taxnotes® state

Volume 117, Number 11 ■ September 15, 2025

Sales and Use Tax Exemptions for Digital Inputs

by Charles C. Kearns, Constance Chien, and Cyavash Ahmadi

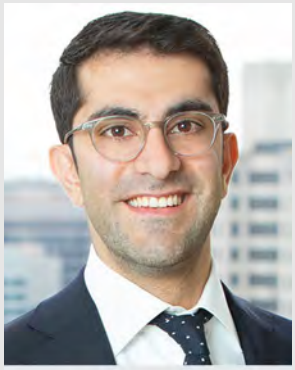
Reprinted from *Tax Notes State*, September 15, 2025, p. 711

Sales and Use Tax Exemptions for Digital Inputs

by Charles C. Kearns, Constance Chien, and Cyavash Ahmadi

Charles C. Kearns

Constance Chien



Cyavash Ahmadi

Charlie C. Kearns is a partner and Constance Chien is an associate in Eversheds Sutherland (US) LLP's Washington office. Cyavash Ahmadi is counsel in the firm's New York office.

In this installment of A Pinch of SALT, the authors analyze the approaches of different states regarding sales and use tax exemptions for digital inputs, including multistate uniformity efforts.

Nearly every year, a state legislature expands its sales and use tax base to include a new facet of the digital economy.[1] These tax expansions include transactions involving digital goods,[2] digital services,[3] as-a-service software offerings,[4] and other components of the digital economy.[5] In doing so, policymakers should consider how sales or use tax would apply — if at all — to business purchases used to develop or provide those offerings.

When states expand their sales and use tax bases, they also have a unique opportunity to implement sound tax policy and exempt digital inputs. Most states that have recently enacted new taxes on digital goods, digital services, or computer software have adopted some form of digital input exemption, to varying degrees of success.[6]

This installment examines different state approaches to those exemptions, including uniformity efforts in the Streamlined Sales and Use Tax Agreement and under review by the Multistate Tax Commission. It will also highlight states that have adopted inadequate exemptions applicable (or inapplicable) to digital inputs.

I. What Is a Digital Input?

We define digital inputs as the ingredients used to develop, produce, or supply a digital product (for example, a digital audiovisual work), digital service (for example, a digital automated service), or computer software and related service

[1] *See generally* Washington S.B. 5814, Maryland H.B. 352, Louisiana H.B. 8, Iowa S.F. 2417, and Connecticut H.B. 7424.

[2] *See* Streamlined Sales and Use Tax Agreement section 332, "Specified Digital Products" (last accessed July 31, 2025).

[3] *See* Wash. Admin. Code section 458-20-15503; Amy Hamilton, "MTC Project Takes Up Automated Digital Product Proposal," *Tax Notes State*, Feb. 3, 2025, p. 357.

[4] *See* NIST SP 800-145; R.I. Gen. Laws section 44-18-7.1(g)(vii); 280-RICR-20-70-46.7.

[5] *See* Md. Code Ann., Tax-Gen. section 11-219 (effective July 1, 2025). This statute was recently amended to incorporate definitions under the North American Industry Classification System.

[6] *See generally* Karl A. Frieden, Fredrick J. Nicely, and Priya D. Nair, "Down the Rabbit Hole: Sales Taxation of Digital Business Inputs," *Tax Notes State*, July 18, 2022, p. 265.

models (for example, software as a service (SaaS)).[7] Digital inputs could include computer software, cloud services, or web hosting services used to create new products and services.

Without an exemption or exclusion applicable to digital inputs, the potential for tax pyramiding increases in two common scenarios: (1) when the digital input is resold "as such," and (2) when a digital input becomes a component or integral part of a digital good, digital service, computer software, or taxable service.

- The former scenario commonly arises when a business purchases a digital good, service, or software and resells or sublicenses that product in the same form — without any modification — to the purchaser. A wholesaler selling (for example, to a retailer) would be a typical example of this sale-for-resale transaction.
- The second scenario involves digital inputs that are incorporated as a component or integral part of a broader taxable digital output for sale at retail. In these situations, the seller may modify or configure the original digital good, software, or service into a new product or service offering. For example, a software developer might license and integrate a digital tool into its software that is then sold to end users. Or a streaming video service provider may obtain licenses that enable it to distribute television shows or movies.

II. Approaches to Exempting Digital Inputs

As states modernize their sales and use tax systems, the treatment of digital inputs has emerged as a critical policy issue. While some states have explored different approaches to taxing or exempting these inputs, most still tax them. This tax pyramiding practice distorts business decisions and increases costs.[8] In the following sections, we discuss notable approaches to exempting (or not) digital business inputs.

A. SSUTA Approach

The SSUTA is a cooperative effort of 44 states, the District of Columbia, local businesses, and the business community to simplify and modernize sales and use tax administration. Among other uniform administrative and definitional provisions, the SSUTA provides a framework for defining specific digital products (including digital audio works, digital audiovisual works, and digital books) or the broader products transferred electronically and how a member state may go about taxing those items should its policymakers decide to do so.[9]

Section 332 of the SSUTA provides operating rules or options (toggles) that a member state may adopt. Among those toggles, section 332.D.1 provides that any statute imposing tax on any or all of the defined specified digital products or products transferred electronically "shall be construed as only imposing the tax on a sale to a purchaser who is an end user unless the statute specifically imposes and separately enumerates the tax on a sale to a purchaser who is not an end user."[10] An end user is "any person other than a person who receives by contract a product 'transferred electronically' for further commercial broadcast, rebroadcast, transmission, retransmission, licensing, relicensing, distribution, redistribution or exhibition of the product, in whole or in part, to another person or persons."[11] Other than South Dakota,[12] all Streamlined member states limit their sales and

[7] Washington law defines a digital automated service as "any service transferred electronically that uses one or more software applications," with exceptions. Wash. Rev. Code section 82.04.192(3)(a).

[8] *See* Frieden, Nicely, and Nair, *supra* note 6.

[9] The SSUTA requires member states that want to tax digital products to adopt the specified digital products definitions. SSUTA section 332. Alternatively, a member state may tax products transferred electronically so long as it does not do so through its definition of tangible personal property, which includes prewritten computer software. SSUTA section 333.

[10] SSUTA section 332.D.1.

[11] *Id*. For purposes of the SSUTA's end-user limitation, transferred electronically means "obtained by the purchaser by means other than tangible storage media" (SSUTA section 332.I); *see also* Streamlined Sales Tax Governing Board Rule 332.D.1 (last accessed Aug. 14, 2025).

[12] South Dakota taxes all products transferred electronically and, more generally, has adopted the broadest sales tax base among the member states. *See* S.D. Codified Laws section 10-45-2.4(2) (imposing tax on the sale to a "person who is not an end user, unless otherwise exempted"); *see also* SSUTA section 333 ("A member state shall not include any product transferred electronically in its definition of 'tangible personal property.' 'Ancillary services', 'computer software', and 'telecommunication services' shall be excluded from the term 'products transferred electronically.' For purposes of this section, the term 'transferred electronically' means obtained by the purchaser by means other than tangible storage media.").

use taxes on specified digital products or products transferred electronically to end users.

The SSUTA requires member states to include prewritten computer software in their tangible personal property definitions. In so doing, member states[13] incorporate prewritten computer software into their resale exemptions and — where applicable — into their general component part exemptions.[14] Although the SSUTA incorporates digital inputs that fall within the prewritten computer software definition into the general resale or component part exemptions, the framework does not expressly address situations in which prewritten computer software becomes a component or integral part of an output characterized as a product transferred electronically, including specified digital products, or other taxable service for sale at retail, such as data processing or information service.[15]

Because it has been nearly two decades since the end-user concept became effective as part of section 332,[16] the potential misalignment between prewritten computer software inputs and outputs characterized as products transferred electronically or taxable services (or vice versa) should be addressed if — or when — the SSUTA is updated for common digital economy transactions.

B. The Broad B2B Approaches

1. Iowa's Commercial Enterprise Exemption

When expanding its sales and use tax base to digital goods and other online services, Iowa adopted a commercial enterprise exemption for business-to-business (B2B) sales, which allows businesses to exclude digital inputs from taxation when used in trade or business.[17] The Legislature approved a statutory exemption for specified digital products, prewritten computer software, information services, and SaaS "when purchased by a commercial enterprise and used exclusively by or furnished to that commercial enterprise."[18] To qualify for "use exclusively by the commercial enterprise," the use for noncommercial purposes must not be more than de minimis.[19] To claim the exemption, taxpayers simply complete an Iowa sales tax exemption certificate.

2. Potential MTC Model B2B Exemption?

Similar to the Iowa approach to exempting commercial enterprise purchases, an MTC digital products work group is considering a broad definition of automated digital products while emphasizing the need for an equally broad B2B exemption to avoid pyramiding.[20] This proposal would exempt all products from taxation as an automated digital product "if the product will be used predominantly for a trade or business."[21] This is just one of the several broad approaches under review by the work group and, so far, the only one not adopted by a state.[22]

[13] *See, e.g.*, N.C. Gen. Stat. section 105-164.13(8) ("Sales to a manufacturer of tangible personal property that enters into or becomes an ingredient or component part of tangible personal property that is manufactured. This exemption does not apply to sales of electricity."); Ga. Code Ann. section 48-8-3.2(a)(5); Ga. Comp. R. & Regs. 560-12-2-.62(4) ("The sale, use, storage, and consumption of industrial materials are exempt from sales and use tax. In order to qualify for the exemption, the materials must be used for the processing or manufacture of, or conversion into, articles of tangible personal property; and the industrial materials must: (a) become a component part of the finished product or (b) be coated upon or impregnated into the product at any stage of its processing, manufacture, or conversion, even though such materials do not remain a component part of the finished product for sale.").

[14] *See* SSUTA, Appendix C, Part I (Administrative Definitions) (defining tangible personal property) and Part II (Product Definitions) (defining prewritten computer software and other computer-related terms).

[15] Ohio has adopted a regulation under which "a provider of automatic data processing, computer services, or electronic information services may claim resale on any purchase of tangible personal property that is or is to be transferred permanently to the consumer of the service as an integral part of the performance of the service." Ohio Admin. Code 5703-9-46(F). However, the same regulation explains that the provision of automatic data processing services does not constitute manufacturing. Ohio Admin. Code 5703-9-46(D).

[16] Section 332 was added to the SSUTA on September 20, 2007, and became effective on January 1, 2008.

[17] Iowa Code section 423.3(104)(a), (47)(d)(1), (104)(b)(1).

[18] Iowa Department of Revenue, "Taxation of Specified Digital Products, Software, and Related Services" (last accessed July 31, 2025).

[19] Iowa Admin. Code 701-225.7(5) ("'De minimis' means an amount of use of a product for noncommercial purposes that, when considering the product's value and the frequency with which the use for noncommercial purposes occurs during the product's total use time, is so small as to make accounting for that use unreasonable or impractical. Whether a use is de minimis is a fact-based determination that shall be made on a case-by-case basis.").

[20] For drafts, meeting notes, and ongoing research updates, see MTC, "Sales Tax on Digital Products" (last accessed Aug. 1, 2025).

[21] For relevant MTC discussions on its uniformity project on state sales and use taxation of digital goods, see MTC, "Tax Pyramiding and Business-to-Business Exemptions in the Context of State Taxation of Digital Products" (last accessed Aug. 2, 2025).

[22] Other broad approaches to taxing digital products are those adopted by Maryland, Ohio, South Dakota, Washington, Wisconsin, and Utah. *See* MTC, *supra* note 20.

3. Washington: Close, Yet So Far

Washington illustrates the risks of incorporating a partial business purpose exemption for some B2B transactions. Washington adopted a business purpose exemption for digital goods, but not for digital automated services or remote access software.[23] Digital goods are defined as "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."[24]

The business purpose exemption applies to "the sale to a business of digital goods, and services rendered in respect to digital goods, if the digital goods and services rendered in respect to digital goods are purchased solely for business purposes."[25] Regarding the exemption, business purposes means "any purpose relevant to the business needs of the taxpayer claiming an exemption [but] do not include any personal, family, or household purpose"; and "services rendered in respect to digital goods" includes installing, repairing, altering, or improving digital goods for consumers.[26]

As a Streamlined member state subject to the rules of construction in section 332 of the SSUTA, Washington limits its sales and use tax to end users' digital goods and digital automated services.[27] However, from the enactment of the digital products regime in 2009 until 2020, Washington law also included a more expansive digital input exemption for "consuming the digital good, digital code, digital automated service, or service defined as a retail sale . . . in producing for sale a new product, where the digital good, digital code, digital automated service, or service defined as a retail sale . . . becomes an ingredient or component of the new product."[28] The 2020 amendment effectively limited the input exemption under the SSUTA's end-user concept, which may not include all permutations of digital inputs in accordance with current industry practice.

The Washington framework has led to persistent challenges in the characterization of a transaction as a taxable digital automated service, including the adoption of *16* exclusions from the base definition of the term and the recent repeal of an unworkable human effort exemption.[29] This is in part because the partial B2B exemption for digital goods primarily applies to individual consumer transactions such as specified digital products.[30] Instead of providing a meaningful B2B exemption for digital automated services or remote access software — items primarily purchased by businesses — the Washington Legislature limited the business purpose exemption to transactions that, in practice, are not common purchases by businesses regardless of whether they are end users.

[23]Wash. Rev. Code section 82.08.0208(3) ("The tax imposed by [the sales tax statute] does not apply to the sale to a business of digital goods, and services rendered in respect to digital goods, if the digital goods and services rendered in respect to digital goods are purchased solely for business purposes."). As originally enacted as part of Washington's digital products tax regime, the business purpose exemption was limited to sales "to a business of standard digital information purchased solely for business purposes." Wash. H.B. 2075, original bill, sections 404, 505.

Under the original regime, business purpose meant "any purpose relevant to the business needs of the taxpayer claiming an exemption under this section [but] do not include any personal, family, or household purpose"; and standard digital information meant a "digital good consisting primarily of data, facts, or information, or any combination thereof, not generated or compiled for a specific client or customer." The business purpose exemption for standardized digital information was repealed in 2019, though the exemption was more expressly limited to digital goods. Wash. S.B. 5402 section 64. As noted, the state's current exemption applies to digital goods and services rendered concerning digital goods.

[24]Wash. Rev. Code section 82.04.192(6)(a); Wash. Admin. Code 458-20-15503(202), -(203).

[25]Wash. Rev. Code section 82.08.0208(3)(a).

[26]Wash. Rev. Code sections 82.08.0208(3)(b)(ii), 82.04.050(2)(g).

[27]Wash. Rev. Code sections 82.08.010(8)(a); 82.12.020(1)(e)(ii); Wash. Admin. Code 458-20-15503(201).

[28]See former Wash. Rev. Code section 82.08.02082 (enacted by Wash. H.B. 2075, section 503 (2009), repealed by S.B. 5402, section 64(5) (2020)).

[29]Wash. Rev. Code section 82.04.192(3)(b) (2024) (excluding from digital automated services, *inter alia*, "any service that primarily involves the application of human effort by the seller, and the human effort originated after the customer requested the service"); Wash. S.B. 5814, section 201 (2025) (repealing human effort exclusion).

[30]Digital goods are defined in Wash. Rev. Code section 82.04.192(6)(a) as "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." This legislation builds on an initial bill to modernize the tax base for digital goods and services in 2009, which initially referred to standard digital information and services under Wash. Rev. Code section 82.08.02087. H.B. 2075, 61st Leg., Reg. Sess. (Wash. 2009).

C. Critiques of Broad B2B Exemptions

The broad Iowa-style B2B exemption has drawn criticism from administrators and policymakers, who argue that —

- This approach would result in significant state revenue losses, dramatically shrinking state tax bases.[31]
- It would exempt digital transactions that would be taxed if transferred in tangible form or as an offline taxable service. For example, only digital inputs such as resales or component parts should be exempt.
- A more narrowly focused approach (for example, exemptions on digital resales or component parts) would be more administrable because delineating between exempt B2B use and taxable personal use would prove difficult.

But while some states tax business purchases or inputs, it has never been considered sound tax policy.[32] And a broad exemption will generally stabilize the system by reducing the need for constant legislative amendment. The appropriate response to these states' concerns appears to be that guardrails like Iowa's de minimis rule for noncommercial uses of business inputs and the SSUTA's de minimis test under its definition of a bundled transaction could be incorporated to reduce the risk that a broad exemption is abused.[33] Finally, the contention that a broad B2B exemption is not administrable does not hold water. Auditors regularly determine the validity of use-based exemptions. They also regularly make distinctions between business and personal use for income tax deductions.[34]

D. Resale and Component Part Approaches

States wary of establishing a broad exemption could instead reduce the negative effects of tax pyramiding on digital business inputs using the tried-and-true concepts of sales-for-resale and component-part exclusions to accommodate the modern digital economy. This approach not only represents the bare minimum of sound tax policy but also mitigates risk of a prohibited "discriminatory tax on electronic commerce" under the Internet Tax Freedom Act in which tangible inputs would be taxed at a lower rate than their similar internet-based equivalents.[35]

A resale refers to the subsequent sale of goods after acquisition, whether in the same form or altered. Resellers are often exempt from paying sales tax on purchases of goods intended for resale. For example, if a business purchases goods for resale, those purchases may be exempt from sales tax, but the final sale to the consumer may be taxable.[36] A component part is an item that becomes incorporated into a finished product. The Arkansas exemption for tangible personal property sold for use in manufacturing requires that the purchased property become a recognizable integral part of the product.[37] These concepts have been applied to tangible personal property and, to the extent that an analogy may be drawn between the incorporation or resale of tangible personal property and a digital product, expanding them to digital business inputs would provide certainty to businesses. A few states have already taken — or rejected — this approach.

[31] MTC, "Tax Pyramiding and BusinesstoBusiness Exemptions in the Context of State Taxation of Digital Products" (Jan. 30, 2024) (quoting a Washington State Department of Revenue representative as stating that the digital goods exemption stands to cost the state around $1.4 million in the next biennium and around $1.6 million in the 2028-2029 biennium; digital automated services exemptions would cost around $182 million, going up to almost $300 million by the 2028-2029 biennium).

[32] *See, e.g.*, Jared Walczak, Katherine Loughead, and Andrey Yushkov, "Sales Tax Reform & Modernization," Tax Foundation (Jan. 24, 2024).

[33] A transaction is not treated as a bundled transaction if the taxable products make up 10 percent or less of the total purchase price or sales price, so long as sellers consistently use either metric during the term of the contract. SSUTA, Appendix C, Part I (Administrative Definitions).

[34] *See, e.g.*, 26 U.S.C. sections 280A and 162(a).

[35] 47 U.S.C. section 151 note, section 1105(2) (2024) (defining discriminatory tax).

[36] *See, e.g.*, Md. Code Ann., Tax-Gen. section 11-101(h)(3) (exempting sales of digital products from the definition of retail sale if the buyer intends to "use or incorporate the . . . digital product in a production activity as a material or part of other tangible personal property or another digital product to be produced for sale" or resells it "in the form that the buyer receives or is to receive the . . . digital product").

[37] Ark. Code Ann. section 26-52-401(12)(B)(i). A legal opinion from the Arkansas Department of Finance and Administration stated that certain software used to monitor and operate a solar energy generation facility may qualify for the manufacturing machinery and equipment exemption "because they are computers and related peripheral equipment that directly control or measure the manufacturing process." However, if the function of this equipment is to monitor and operate aspects of the business that do not directly control or measure the manufacturing process (for example, operating entrance gates), "the answer could be different." Arkansas Department of Finance and Administration, Revenue Legal Op. No. 20190510 (June 17, 2019).

Since October 1, 2019, Connecticut has taxed digital goods[38] and prewritten computer software purchased for nonbusiness use as tangible personal property, subject to tax at the general 6.35 percent rate.[39] But electronically accessed or transferred canned or prewritten software sold to a "business for use by the business" is characterized as computer and data processing services subject to a reduced 1 percent rate.[40] As part of that 2019 tax base expansion, however, Connecticut also modernized its resale and component part exemptions to account for digital goods and electronically accessed prewritten computer software purchased for business use (computer and data processing services, that is, SaaS). In addition to digital input exemptions for computer and data processing services, nonbusiness prewritten computer software, and digital goods that are incorporated as component parts into a sale of the same character,[41] Connecticut also exempts digital inputs as follows:

> The sale of digital goods shall be considered a sale for resale if the digital goods are subsequently sold, licensed, leased, broadcast, transmitted, or distributed, in whole or in part, as an integral, inseparable component part of a digital good or ["telecommunications service"], ["community antennae television service"], ["computer and data processing services," among other taxable services] or ["certified competitive video service"] by the purchaser of the digital goods to an ultimate consumer.[42]
>
> The sale of ["computer and data processing services," among other taxable services] shall be considered a sale for resale if such services are subsequently resold as an integral, inseparable component part of digital goods sold by the purchaser of the services to an ultimate consumer of the digital goods.[43]

Connecticut's digital input exemptions thus account for and properly exempt the various ways digital inputs may be incorporated into digital goods, SaaS, or other digital outputs. Therefore, to the extent a state's policymakers may not deem a broad B2B exemption appropriate, the Connecticut approach — used in tandem with the SSUTA's end-user concept — may be viewed as a model to exempt digital inputs.

Louisiana similarly exempts sales of computer software or prewritten computer software access services, information services, or digital products when the following requirements are met:

- "the service or product is purchased or licensed exclusively for commercial purposes";
- "the service or product is used by the business directly in the production of goods or services for sale to its customers"; and
- "the goods or services produced and sold by the business are subject to sales and use tax."[44]

Louisiana also exempts self-produced or self-developed digital products used solely by the business that produced or developed them and that are not offered for sale.[45] The exemption does "not apply to computer software or computer software access services not directly involved in the production of goods or services for the customers of the business."[46]

Maryland offers exemptions for digital products if the buyer intends to resell the product either in the form in which it is received or as incorporated in another digital product or taxable service for sale.[47] However, Maryland failed to fully extend such a component part exemption to

[38] Connecticut defines digital goods as "audio works, visual works, audio-visual works, reading materials or ring tones, that are electronically accessed or transferred." Conn. Gen. Stat. section 12-407(a)(43).

[39] Conn. Gen. Stat. section 12-407(a)(13).

[40] Conn. Gen. Stat. sections 12-408(1)(D)(i), 12-407(a)(37)(A); *see also* Connecticut Department of Revenue Services, "Sales and Use Taxes on Digital Goods and Canned or Prewritten Software" (Sept. 4, 2019).

[41] Conn. Gen. Stat. section 12-410(e).

[42] Conn. Gen. Stat. section 12-410(e)(4).

[43] Conn. Gen. Stat. section 12-410(e)(5).

[44] La. Rev. Stat. section 47:305.12(A)(1)(a), -(b), and -(c).

[45] La. Rev. Stat. section 47:305.12(B).

[46] La. Rev. Stat. section 47:305.12(A)(2).

[47] Md. Code Ann., Tax-Gen. section 11-101(h)(3).

the taxable services included within its recent 3 percent tech tax base expansion.[48] Those tech tax services include cloud computing and many other digital services.[49] Under current law, Maryland exempts the tech tax services only if the buyer resells the service in its original form.[50] Thus, if the buyer incorporates a modified or altered tech tax service into another taxable service or even a digital product, the buyer's purchase of the business input is taxable.[51] Given Maryland's enactment of appropriate exemptions for digital inputs during its prior base expansion to digital products in 2021, the failure to enact a component part exemption for the tech tax services is likely a legislative oversight that nonetheless should be corrected.

Mitigating the potential tax pyramiding, at least for in-state sales, Maryland enacted an intercompany exemption that it has incorporated into its multiple points of use apportionment regime for purchases and sales of certain digital services used in and out of state. If a buyer knows at the time of purchase that a taxable digital product or service will be used both inside and outside Maryland, or resold in its original form to an affiliated entity, she may apply for the authorization to issue a multiple point of use certificate. The certificate shifts the obligation to collect and remit the sales and use tax from the seller to the buyer.[52]

E. Excessive Taxation of Digital Inputs

Texas exemplifies a piecemeal approach that has resulted in excessive taxation of digital business inputs. The state characterizes digital products variously as tangible personal property,[53] taxable services, or data processing/information services.[54] The data processing regulation further complicates compliance and increases the tax burden on digital inputs. Exemptions, such as the general resale and component part exemptions, are not tailored to digital industries.[55] For example, Texas provides that data processing providers may purchase tangible personal property (that is, canned software) for resale, but only if "care, custody, and control" of the property is transferred to the client.[56] If the software becomes a component of the service itself, the resale exemption presumably does not apply (think software components used by developers to produce their own SaaS products).[57]

Ohio's taxation of digital services — that is, automatic data processing, computer services, and electronic information services — is among the more problematic in the country because it taxes those transactions only if purchased for business use.[58] The Ohio tax structure not only facilitates tax pyramiding — indeed, taxing business inputs is a feature, not a bug, of the regime — but has caused frequent controversies regarding characterization.[59]

III. Recommendations

State sales tax modernization efforts through base expansion are nascent. As we have shown, approaches to mitigating the tax pyramiding of business inputs are varied. There is a window of opportunity to adapt the taxation of digital goods and services to the economic realities of the 21st century by drawing lessons from the taxation of the manufacturing sector in the 20th century. By broadly exempting digital business inputs in a manner similar to Iowa, states can foster economic efficiency, reduce compliance burdens, and support the growth of the modern services economy.

At a minimum, states seeking to expand their tax bases to digital services and other facets of electronic commerce should provide adequate exemptions for digital inputs — namely, sale-for-

[48] Md. Code Ann., Tax-Gen. section 11-101(m)(14), -(15).

[49] *See generally* Comptroller of Maryland, Technical Bulletin No. 56, "Sales and Use Tax on Data or Information Technology Services and Software Publishing Services: Questions and Answers" (June 10, 2025).

[50] Md. Code Ann., Tax-Gen. section 11-101(h)(3)(iii).

[51] Comptroller of Maryland, *supra* note 49, at Section III, paras, 21-22.

[52] *Id*.

[53] Tex. Tax Code section 151.009.

[54] Tex. Tax Code section 151.0101(a)(6); 34 Tex. Admin. Code 3.330.

[55] Tex. Tax Code section 151.302(b).

[56] 34 Tex. Admin. Code 3.330(d)(1).

[57] *See* 34 Tex. Admin. Code 3.330(d)(1).

[58] Ohio Rev. Code Ann. section 5739.01(B)(3)(e).

[59] *Cincinnati Federal Savings & Loan Co. v. McClain*, 196 N.E.3d 799 (Ohio 2022).

resale and component-part exemptions — similar to those provided in Connecticut, for three reasons:

- a digital input exemption reflects sound tax policy consistent with taxing end-user consumption under a normative retail sales and use tax;
- like manufacturing exemptions for tangible personal property, broad digital input exemptions encourage economic development while avoiding the pyramiding of tax for in-state companies; and
- a digital input exemption helps to avert potential ITFA violations by avoiding discriminatory taxation on electronic commerce. ■