was stated that there is no workable, brightline definition of the term. There are, however, concrete ways to determine whether any “human intervention” is, in fact, “minimal.”

The Agreement’s “bundled transaction” definition includes, for instance, a “*de minimis*” test to determine whether a transaction involving both taxable and non-taxable products qualifies as a “bundled transaction.”⁶ Under this test, a transaction is not treated as a bundled transaction if the taxable products make up ten percent or less of the total purchase price or sales price, so long as sellers use either metric on a consistent basis during the term of the contract.⁷ In our experience, the Agreement’s *de minimis* test has been useful to taxpayers and the states in evaluating something that is minimal.

The Proposed Definition could employ a similar percentage or valuation standard in measuring what constitutes “minimal” additional human intervention. In this context, the seller could substantiate, via cost accounting or other non-tax books and records, the “human effort” percentage as a measure of sales price or purchase (cost) price relative to the components of the transaction.

3. The Purchaser’s Perspective Should Be Considered in Determining Characterization

In our previous letter, we raised concerns about how the Proposed Definition focuses solely on the service provider’s side, “without regard to any human intervention on the side of the user,” when determining whether a product involves only “minimal human intervention.” We noted that virtually all states look to what the purchaser is seeking in determining the characterization and taxability of a product or service. We referenced the widely used “true object test.” Some states refer to the test by other names, such as “essence of transaction” in Texas,⁸ “dominant purpose” in Pennsylvania,⁹ and “real object” in Rhode Island, though the underlying principle is the same.¹⁰

⁶ Streamlined Sales and Use Tax Agreement, Appendix C, Part I (Administrative Definitions).

⁷ *Id.*

⁸ See, e.g., 34 Tex. Admin. Code § 3.330, for a statute that contains a test of whether a service is “essential to the performance of the taxable service.”

⁹ 72 Pa. Cons. Stat. § 7201(o)(5).

¹⁰ See R.I. Ruling Request 2017-02, 03/31/2017, for an example of a declaratory ruling in Rhode Island that follows the “real object” test. In Rhode Island, if even one of the products in a bundle (two or more products, except real property and services to real property, where (1) the products are otherwise distinct and identifiable, and (2) the products are sold for one non-itemized price is taxable), the entire bundled transaction is taxable unless the real object of the transaction is nontaxable.

It was suggested that the purchaser’s perspective is irrelevant in determining characterization. We disagree. These tests remain the law in many states, whether adopted by state legislatures or state supreme courts.¹¹ Changes to these well-established tests should require legislative action. In lieu of upending decades-long precedent and practice that considers the purchaser’s perspective, we suggest that the Study Group consider adopting the “common understanding” test, which determines the characterization of a transaction based on the “common understanding” of a trade, business, or occupation.¹² This approach evaluates the transaction based on the totality of the circumstances and the understanding that an average purchaser would have as to the characterization of the transaction.¹³ The Colorado Supreme Court adopted this method in *City of Boulder v. Leanin’ Tree, Inc.*¹⁴ The test has also been used in the Arizona Court of Appeals.¹⁵

4. “Binary Format” Limits the Useful Life of the Proposed Definition.

Finally, there was concern with our proposal to replace “binary format” with “transferred electronically,” because that the phrase would run afoul of ITFA. We prefer the term “transferred electronically,” as it is already defined in the Agreement and used by Streamlined member states, and it allows for a more flexible definition for future technological advances that may not use the binary format.¹⁶

In addition, the intent and application of ITFA often requires courts and tax authorities to examine the true nature of the service or the transaction, i.e., a substance over form approach.¹⁷ As such, the term “binary format” also has just as much potential to violate ITFA as “transferred electronically.”

We appreciate the study group’s efforts and look forward to further discussing these issues.

¹¹ See generally, Hellerstein, Hellerstein & Appleby, *State Taxation* (Thomson Reuters/Tax & Accounting, 3rd ed., with updates through April 2025) (online version accessed on Checkpoint (www.checkpoint.riag.com) June 26, 2025) (hereinafter “Hellerstein Treatise”) at ¶ 12.08

¹² Hellerstein Treatise at ¶12.08[2].

¹³ *Id.*

¹⁴ *City of Boulder v. Leanin’ Tree, Inc.*, 72 P.3d 361 (Colo. 2003).

¹⁵ *Val-Pak E. Valley, Inc. v. Arizona Dep’t of Revenue*, 229 Ariz. 164, 272 P3d 1055 (Ct. App. 2012).

¹⁶ “Delivered electronically” is defined in SSUTA as “delivered to the purchaser by means other than tangible storage media.” Streamlined Sales and Use Tax Agreement, Appendix C – Library of Definitions, Part II – Product Definitions (Computer Related) (Rev’d Dec. 20 2024).

¹⁷ One example, among many, is *Petition of Verizon New York Inc.*, DTA No. 829240 (May 4, 2023), where an administrative law judge ruled that the gross receipts tax on transportation and transmission corporations could not be applied to revenues from services that were federally preempted under ITFA as Internet Access.

Sincerely,

Michele Borens



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Charlie Kearns

Eversheds Sutherland (US) LLP

CC: Helen Hecht, Uniformity Counsel, Multistate Tax Commission