

Report of the Chair of the Digital Products Definition Study Group

By Ray Langenberg

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The task: The Definition Study Group was tasked with evaluating possible methods to broadly define digital products for inclusion in the sales tax base.

The process: The Chair invited members of the Study Group to identify existing methods of defining and taxing digital products, to propose new methods, to identify the criteria for evaluation, and to discuss and evaluate the methods. The group evaluated, but did not endorse or reject, the methods used by Washington, South Dakota, Ohio, Utah, and Wisconsin. In addition, the group received one proposed new method for defining and taxing “automated digital products” along with a related exemption for business inputs. The Appendix contains a lead document for each method evaluated and other written comments submitted by group members.

Criteria for evaluation:

- Clarity and ease of application
- Revenue generation or stability
- Compatibility with other elements of the tax structure
- Pyramiding of taxes
- Other considerations

Categorizing the methods:

The methods have been categorized on the breadth of the base definition or definitions, and not the breadth of the resulting taxation. Broad definitions may not result in broad taxation if there are significant exclusions or exemptions.

Early in the project, MTC counsel Jonathan White drafted a multipage memorandum and matrix analyzing narrow, medium, and broad methods currently used for the taxation of digital products (the White memorandum). The analysis is included in this Chair’s Report and may be useful to a state in evaluating the appropriate digital tax base.

For this report, the Chair has rearticulated the narrow, medium, and broad methods as the specific, expansive, and universal definition methods.

Specific definition method:

The specific definition method uses multiple narrow definitions aimed at specific products, typically with specific exclusions for each product, and generally applicable exemptions such as the sale-for-resale exemption.

- **Streamlined Sales Tax and Use Tax Agreement (SSUTA)**

Examples of specific definitions are the “specified digital products” (digital audio visual works, digital audio works, and digital books) listed in the SSUTA.

- **Wisconsin**

In addition to the SSUTA “specified digital products,” Wisconsin adds “additional digital goods” transferred electronically: greeting cards, finished artwork, periodicals, video or electronic games, and newspaper or other news or information products.

Expansive definition method:

The expansive definition method uses several expansive, but not all-inclusive, definitions for inclusion in the tax base with one or more exclusions applied to the definitions, and generally applicable exemptions such as the sale-for-resale exemption.

- **Ohio**

In addition to the SSUTA “specified digital products,” the tax base also includes transactions in which “[a]utomatic data processing, computer services, or electronic information services are or are to be provided for use in business when the true object of the transaction is the receipt by the consumer of automatic data processing, computer services, or electronic information services rather than the receipt of personal or professional services to which automatic data processing, computer services, or electronic information services are incidental or supplemental.”

“‘Automatic data processing’ means processing of others’ data, including keypunching or similar data entry services together with verification thereof, or providing access to computer equipment for the purpose of processing data.”

“‘Computer services’ means providing services consisting of specifying computer hardware configurations and evaluating technical processing characteristics, computer programming, and training of computer programmers and operators, provided in conjunction with and to support the sale, lease, or operation of taxable computer equipment or systems.”

“‘Electronic information services’ means providing access to computer equipment by means of telecommunications equipment for either examining or acquiring data stored in or accessible to the computer equipment or placing data into the computer to be retrieved by a designated recipient with access to the computer equipment.”

Automatic data processing, computer services, and electronic information services do not include personal or professional services.

Universal definition method:

The universal definition method uses a single, broad definition of digital products with one or more specific exclusions applied to that definition, and generally applicable exemptions such as the sale-for-resale exemption.

- **Washington**

In Washington, the term “digital products” consists of:

“Digital automated service,’... any service transferred electronically that uses one or more software applications.”

“Digital goods,’... sounds, images, data, facts, or information, or any combination thereof, transferred electronically, including, but not limited to, specified digital products and other products transferred electronically not included within the definition of specified digital products.”

The tax base has been limited by over a dozen exclusions, including an exclusion for services involving primarily human effort. The Washington legislature has now repealed the primarily human effort exclusion, effective October 1, 2025.

- **Utah**

Utah imposes sales and use tax on amounts paid or charged for a sale of: (i) a “product transferred electronically” and (ii) a repair or renovation of a product transferred electronically, including maintenance agreements.

Utah’s definition of “product transferred electronically” is limited to “a product transferred electronically that would be subject to a tax under this chapter if that product was transferred in a manner other than electronically.”

It could be said that the Utah approach singlehandedly taxes all the Streamlined “specified digital products” (digital audio visual works, digital audio works, and digital books) because all the specified digital products have a taxable tangible counterpart.

The State Tax Commission has interpreted “product transferred electronically” to be limited to products that can be downloaded by the purchaser.

- **South Dakota**

South Dakota broadly imposes tax based on gross receipts received from sales of tangible personal property, products transferred electronically, and services.

- **Proposal - “automated digital product”**

The only new method, proposed by the Chair, defines “automated digital product” as “a digital product [a separately defined term] that can be provided to multiple customers in the same or substantially similar form with minimal human intervention.”

A product would be exempt from taxation as an automated digital product if the product would be used predominantly for a trade or business.

The Chair’s critique of the methods:

In addition to the White memorandum, and the detailed critiques specific to the methods described in the Appendix, the Chair offers the following summary.

Because universal and expansive definitions describe broad categories of products, they are likely to be more adaptable to new and innovative products than specific definitions, and they may raise more revenue over time, depending on the exclusions and exemptions.

But, universal and expansive definitions describing broad categories of products have the potential to be less clear than specific definitions focused on specific products.

On the other hand, multiple specific definitions require multiple criteria for describing the products that are included and excluded. For example, the definition for “digital book” in the SSUTA requires a detailed rule to explain what is and is not a “book,” and there are similar detailed explanations for “digital audio visual works,” and “digital audio works.”

Ultimately, clarity depends upon the articulation of ascertainable terms of inclusion and exclusion rather than the type of approach.

Pyramiding of taxes:

The Study Group did not attempt to catalog potential exclusions and exemptions that may be applied to digital products. But, in response to the concerns of group participants, the pyramiding of taxes was listed as a criterion for evaluation. Accordingly, the scope of any business-to-business exclusions are discussed in the evaluations.

The proposed definition of “automated digital products” includes a proposed business-to-business exclusion in the form of an exemption based on the customer’s use in a trade or business. And, the Council on State Taxation submitted a stand-alone memorandum on the business-to-business exclusion.

List of documents in the Appendix:

- Memorandum regarding the Three Approaches Matrix
- Descriptions and critiques of selected state approaches
 - Washington
 - Utah
 - Ohio
 - South Dakota
 - Wisconsin
- Proposed model definition of “automated digital product,” regulations, and related exemption
- Comments from Craig Johnson, Executive Director, Streamlined Sales Tax Governing Board
- Comments from The Council on State Taxation
- Comments from Eversheds Sutherland
- Comments from Edward Bernert
- Information on business-to-business exemptions from Diane Yetter