

**August 17, 2007**

**A motion by Oklahoma for an interpretive rule relating to digital products and Section 332 of the Agreement.**

**Sec. 332.1 Digital Products**

- A. Section 332A provides that specified digital products and the subcategories thereof are not within the definition of tangible personal property. The purpose of Section 332A is to make it clear that specified digital products and the subcategories are a separate class of property outside of tangible personal property. States are not free to interpret the definition of tangible personal property as including any item within the definition of specified digital products.
- B. 1. Section 332B 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. A member state may exclude “Digital Audio-Visual Works”, “Digital Audio Works”, or “Digital Books” from its definition of “Specified Digital Products”.
2. If a state imposes its tax on “Specified Digital Products” then the tax applies to all three subcategories of digital products. However, the specified 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 does not impose a tax on “digital books.”

- C. 1. Section 332C addresses how states may impose tax on or exempt specified digital products and the subcategories. Section 332C 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 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 be in substantially the same language and cannot be used in a manner that is contrary to the meaning as the definitions set forth in the Library of Definitions.

2. Examples of imposition statutes which conform to the requirements of 332C:
  - a. There is hereby imposed a tax of 5% on the sales price of sales of specified digital products to an end user with the right of permanent use granted by the seller which is not conditioned upon continued payment from the purchaser.
  - b. There is hereby imposed a tax of 5% on the sales price of sales of specified digital products.

*To be consistent with the agreement both of these examples would have to be construed to only impose a tax on specified digital products sold to an end user with the right of permanent use for a transaction that is not conditioned upon continued payment by the purchaser. These requirements do not have to be contained in the imposition statutes. They may be in a separate statute or in an administrative rule.*

3. Section 332C requires that if a state legislature chooses to impose its sales tax on specified digital products or the subcategories it must use the term “Specified Digital Products” or one or more of the subcategories in its imposition statute; 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 specified 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. In order to comply with the requirements of the Agreement, State X’s legislature must enact a specific tax imposition on “digital audio works” to impose its tax on electronically delivered music.

Example 2: State Y has a definition of tangible personal property that provides that it applies regardless of the method of delivery. If State Y imposed a tax on specified digital products based on this definition of tangible personal property, it would not be in compliance with the Agreement.

D. States remain free to incorporate terms such as “digital audio visual works,” “digital audio works” and “digital books” within their sales and use tax statutes and to tax or exempt those products when they do not otherwise meet the end user, permanent use or continued payment restrictions. For instance, a state may impose a tax on “digital books” purchased by someone who receives less than a right of permanent use. However, such imposition must be specifically imposed and separately enumerated.

1. Section 332D provides a rule of construction such 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 if the purchaser is an “end user” unless the imposition

statute provides that the tax is specifically imposed on and separately enumerates another class or classes of purchasers. This section is designed to give states flexibility in how they limit their tax to end users. States may choose to implement the end user requirement through their sale-for-resale exemption regime. The application and imposition of the end user requirement must be consistent with 332D.

Example of an imposition statute in a State which has a series of deductions/exemptions that when taken in combination meet the conditions imposed by “sold to end user” as required by the Agreement.

“There is hereby imposed a tax of 5% on the sales price of sales of specified digital products with the right of permanent use granted by the seller which is not conditioned upon continued payment from the purchaser.”

Section 332D also defines “end user” broadly as encompassing any purchaser. However, the 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 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 Section 332D, includes contracts formed by any means enforceable in a court of law. The term includes contracts and agreements formed electronically and “online” and includes “user agreements,” “terms of service” or “end user license agreements.” Unless such an agreement with the seller includes an explicit 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. a. Unless a statute specifically imposes and separately enumerates a tax on a sale of a specified digital product for less than permanent use, a statute which imposes a tax on a “specified digital product” will not be construed as imposing tax on the sale unless the purchaser is granted by the seller the right to permanently use the product.
- b. Even though the transaction might result in the transfer of a right to permanently retain a copy of the product, the transaction will not be subject to tax unless the seller authorizes the purchaser to view, listen to read or otherwise use the product in perpetuity.
- c. Further, placing time limits on the purchaser’s continuing future use will result in not satisfying the “right of permanent use” and the transaction will not be taxable.
- d. A right of permanent use has been granted unless the agreement between the seller and the purchaser specifies or the circumstances surrounding the transaction suggest or indicate that the right to use terminates on the occurrence of a condition subsequent.

Example: A cable company offers its customers basic and premium cable services which provide scheduled programming for a monthly fee. In addition to the scheduled programming, the premium level service provides an "on-demand" feature included in the monthly fee. This on-demand feature allows the customer to select the time when certain specified programs are delivered to the viewing screen. The cable company may also permit the customer to watch additional single programs such as movies, concerts and sporting events on a "pay-per-view" basis with viewing limited to a set time period. The time period limitation may be set forth on-screen, online or in the subscriber agreement. The company does not authorize the customer to permanently retain the programming. For these reasons, none of the cable company’s basic, premium and pay per view services are "specified digital products."

The fact that a customer uses a recording device, such as a VCR or DVR, does not result in the cable company's programming services (i.e., basic, premium, on demand, or pay per view) being characterized as a specified digital product since any rights granted to access the services offered by the cable company terminate upon discontinuation of payment to the cable company and no permanent right to keep the programming was ever allowed, granted or authorized by the cable company. Any right to maintain the programming on a DVR or any other recording device, if it exists at all, is provided by other law.

- e. Example of an imposition statute that imposes a tax on Specified Digital Products sold with the right of permanent use and on Specified Digital Products sold with a right of use which is less than permanent but is more than 24 hours which conforms to 332D.

“There is hereby imposed a sales tax of 5% of the sales price of sales (i) of specified digital products to 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.”

- f. Example of an imposition statute that imposes a tax on Specified Digital Products sold with the right of permanent use and on Specified Digital Products sold with a right of use which is less than permanent but is more than 24 hours which does not conform to 332D

“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.”

- g. Even though a purchaser might obtain a right of permanent use under a statutory right or common law regime such as “fair use” or similar doctrine, such rights are not “granted by the seller”; the presence of such a permanent use right would not be sufficient to come within the definition of permanent use set forth in the Agreement.

Example: State D imposes its sales and use tax on all electronically transferred “digital audio works.” Its definition of “digital audio works” is consistent with the definition set forth in the SSUTA. However, State D has a separate imposition statute that specifically extends its tax to “digital audio works” sold regardless of the length of time the purchaser may use it. State D’s use of the label “digital audio works” to impose tax on “digital audio works” with and without the right of permanent use is permissible. State D’s “taxability matrix” would show that it taxes “digital audio works” that meet the “specified digital products” definition. Its “taxability matrix” would show the tax treatment of “digital audio works” that are sold with the right of

permanent use and would also show the tax treatment of “digital audio works” that are sold with less than the right of permanent use.-

3. A transaction is not taxable 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 transaction is not a taxable transaction.

a. Example: A purchaser makes a purchase that allows the purchaser to download music to a device owned and controlled by the purchaser. The purchaser is required to pay a monthly fee and connect the device monthly to a computer or the downloaded music becomes disabled. The transaction would not be taxable as the sale of “digital audio works” or “specified digital products” unless the statute imposing the taxes specifically imposed and separately enumerated a tax on digital audio works, the use of which is conditioned on continued payment by the purchaser.

b. Example: A purchaser makes a purchase that allows the purchaser to download music to a device owned and controlled by the purchaser. The purchaser is required to pay a monthly fee in order to have the right to continue to play the music for more than a month. The device is not disabled if the purchaser fails to make the continued payment. This transaction would not be taxable as the sale of “digital audio works” or “specified digital products” unless the statute imposing the taxes specifically imposed and separately enumerated a tax on digital audio works, the use of which is conditioned on continued payment by the purchaser. It is the contractual right to continue to use the product which is legally significant and not the physical ability of the purchaser to use the product.

- E. Section 332E provides that “nothing in this section or the definition of “Specified Digital Products” limits a state’s treatment of other products or services that are outside the definition of “specified digital products.” The section recognizes that states have broad freedom to determine those products that are within and without their tax bases. While the definition of “specified digital products” must be used consistently by the Member States, it does not limit a Member State’s ability to otherwise impose tax on products that the Member State’s legislature chooses.

Example 1: State A has a statute that imposes its sales tax on transactions involving digital mailing lists that are transferred electronically. Because digital mailing lists are not “digital audio-visual works,” “digital audio works” or “digital books,” they are not within the definition of “specified digital products.” However, because State A has a special imposition that does not implicate the definition of “specified digital products,” State A’s sales and use tax laws are compliant with the SSUTA.

Example 2. State B has a statute that imposes its sales and use tax on “specified digital products.” However, its definition of “specified digital products” deviates from the SSUTA definition in that it includes electronically delivered “digital mailing lists” within the category of products within “specified digital products.” State B’s

inclusion of digital mailing lists in its “specified digital products” definition does not comply with the SSUTA.

- F. Section 332 F provides that a state may treat a subscription to “specified digital products” differently than a non-subscription purchase of such products. The purpose of this section is to give states a means to maintain neutrality with items within the subcategories that are not delivered electronically. A state may choose to tax (or exempt) a single, over the counter purchase of a product within one of the subcategories but exempt (or tax) a subscription of the same product. “Subscription” means an agreement with a seller that grants a consumer the right to obtain “specified digital products” having the same tax treatment in a fixed quantity or for a fixed period of time, or both.

Example 1: State A imposes its sales tax on books sold at retail in an over-the-counter transaction. However, State A exempts from sales tax a fee paid to join a club that provides the customer with one book per month by mail. In order to maintain parity with physical deliveries of books, State A imposes its sales tax on single electronic deliveries of books but exempts from tax a subscription that provides customers with electronic book deliveries on a monthly basis.

- G. 1. Section 332 G provides that the tax treatment of a “Digital Code” shall be the same as the tax treatment of the “Specified Digital Product” to which the “Digital Code” relates and that the retail sale of the “Digital Code” shall be considered the transaction for purposes of the Agreement. Under this section, whether or not the sale of a digital code is taxable will depend on whether the “specified digital product” which the digital code allows the purchaser to obtain is taxable. Additionally, the transfer of the digital code to the customer is the taxable event; no taxable event occurs when the purchaser later exercises the digital code and takes electronic delivery of the “digital product.”
2. Digital Code means an alphabetic, numeric or alphanumeric code that provides a purchaser with a right to obtain one or more digital product(s) within one or more of the specified digital product subcategories having the same tax treatment.
3. A digital code may be transferred electronically or it may be transferred on a tangible medium such as piece of paper, plastic card, invoice or certificate or imprinted on another product.
4. If the code permits the purchaser to obtain a product from more than one subcategory of specified digital products, it is a digital code only if all of the subcategories have the same tax treatment. For instance, if the code allows the purchaser to obtain either a digital audio visual work or a digital book (each of which meets the definition of a “specified digital product”), it would be a digital code only if the taxing state either tax or exempts both digital audio works and digital books; if the state taxes one subcategory and exempts the other, then the code is not a digital code. Only if the taxable or nontaxable nature of the underlying specified digital product or

products is ascertainable at the time the code is purchased does the code qualify as a digital code.

5. A code that represents a stored monetary value that is deducted from a total as it is used by the purchaser is not a digital code. Nor is a code that represents a redeemable card, gift card or gift certificate that entitles the holder to select specified digital products of an indicated cash value a digital code. Only if the code may be used to obtain one or more identifiable products within one or more subcategories of specified digital products having the same tax treatment does the code qualify as a digital code.

6. The placement of a time restriction on the redemption of a digital code in no way impacts whether the right to use the underlying digital product is temporary or permanent.

#### 7. Examples:

Example 1: State A does not tax any of the subcategories of “specified digital products.” Customer in State A purchases a digital code that allows the electronic delivery of a single song. The sale of the digital code is not subject to tax and no taxable event occurs when the customer uses the digital code to download a song.

Example 2: State B imposes its sales tax on digital audio works. Customer in State B purchases a digital code that allows the electronic delivery of a single song (which constitutes a digital audio work). The purchase of the digital code is subject to tax because State B taxes digital audio works. However, when the customer takes electronic delivery of the digital audio work, no taxable event occurs; the customer has already paid the tax due with respect to the sale of the digital audio work.

8. Interaction between “end user” and “digital codes: As noted in Rule332.1C, above, an end user is any purchaser except one who receives the contractual right to redistribute the specified digital product which is the subject of the transaction. When a digital code is used to distribute the specified digital product, the “end user” focus is on the whether the holder of the digital code receives a right to redistribute the underlying specified digital product, not whether the holder of the digital code receives the right to further redistribute the digital code. If the purchaser of the digital code does not receive any right to further distribute the specified digital product after the digital code is redeemed and the specified digital product is downloaded, then the purchaser of the digital code will be an end user of the specified digital product. If the purchaser of the digital code receives the right to redistribute the specified digital product after the digital code is redeemed and the specified digital product is downloaded, then the purchaser of the digital code will not be an end user. The receipt of a right by contract to redistribute the digital code does not exclude the initial purchaser of the digital code from being an end user of the underlying specified digital product to which the digital code relates.



Example 1: Facts: SongCo operates a website that maintains a catalog of songs available for customers to download. SongCo uses digital codes to facilitate the download of songs by customers. ColaCo, a soft drink bottling company, purchases from SongCo 10,000 digital codes. The contract between SongCo and ColaCo does not give ColaCo the right to redistribute the songs once they have been downloaded. ColaCo, as part of a promotion, places the digital codes in the bottle caps of some of its soft drink products. Customers who buy ColaCo's products receive the digital codes when they purchase a bottle of one of its soft drinks. The customer uses the digital codes to download songs from SongCo's website.

Conclusion: Because ColaCo did not receive any right to redistribute the songs once they were downloaded, ColaCo is an end user of the songs represented by the digital codes. The transaction between SongCo and ColaCo is a sale to an end user for purposes of Section 332 C.

Example 2: Facts: Same facts as in example 1, above, except that ColaCo, instead of using the digital codes as part of a promotion intends to resell the digital codes in several states, some of which impose sales tax on electronically transferred digital audio works and some which do not. ColaCo provides SongCo with a sale for resale exemption certificate. ColaCo charges sales tax on the resale of the digital codes in those states that impose tax on electronically transferred digital audio works.

Conclusion: The codes purchased by ColaCo are digital codes because ColaCo did not receive any right to redistribute songs after they are downloaded. The fact that ColaCo resold the codes does not disqualify them from being digital codes.

- H. Section 332 H provides that notwithstanding the provisions of Section 316 of the Agreement, a member state may provide a product based exemption for specific items within the definition of "specified digital products", provided such items which are not transferred electronically must also be granted a product based exemption by the member state. The purpose of this section is to afford states a means of maintaining compliance with the Internet Tax Freedom Act when their state law exempts a product that falls within a subcategory of "specified digital products" but does not exempt all products within the subcategory.

Example: State A generally imposes sales tax on over-the-counter sales of books but it exempts sales of Bibles. State A may also exempt electronic transfers of Bibles without exempting other types of digital books.

## **Sec. 332.2 Digital Products Definitions:**

**A. General Purpose**—The general purpose of this Rule is to describe the scope and operation of the provisions of the "Digital Products Definitions" section of Appendix C, Part II of the Streamlined Sales and Use Tax Agreement.

**B. Specified Digital Products—**

1. **Digital Audio Visual Works** -Products within the definition of the term “digital audio visual works” include movies, motion pictures, musical videos, news and entertainment programs and live events. “Digital Audio Visual Works” shall not include video greeting cards or video or electronic games.
2. **Digital Audio Works**— Products within the definition of the term “digital audio works” include recorded or live songs, music, readings of books or other written materials, speeches or ringtones or other sound recordings. A “ringtone” is a digitized sound files that is downloaded onto a device and that may be used to alert the customer with respect to a communication. A “ringtone” does not include “ringback tones” or other digital audio files that are not stored on the purchaser’s communications device. “Digital Audio Works” shall not include audio greeting cards sent by electronic mail.
3. **Digital Books**-- Products within the definition of the term “digital books” include any literary work other than “digital audio visual works” or “digital audio works,” expressed in words, numbers, or other verbal or numerical symbols or indicia so long as the product is generally recognized in the ordinary and usual sense as a “ book”. The term includes works of fiction and nonfiction and short stories. The term does not include periodicals, magazines, newspapers or other news or information products, chat rooms or weblogs. Nor does the definition include a chapter or a page from a book.
4. **Transferred electronically**--means accessed or obtained by the purchaser by means other than tangible storage media. It is not necessary that a copy of the product be physically transferred to the purchaser. So long as the purchaser may access the product, it will be considered to have been electronically transferred to the purchaser. For purposes of “specified digital products” the term “transferred electronically” has a broader meaning than the term “delivered electronically” used in the computer related definitions.

**C. Examples**—The following examples illustrate the application of these digital products definitions to certain fact patters:

**1. Facts:** An internet-based business sells music online. For a fixed fee per song, purchasers are authorized to download a song and store it on a portable music playing device and to play the song as many times as they want. There is no time restriction with respect to how long the purchaser can keep the song.

**Conclusion:** The downloaded songs are specified digital products because music is specifically included within the definition of “digital audio works” and the transaction is one which has the right of permanent use granted by the seller.

**2. Facts:** A satellite television company offers a movie downloading product for all of its subscribers. For an additional fee per movie, paid in addition to the monthly subscription fee, a subscriber can download a movie to a recording device. Once downloaded, the purchaser is authorized to keep and use the movie permanently.

**Conclusion:** The movie is a specified digital product because a movie falls within the definition of a “digital audio visual work” and the sale is a sale to an end user to whom the right of permanent use is granted by the seller.

**3. Facts:** A cable television service company offers a movie downloading product for all of its subscribers. For an additional fee per movie, paid in addition to the monthly cable television subscription fee, a subscriber can download a movie and save it to a recording device. Once downloaded, the purchaser is only able to watch the movie for 24 hours. After the 24 hours period lapses, even though the copy of the movie remains on the purchaser’s device, the purchaser is unable to view it.

**Conclusion:** Because the purchaser is unable to use the copy of the movie after the expiration of 24 hours the sale of the movie would not be subject to tax by a statute which imposed a tax on specified digital products unless the statute specifically imposed and separately enumerated a tax on the sale of a specified digital product with less than the right of permanent use. The fact that the copy remains on the purchaser’s device is not relevant because the purchaser does not have the right to use the movie permanently.

**4. Facts:** A music download service vendor provides a subscriber the right to download a song for a set price and copy that song to a portable music playing device. The subscriber can continue to use that song as long as a monthly fee is paid. If the subscriber fails to pay the required fee, the purchaser is no longer authorized to use or play the song.

**Application:** The song is not subject to tax by a statute which imposes a tax on specified digital products unless the statute also specifically imposes and separately enumerates a tax on the sale of specified digital products or digital audio works with less than the right of permanent use or the use of which is conditioned upon the purchaser’s continued payment.

5. **Facts:** Company F also sells music over the Internet for a fixed fee per song. Purchasers download the songs to their portable electronic recording device. The terms of use that govern the purchaser’s use of the songs provide that the purchaser’s right to use the song terminates in 99 years.

**Conclusion:** The songs are “specified digital products.” The terms of use are part of the agreement between the seller and the purchaser. Even though the agreement expressly

places a time limit on the purchaser's use of the songs, the circumstances surrounding the transaction indicate that a permanent right of use has been granted. A time limit of 99 years is effectively a permanent right of use.