

Digital Taxation: The Source of the Problem



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It's awfully convenient for this installment of Board Briefs to involve a topic that basically mirrors a program I

participated in at the Council On State Taxation's annual Sales Tax Conference in Las Vegas last month. There's nothing like a little economies of scale for a busy tax practitioner!

As I prepared for the COST event, it was interesting to see all sorts of developments around taxability, meaning that states have quickly jumped on the digital bandwagon, coming out with new legislation, rulings, or policy guidance outlining their intentions to tax basically anything that moves in the digital economy.²⁹ Digital goods? Sure, we'll tax them.³⁰ Software as a service? Well, it's kind of like tangible property.³¹ Streaming services? What the heck, why not!³² And I suspect some of my colleagues on the advisory board will comment about the new and wacky (tax term) attempts to tax digital advertising and consumer data.³³

This, of course, puts taxpayers in the unenviable position of trying to keep up with all the new and exciting ways states are looking to raise revenue. And nowhere is this more problematic than with the issue of sourcing. Sales taxes, for example, are generally destination-based taxes; the imposition of tax is based on where an item is delivered. This is very easy to

determine for sellers of tangible personal property; just check the FedEx label. But what is a seller of digital goods or services or software to do when its customers use the seller's products in multiple jurisdictions? If you ask that question in most states, you'll be greeted by the familiar sound of chirping crickets. There's just no guidance. And the few states that have adopted some form of guidance appear to outline differing and sometimes contradictory methods for the determination of which state's tax is supposed to apply or at least how to go about proving it.

For example, in the since-repealed "multiple points of use" rules from the Streamlined Sales and Use Tax Agreement, a purchaser who knew at the time of purchase the digital good or service would be used in multiple places could provide the seller with a multiple points of use certificate that relieved the seller from the collection of tax or allowed the parties to determine points of use.³⁴ Some states (Ohio, Minnesota, Massachusetts, and Washington) have adopted similar provisions. Other states, like Utah and Tennessee, have outlined legislation or regulations staking out their own provisions, based on the percentage of users or other reasonable methods.³⁵

The SSTUA itself suggests a sourcing determination based on a set of hierarchy rules. And a couple of states, like New York and Pennsylvania, have chosen (or been forced) to stake out a position in response to a ruling request by a taxpayer.³⁶ In New York, for example, the taxpayer was instructed to simply get a letter from its customer on the customer's letterhead outlining the number of users located inside and outside New York.³⁷ Colorado has issued similar guidance.³⁸ Finally, Texas has adopted regulations applicable to data processing services and

²⁹ See Storage of Tangible or Electronic Files, Documents, or Other Records (Iowa Department of Revenue, Feb. 14, 2019); Indiana Rev. Rul. 2018-075T, (Indiana Department of Revenue, Sept. 25, 2019).

³⁰ See District of Columbia Office of Tax and Revenue, "Taxation of Digital Goods in the District of Columbia" (Jan. 3, 2019) (announcing that sales of, or charges for, digital goods are subject to the District's sales and use tax effective Jan. 1, 2019).

³¹ See *Citrix Systems Inc. v. Massachusetts Commissioner of Revenue*, No. SJ-C-12741 (Mass. Sup. Jud. Ct. Feb. 5, 2020).

³² See South Carolina Private Letter Ruling 18-1.

³³ See Maryland S.B. 2 (introduced Jan. 8, 2020); Nebraska L.B. 989 (introduced Jan. 14, 2020); New York S. 6102/A. 9112 (introduced Jan. 21, 2020).

³⁴ See MTC Streamlined Sales and Use Tax Agreement, former section 312 (repealed Dec. 14, 2006).

³⁵ See Utah Info. Pub. No. 64 (May 1, 2012); Utah Admin. Code r. R865-19S-92; Utah Code Ann. section 59-12-211; Tenn. Code Ann. section 67-6-231; Tennessee Important Notice No. 15-14 (Dec. 2015).

³⁶ See Pennsylvania Sales and Use Tax Ruling No. SUT-12-001 (May 31, 2012); New York State Department of Taxation and Finance, TSB-A-09(41)S (Sept. 22, 2009); TSB-A-10(10)S (Mar. 16, 2010); TSB-A-09(55)S (Dec. 7, 2009); TSB-A-03(55)S (Jan. 31, 2003).

³⁷ See New York State Department of Taxation and Finance, TSB-A-03(55)S (Jan. 31, 2003).

³⁸ Colorado Department of Revenue, Sales Tax Topics: Computer Software (December 2018).

software that look a little more like the kind of market-based sourcing rules we see for income taxes, allowing an allocation not based on the number of users but instead based on where the benefit is received by a “separate, identifiable segment of a customer’s business.”³⁹

But that’s basically all there is. In most states, we’re left to figure it out for ourselves, which often leaves us trying to fashion remedies and ways to resolve sourcing issues on an ad hoc basis during an audit. Of course, we SALT practitioners are used to dealing with varying and often inconsistent approaches by states, especially in the sales tax area. But as states are seemingly falling over themselves seeking to expand the reach of their sales taxes to cover digital goods and services, this kind of “tax first, ask questions later” approach puts many taxpayers in the sometimes impossible position of trying to comply with new state tax policies and practices in the dark.

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³⁹ See Tex. Admin. Code Ann. section 3.330(f); Tex. Policy Letter Ruling No. 201004665L (Apr. 29, 2010); Tex. Comptroller Decision No. 111,499 (June 9, 2015).