

Interpretative Rules

Sec. 332.1 Digital Products

A. Section 332A provides definitions for the terms “end user” and “permanent” for purposes of Section 332.

1. **“End user”** is to be construed broadly and generally encompasses any purchaser. However, term excludes a person who receives by contract a specified digital product for further commercial broadcast, rebroadcast, transmission, retransmission, licensing, relicensing, distribution, redistribution or exhibition of the specified digital product, in whole or in part, to another person or persons (hereinafter collectively referred to as either “right to redistribute” or “redistribution”). Rights to redistribute, if any, that arise under some statutory or common law doctrine (such as “fair use) are not rights to redistribute that are transferred by contract and persons who receives such rights are not within the exclusion. The term “contract,” as used in conjunction with the term “end user”, includes contracts formed by any means enforceable in a court of law. The term includes contracts and agreements formed electronically and “online,” including “user agreements,” “terms of service” or “end user license agreements.” Unless such an agreement with the seller includes a redistribution right, the purchaser will be an end user under this section.

Example 1. Facts: The owner of a bar downloads a group of songs for a fixed fee. The owner is authorized to download the songs and store them on a hard drive and keep the songs permanently. The bar owner’s contract with the music vendor does not convey any right to redistribute the songs or to play them in the bar. However, the bar owner also has a license from a third party society of music composers, authors, and publishers that collects fees from users of music created by its members. The license permits the bar owner to play the songs in the bar. The third party licensing society is unaffiliated with the seller of the songs. Under the license from the third-party society, the bar owner plays the songs in the bar for the bar patrons’ enjoyment.

Conclusion: The bar owner is an end user. Assuming that the playing of the songs in the bar constitutes “redistribution” within the meaning of Section 332D, the contract between the bar owner and the music seller does not convey any rights to redistribute the songs. The fact that the bar owner has separately acquired the rights from a third party to play the songs in the bar has no impact on whether the bar owner is an end user of the songs. Even if the bar owner failed to obtain permission to play the songs in the bar but did so anyway, the bar owner would be an “end user” of the songs.

Example 2: A television program distribution company transfers a television program electronically to a television station. The contract between the

distribution company and the station grants the station the right to broadcast the program in the station's local market.

Conclusion: Because the contract between the distribution company and the station confers the right to broadcast the program, the television station is not an end user of the television program.

2. "Permanent" as used in this Section, means perpetual or for an indefinite or unspecified length of time.
- B. Section 332B provides a presumption that the imposition of a sales or use tax on a transaction involving specified digital products, or one or more of the subcategories, only applies to sales where the seller grants the purchaser the right to permanently use the product, which right is which is not conditioned upon continued payment from the purchaser, to a purchaser who is an end user.

1. **Right of permanent use.**—

- i. A tax imposed on "specified digital product" generally will not apply to a transaction unless the purchaser is granted by the seller the right to permanently use the product. Even though the transaction might result in the transfer of a right to permanently retain a copy of the product, the tax will not apply unless seller allows the purchaser to view, listen to read or otherwise use the "specified digital product" in perpetuity. Placing time limits on the purchaser's continuing future use will result in not satisfying the "right of permanent use" requirement and the tax will not apply. Also, the tax will not apply if the purchaser's right to use the product is conditioned on continued payment by the purchaser. If the purchaser's right to use the property ends upon the cessation of the purchaser's payment, the tax does not apply
 - ii. A right of permanent use shall be presumed to have been granted unless the agreement between the seller and the purchaser expressly places limits on the length of time that the product may be used or the agreement specifies that the right to use terminates on the occurrence of a condition subsequent.
2. **"Granted by the seller."**—A tax imposed on "specified digital products" also will not apply unless the right of permanent use is granted by the seller. Even though a purchaser might obtain a right of permanent use under a statutory right or common law regime such as "fair use" or a similar doctrine, such rights are not "granted by the seller"; the presence of such a permanent use right would not be sufficient to satisfy the requirement the right of permanent use be granted by the seller.

This section also is designed to give states flexibility in how they limit their tax to end users. Some states may choose to implement the end user requirement through their sale-for-resale exemption regime. However, even if a state partially or wholly fails to implement the end user requirement in some fashion, it may fail to substantially comply with the Agreement.

- C. Section 332C provides that if a state seeks to impose a tax on sales of “specified digital products” or on products within one of the subcategories, where the right to use granted by the seller is only temporary, conditioned on continued payment by the purchaser or on sales to purchasers other than end users, care must be taken in how the imposition statute is drafted. Section 332C requires that the imposition be specific and separated in some fashion from the imposition on products that meet the presumption described in Section 332B.

Example 1: State A has an imposition statute as follows:

There is hereby imposed a tax of 5% of the sales price of sales: (i) of specified digital products to an end users with the right of permanent use granted by the seller which is not conditioned upon continued payment from the purchaser; and (ii) of specified digital products to an end user with the right of more than 24 hours of access granted by the seller which is not conditioned upon continued payment from the purchaser.

This imposition statute satisfies the “specifically imposed and separately enumerated” requirements of Section 332C because the imposition on sales of specified digital products where the seller has granted less than permanent use rights because the imposition is specific and enumerated in a separate subsection of the general imposition statute.

Example 2: State B has an imposition statute as follows:

There is hereby imposed a tax of 5% on the sales price of sales of specified digital products with the right to use for more than 24 hours granted by the seller which is not conditioned upon continued payment from the purchaser.

This imposition does not comply with the “specifically imposed and separately enumerated” requirements of Section 332 C because the expansion of the tax to specified digital products sold with use rights that are less than permanent is not separated from the imposition on specified digital products that are sold with permanent use rights.

- D. Section 332D provides rules similar to those provided in Section 332C for imposing sales tax on other products that are transferred electronically. Statutes imposing sales tax on other products transferred electronically must be specific and separately enumerated.

Example 1: State A has an imposition statute as follows:

There is hereby imposed a tax of 5% of the sales price of sales of (i) specified digital products and (ii) electronically transferred magazines to end users with the right of permanent use granted by the seller which is not conditioned upon continued payment from the purchaser;

This imposition statute satisfies the “specifically imposed and separately enumerated” requirements of Section 332D because the imposition on sales of electronically transferred magazines is specific and enumerated in a separate subsection of the general imposition statute.

Example 2: State B has an imposition statute as follows:

There is hereby imposed a tax of 5% of the sales price of sales: (i) of specified digital products to an end users with the right of permanent use granted by the seller which is not conditioned upon continued payment from the purchaser; and (ii) all other products transferred electronically regardless whether the seller has granted the purchaser a right of permanent use, whether the right to use is conditioned on continued payment and whether the purchaser is an end user.

This imposition statute satisfies the “specifically imposed and separately enumerated” requirements of Section 332D because the imposition on sales of all other electronically transferred products is specifically called out and enumerated in a separate subsection of the general imposition statute.

- E. Section 332A provides that for purpose of Section 327(C) and the taxability matrix, the subcategories “Digital Audio Visual Works”, “Digital Audio Works”, and “Digital books” are separate definitions and that a member state may exclude “Digital Audio-Visual Works”, “Digital Audio Works”, or “Digital Books” from its definition of “Specified Digital Products”.

If a state imposes its tax on or exempts “Specified Digital Products” then the tax or exemption applies to all three subcategories of digital products. However, the digital products definition does not require that a state tax or exempt all of its subcategories. A state may choose to impose its tax on one or more subcategories and exempt the remainder. For instance, a state may choose to impose its tax only on “digital audio-visual works” and exempt “digital audio works” and “digital books.”

Example 1: State A’s imposition statute provides that “Specified Digital Products” are subject to sales tax except for “digital books.” This imposition statute is sufficient to impose a sales tax only on “digital audio works” and “digital audio-visual” works.

Example 2: State B’s imposition statute provides “digital audio-visual works” and “digital audio works” are subject to sales tax. This imposition statute is sufficient to exclude from tax “digital books.”

F. Section 332F provides the rules for how states may impose tax on or exempt “specified digital products” and products within the subcategories. Section 332D specifies that if a state seeks to impose a sales or use tax on specified digital products or one or more of the subcategories, it must specifically use those terms in its imposition statutes and must adopt the definitions as set forth in the Library of Definitions. Thus, while the imposition statute must use the specific labels “specified digital products” and/or “digital audio-visual works,” “digital audio works” and “digital books” the definitions accompanying those labels may either be in another part of the statute or may be in an administratively adopted rule or regulation. However, in all events, the definitions, regardless of where they appear, must substantially comply with the definitions set forth in the Library of Definitions.

The section also makes it clear that while states are not precluded from imposing sales and use taxes on products not meeting the definitions of specified digital products, such imposition must otherwise meet the requirements of this section.

This provision requires that if a state legislature chooses to impose its sales tax on specified digital products or the subcategories it must use a separate imposition statute using the term “Specified Digital Products” or one or more of the subcategories; it may not rely upon a regulatory or judicial interpretation of the definition of tangible personal property. Additionally, a state may not rely upon an imposition statute (or other provision) that is imposed based on the method of delivery of the product in order to tax a digital product.

Example 1: State X, has a sales tax imposition statute that applies to “tangible personal property.” It also has a court case holding that electronically delivered music is tangible personal property under the state’s definition of tangible personal property. The judicial interpretation of the definition of tangible personal property does not comply with the Agreement’s definition of tangible personal property and is barred by Section 332 C. In order to comply with the requirements of the Agreement and to impose its tax on electronically delivered music, State X’s legislature must enact a specific tax imposition on “digital audio works.”

Example 2: State Y has a definition of tangible personal property that provides that it applies regardless of the method of delivery. State Y’s definition of tangible personal property, if it is interpreted as including digital products, would be sufficient to comply with the requirements of the agreement that the imposition on “specified digital products” use that term and its corresponding definitions.