# Texas Comptroller Announces Changes to Sales Tax Rule for Data Processing Services

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Effective April 2, 2025, The Texas Comptroller is implementing significant changes to Title 34 TAC §3.330 regarding the application of sales and use tax to data processing services. The proposed changes were published in the Texas Register on September 13, 2024, and gave interested parties 30 days to submit comments. At the request of taxpayer advocacy groups, a public hearing was held by the Texas Comptroller on December 6, 2024.

Companies which benefit from the use of data processing services in Texas need to be aware of the regulatory change to the definition of data processing services, the new requirements for determining ancillary services, and know the updated services that are now listed as data processing services within the Texas Administrative Code.

## UPDATED DEFINITION OF DATA PROCESSING SERVICES

The new data processing service definition expands upon the previous regulatory definition of data processing services, which is the computerized entry, retrieval, search, compilation, manipulation, or storage of data or information.

The updated rule clarifies that services excluded from the definition of data processing are internet access service, transcription of medical dictation by a medical transcriptionist, and certain digital advertising services such as display of a classified advertisement, banner advertisement, and “vertical advertisement”, or link on an internet website owned by another person. Additionally, the updated regulation clarifies that payment processing services as defined in Texas Tax Code §151.0035(b)(2) and (3) are excluded from the regulatory definition of data processing services.

In line with recent audit decisions and rulings, the updated Rule §3.330 specifies that search engine optimization (SEO) services, social media marketing, and lead generation are taxable data processing services, and, effective October 1, 2025, marketplace provider services will also be considered taxable data processing under certain conditions.

## ANCILLARY DATA PROCESSING SERVICES

The Texas Comptroller has excluded services from tax which would otherwise be taxable data processing services, when such service is sold for a single charge with another (non-taxable) service, does not have a “separate value” and is ancillary to the other, non-taxable service. However, the taxpayer has the burden of proof to demonstrate that a data processing service does not have a separate value and is ancillary to the other service.

The Texas Comptroller looked to *Rylander v. San Antonio SMSA*[1], as its source for the new separate value requirement for data processing services. This represents a break from the Texas Comptroller’s long-standing policy of using the “essence of the transaction test” which, similar to “true object” tests, had looked to the service sought by the customer, and instead, will now

focus on the activities performed by the service provider.

The Texas Comptroller provided guidelines for determining whether data processing services sold with other services for a single charge are ancillary to the other service, have a determinable separate value, whether the services are distinct and identifiable and whether each service is of a type that is commonly provided on a stand-alone basis or commonly provided as an additional service for a greater single charge.

Additionally, in determining whether the data processing service is ancillary to another service, the Comptroller may consider the extent to which the service provider exercises discretion, judgment, or knowledge of principles of science, accounting, law, or other fields of study. Routine or repetitive manipulation of data by the seller is a factor suggesting that the data processing activity is not ancillary to another service and should be considered a taxable data processing service. Manipulation of data that depends on the external knowledge and discretionary judgment of the service provider suggests that the data processing activity is ancillary to another service and should not be taxable as a data processing service. Ultimately, the Texas Comptroller's evaluation is based on what the service provider is doing, not on what the customer wants.

With the burden of proof falling to the taxpayer, both sellers and buyers of digital services need to be aware of the Comptroller's updated rule.

## A&M TAX SAYS

These changes are long overdue and codify many court decisions as well as Comptroller decisions and policies but add new standards of "separate value" "ancillary" and "routine or repetitive," which are subjective, and make it difficult for taxpayers to clearly understand which services are taxable data processing services in Texas. While most businesses welcome clear guidance from taxing authorities, keep in mind that products developed by digital services providers will likely continue to outpace guidance available from taxing authorities.

To make sure your business is keeping up with new or changing sales tax laws, please contact us. A&M Tax can assist with updating your sales tax function to compliant with the latest sales and use tax laws. A&M Tax can also support your sales tax function by conducting sales tax process optimization reviews; updating your sales tax nexus analyses, product characterization and sourcing, and purchase characterization and sourcing; providing sales tax exposure analyses and exposure remediation strategies; providing sales tax audit defense services; and helping to identify and recover sales tax overpayments.

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[1] *Rylander v. San Antonio SMSA Ltd. Partnership.,* 11 S.W.3d 484, 488 (Tex. App.-Austin 2000, no pet.)

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