

August 29, 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 ongoing discussions regarding our May 8, 2025 and June 30, 2025, letters 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 calls, we indicated we would provide examples that illustrate our concerns with the issues addressed in our prior letters. We remain concerned about the implementation of the Proposed Definition by adopting states, namely the potential lack of coordination with existing laws that would result in multiple characterizations of a transaction. Another remaining concern is the relationship between the “minimal human intervention” and the “seller’s perspective” analysis in determining whether a transaction would be an automated digital product. We have set forth some examples below to further address these concerns.

Multiple Characterizations

As noted in the summary document, the “trade or business” exemption “is not intended as an expansion of the exemption to the sale of other types of taxable items.”¹ The summary’s example makes clear that “if the sale of an automated digital product used in a trade of business would be taxable in a state as the non-exempt sale of tangible personal property or the non-exempt sale of a taxable service, it would remain taxable.”² And states only “should consider expanding the exemptions to explicitly cover automated digital products.”³ Because

¹ Proposed Model Digital Product Definition and Related Exemption – 20250509 Draft
, ¶ 3 at 4, <https://www.mtc.gov/wp-content/uploads/2025/05/RLModelDef20250509.pdf>.

² *Id.*

³ *Id.* at 5.

the Proposed Draft expressly treats the trade or business exemption as optional, much less coordination with an adopting state's existing tax regimes, multiple characterizations and the resulting compliance issues will be the rule. Accordingly, we believe (i) the Proposed Draft should replace any overlapping provisions under current law or (ii) at a minimum, adopting states must coordinate pre-existing definitions, exemptions, and other substantive provisions with the trade or business exemption. Without either action, the trade or business exemption will be inconsequential in many states.

- **Prewritten Computer Software.** We have expressed concern about including “software” in the Proposed Definition of an “automated digital product” because most states classify (i) prewritten computer software as tangible personal property and (ii) custom software as a non-taxable service. The characterization – and, hence, taxation – of these common forms of software under potentially different definitions disrupts well-established state tax regimes that may impact sourcing, qualification for exemptions, and other substantive matters.

For example, states have adopted a variety of exemptions for certain business purchases of software. If an adopting state does not coordinate those pre-existing exemptions with the Proposed Definition, then sellers and buyers will face uncertainly as to their respective tax obligations. Texas, for instance, exempts software (which is characterized as tangible personal property) that is “necessary or essential to the manufacturing operation and directly makes or causes a chemical or physical change to the product that is being manufactured for sale or any intermediate or preliminary product that will become an ingredient of the product that is being manufactured for sale.”⁴ But if software is not used in such manner directly related to manufacturing, e.g., for back-office purposes, then Texas sales tax applies. If a state like Texas were to adopt the Proposed Definition, sales of software would be exempt tangible personal property if put to certain manufacturing uses yet be subject to tax as an automated digital product. Conversely, software that is an automated digital product eligible for the trade or business exemption could be taxed as tangible personal property, if not otherwise exempt.

Another example is New York. The New York State Department of Taxation and Finance has taken the position that SaaS is subject to sales tax.⁵ Through multiple advisory opinions, the Department has indicated that SaaS is often taxable as an information service when the SaaS offering involves access to certain data or information.⁶ If New York were to adopt the Proposed Definition, SaaS could be

⁴ See Rules 3.300(d), 3.308; Policy Letter Ruling No. 200205114L, May 29, 2002.

⁵ N.Y. Tax Law § 1105(c). See New York Sales Tax Bulletin No. TB-ST-128 (August 5, 2014) (clarifying that “the sale to a purchaser in New York of a license to remotely access software is subject to state and local sales tax”).

⁶ N.Y. Tax Law § 1105(c)(1); see, e.g., New York Advisory Opinion No. TSB-A-13(32)S (Sept. 10, 2013) (ruling that a taxpayer offering software solutions to law firms is making taxable sales of prewritten

taxable as both an automated digital product and an information service, but the trade or business exemption would only be applicable to those offerings qualifying as an automated digital product. This tension makes it virtually impossible for a taxpayer to determine when its offering falls into one classification rather than the other and will create endless disputes between the state and taxpayers over the proper classification.

- **Individual Consumer Purchases.** Lack of definitional coordination also affects tax compliance for individual consumer transactions. For example, with respect to individual consumers (who would not qualify under the Proposed Draft’s trade or business exemption), some states include prewritten computer software in their back-to-school sales tax holidays.⁷ The potential for dual characterization in such instances exacerbates the already difficult compliance processes of sales tax holiday implementation.

“Minimal Human Intervention” and Purchaser’s Perspective

We previously raised concerns about the lack of a workable definition for “minimal” in terms of the amount of “human intervention” permissible in the Proposed Definition. We also raised concerns about how the suggested application of the “automated digital product” definition only focuses on the seller’s activities is doing, not what the buyer is seeking, in a transaction. The need for clearer standards is underscored by the following real-world examples that illustrate the complexities raised by these provisions.

- First, consider two scenarios involving a certified public accountant providing services to a client. In the first instance, the CPA receives the client’s financial information via email and electronically transfers the data into tax return preparation software program. Minimal adjustments to the data are required due to simplicity of the filing, so the CPA prints the return and provides the return to the client. However, the CPA may have another client who also sends their data electronically. The data is then transferred to the tax return preparation software program, but the CPA performs substantive analysis due to the complexity of the return, before printing the return and providing it to the client. Under the Proposed Definition, as drafted, distinguishing between the taxability of these two transactions would require evaluating the degree of human effort involved without a clear standard, even though the nature of what the customer has contracted for is the same – tax preparation services. We note that the incorporation of the exclusion for “customized professional services,” as included in the “automated digital services” definition in the United Nations and OECD source

software); New York Advisory Opinion No. TSB-A-09(44)S (September 24, 2009) (ruling that product that adds functionality to a website of searchable database of real estate listings, including the ability to enter one-time or private advertising information, is taxable).

⁷ RSMo § 144.049(2); S.C. Code § 12-36-2120(57)(a)(v).

documents, would likely resolve the issues in this example.^{8,9} The Proposed Definition, however, does not include customized professional services or any of the other exclusions in the “negative list” used in those source documents.¹⁰

- Another example is technical support services. Technical support services may include several ways to obtain support – telephone, email, chat feature, chat bots, etc. In the first instance, a customer obtains technical support services but only uses the telephone option to talk with a live person and obtain technical support. In the second instance, a customer obtains technical support services but only uses the chat or chat features. Customers would have to evaluate the degree of human effort involved in the provision of the service even though the nature of what the customer has contracted for is the same – technical support services. The lack of a brightline standard to assist with the “minimal human effort” will lead to audit disputes and litigation, as has been shown among the states under similar circumstances.^{11, 12}

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We believe that these examples illustrate the problems with the Proposed Definition. We appreciate the study group’s efforts and look forward to further discussing these issues.

⁸ See United Nations Model Double Taxation Convention Between Developed and Developing Countries, Sept. 2021, ¶ 59 at 462, https://financing.desa.un.org/sites/default/files/2023-05/UN%20Model_2021.pdf (excluding customized professional services, customized online teaching services, Internet access services, the online sale of goods and services other than automated digital services, and revenue from physical goods irrespective of connectivity (e.g., IoT)).

⁹ “Customized professional services” includes “services whether provided individually or by a firm, such as legal, accounting, architecture, engineering, medical professional or financial or other specialized expert consultancy services. Customized professional services are not within the general definition of automated digital services.” *Id.*, ¶ 60 at 463.

¹⁰ We will address in subsequent comments how the referenced United Nations and OECD source documents should inform the Proposed Definition.

¹¹ As discussed in prior comments, we believe a brightline standard similar to the 10 percent *de minimis* rule in Streamlined’s “bundled transaction” definition would be workable for taxpayers and auditable for state tax agencies.

¹² See, e.g., *Hegar v. CheckFree Servs. Corp.*, No. 14-15-00027-CV, 2016 WL 1576414, (Tex. App. Apr. 19, 2016); *Gartner, Inc. v. Dep’t of Revenue*, 455 P.3d 1179 (Wash. 2020); *Dynamic Logic, Inc. v. Tax Appeals Tribunal*, No. 35, 2025 WL 1127774 (N.Y. Apr. 17, 2025).

Sincerely,

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Charlie Kearns

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Eversheds Sutherland (US) LLP

cc: Helen Hecht, Uniformity Counsel, Multistate Tax Commission