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June 29, 2020

Colorado Department of Revenue
Taxation Division
Public Rulemaking Hearing – Digital Goods

Sent Via E-mail

Re: COST Opposes Promulgation of Sales Tax Rule 39-26-102(15)

Dear Colorado Department of Revenue, Division of Taxation:

On behalf of the Council On State Taxation (COST), I am writing to express our opposition to the promulgation of a rule that, without legislative authorization, would extend Colorado’s definition of tangible personal property to the access and/or streaming of electronic services. The proposed changes exceed the scope of the Department’s regulatory powers. The power to make such changes, if warranted, rests solely with Colorado’s legislature.

About COST

COST is a nonprofit trade association consisting of approximately 550 multistate corporations engaged in interstate and international business, many of which directly do business in Colorado. COST’s objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

The Proposed Rule Exceeds Statutory Authority

As indicated in COST letter on March 4 to a stakeholder work group meeting, any changes to subject electronic services to Colorado’s sales/use tax should be made by the legislature, and rules should be used only to clarify tax laws. However, proposed Rule 39-26-102(15) inappropriately stretches the definition of what constitutes tangible personal property beyond the Department’s regulatory authority. It does not foster a clarification of the law; instead, it would lead to more confusion and controversy, and will almost certainly lead to protracted litigation. Tangible personal property is something that can be physically received and/or delivered to a purchaser. In contrast, electronic services, whether streamed or accessed, are not physically delivered to a purchaser and require special sourcing rules (e.g., where the purchaser receives the benefit of a service). The rule also fails to address issues related to the resale of electronic services and whether a purchaser holds permanent or temporary rights to a service.

COST Sales Tax Systems Scorecard

COST issued its first scorecard on the states’ sales tax administrative systems, “Best and Worst of State Sales Tax Systems - COST Scorecard on Sales Tax Simplification,

Uniformity & the Exemption of Business Inputs” in April 2018.¹ Unfortunately, due primarily to decentralized local sales tax administration, Colorado received an “F” grade. The scorecard provides the following regarding the imposition of tax on access to prewritten software:

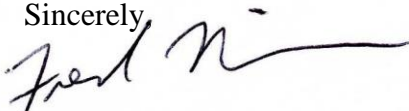
While COST does not take a position in support or opposition to a state legislature’s decisions on the breadth of its tax base (other than opposing the taxation of business inputs), the determination of taxable goods and services must be done with clear legislative authority. Failure to do so adds significant uncertainty, makes the state a less attractive place to do business, and unnecessarily subjects sellers to risk for collecting (or not collecting) tax.²

The Scorecard identified Colorado as a state in which the revenue agency, without clear legislative authority, included digital goods in the State’s tax base. The Department now, through a proposed rule, seeks to also tax the mere access to software, again, without clear legislative authority. Thus, the proposed rule would only worsen Colorado’s sales tax administration, moving it in the wrong direction.

Conclusion

COST does not oppose state imposition of a tax on electronic services, as long as it is done with clear legislative authority and the state provides an exemption for business-to-business transactions (to prevent pyramiding of the tax). The issues contained in Proposed Rule 39-26-102(15) should be addressed by Colorado’s legislature. For the reasons set forth above, COST requests the Department to withdraw this rule. Please feel free to contact me with any questions.

Sincerely,



Fredrick J. Nicely

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

¹ COST’s Scorecard is available at: <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/the-best-and-worst-of-state-sales-tax-systems-august-17-2018-final.pdf>.

² See page 14 of the Scorecard.