

Software, Digital Goods, NFTs and Digital Currency: What You Need to Know for Sales Tax



SALES TAX
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On-Demand Webinar



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Definitions

Computer Software

- Tangibly Delivered: Software that is delivered on a tangible medium, such as a disk or CD.
- Electronically Delivered: Software is transferred by electronic means (downloaded from the internet) as opposed to delivered in a tangible format
- Remotely Accessed: Software that enables a local user to connect to and access a remote computer, server or network. It enables connectivity of two or more computers/network nodes that are on separate networks and/or in different geographical locations
- License Renewals: A periodic license-to-use fee on previously purchased software. No new software is delivered or transferred

Software as a Service (“SaaS”)

- The *SaaS* model allows the consumer to use the provider’s software applications running on a cloud infrastructure.
- The applications are accessible from various client devices through a client interface such as a web browser (e.g., web-based email).
- The consumer does not manage or control the underlying cloud infrastructure including network, servers, operating systems, storage, or application capabilities.
- Under the SaaS model a service agreement is almost always executed (vs. a software license agreement or services agreement for an ASP).
- SaaS model is familiar to most Internet users, and includes such offerings as web-based e-mail, calendars, word processing, and digital photo applications.

Load & Leave

- In the Load & Leave method, software is loaded by the vendor and not transferred in tangible form to the customer
- Similar to electronically delivered software, many states exclude sales of software delivered via the Load & Leave method from sales and use tax
 - Florida, however, exempts electronic delivery, but taxes load and leave transactions.
- Note that generally, states that tax software delivered electronically have amended their definition of TPP to include canned or prewritten computer software



Load & Return

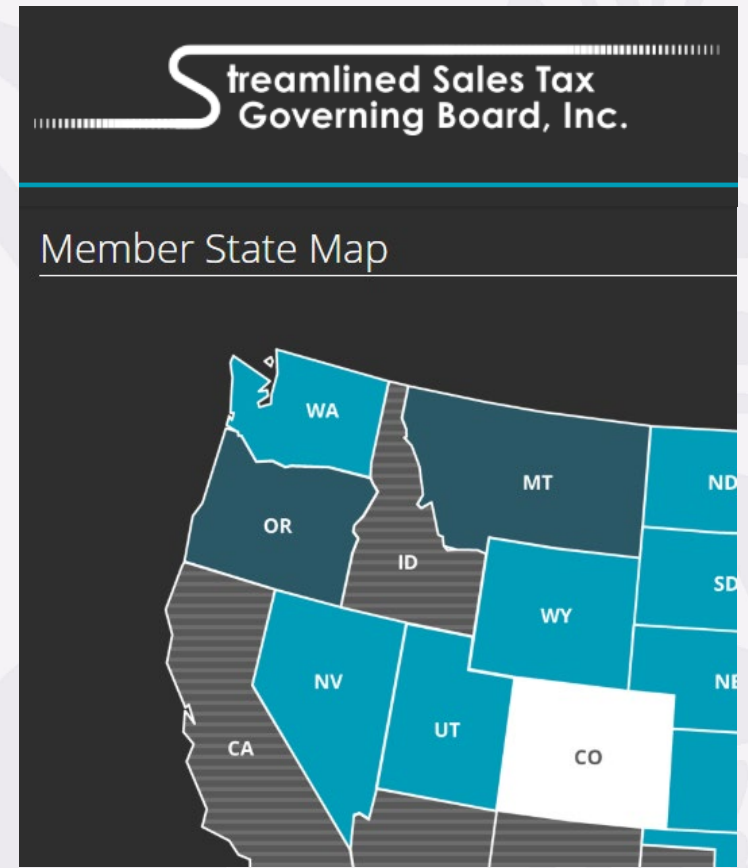
- In the Load & Return method, the vendor sends software media to the customer, the customer loads the software, then returns the software media to the vendor
 - In Missouri, both Load & Leave and Load & Return transactions qualify as a taxable “sale at retail” (*Missouri Tax Policy Notice TPN16*)

Rights Licenses and Right-to-Use

- License Rights or “key number” purchases are a way of receiving software and software updates based on access capability. For example, instead of buying software tangibly, or downloading an entire software package, this method allows the purchaser to access and use only the licensed portion of the software and only provides access to the intended users based on the use of a password or key.
- These transactions can also be structured to cover a specific time period for the right to use the software.
- This is a difficult topic for states to determine the taxability. It is controversial when deciding whether it is an intangible right to use or if it should be taxable as software. Typically, these follow the taxability of the original software license

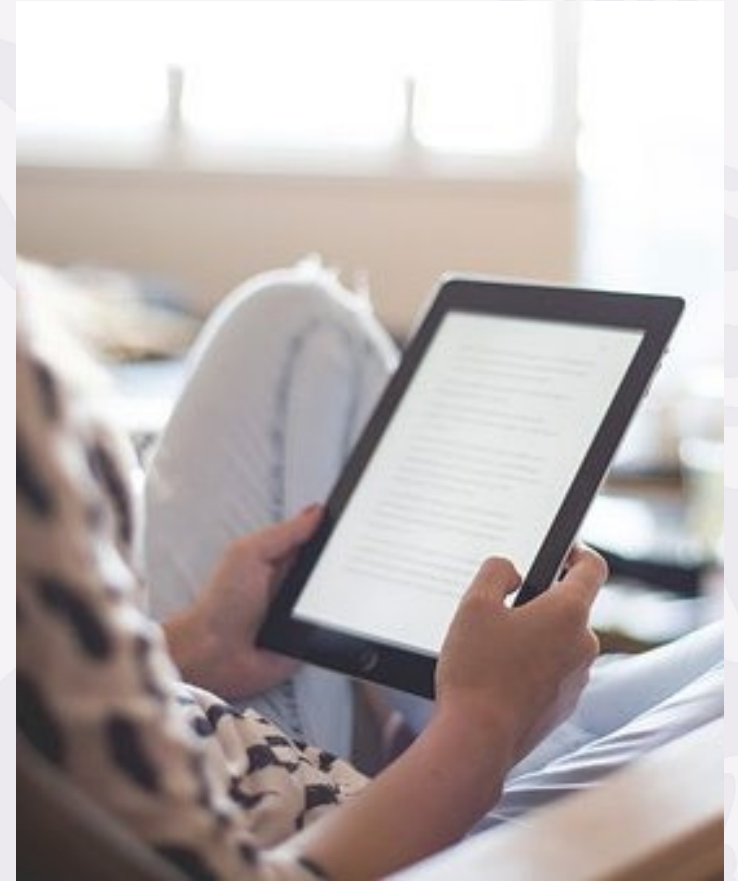
Digital Goods – SST Definition

- “Specified digital products” means electronically transferred:
 - “**Digital Audio-Visual Works**” which means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.
 - “**Digital Audio Works**” which means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones.



Digital Goods – SST Definition (cont.)

- “Specified digital products” means electronically transferred:
 - “**Digital Books**” which means works that are generally recognized in the ordinary and usual sense as “books.”
- For purposes of the definitions of specified digital products, “transferred electronically” means obtained by the purchaser by means other than tangible storage media.





Taxability of Software

Tangible vs. Electronically Delivered

- All states will tax the sale of canned software delivered in tangible form, since most states tax sales of tangible personal property (TPP) with minor exceptions
 - Commercial Use Exemptions: IA, MD
 - Lease Exemptions: IL, ME
 - Negotiable License: CO
 - Instructional Material: MN
 - Enterprise Server, Data Center or Cable/Telecom Service: NC

Tangible vs. Electronically Delivered

- Many states will exclude sales of software which is transferred by electronic means (downloaded from the internet) from sales and use tax
 - Since the software is not delivered in tangible form, it doesn't meet the definition of TPP and is therefore exempt.
 - No tangible delivery of manuals or backup copies should be provided as part of the charge or else there is the potential to taint the transaction.

California – Backup Disk

- Per the California Department of Tax and Fee Administration's Audit Manual, section 0421.03:
 - “Sales and purchases of software transferred electronically are not subject to tax if no tangible personal property is furnished by the seller in the transaction. **In cases where tangible personal property is provided in the transaction**, in any format except written documentation or manuals (including documentation or manuals in machine-readable form) designed to facilitate the use of the program, **tax applies to the original electronic transfer of the software**, even when the tangible personal property is shipped subsequent to the electronic transfer of the software provided that the transfer of tangible personal property is part of the original sale of the software.”

Licensed Software

- Maine does not consider an annual license or a license for less than 10 years to be a sale.
 - Software licenses that are perpetual or for 10 years or more (with no annual renewals) are subject to sales tax. The seller would be required to collect sales tax based upon the total amount of the license payments.
 - If the software license is renewed on an annual basis, it is not subject to sales tax, but the seller is liable for use tax upon the purchase price of the software (or material costs if developed by the seller).



Illinois 5-Prong Test

- Illinois exempts true licenses of canned software, as the state does not tax leases of property. If a license agreement meets the five tests, it will be considered a license and exempt from tax. The city of Chicago will however tax the license in Chicago under their lease tax including perpetual licenses.
 - License agreement signed by both the licensor and licensee.
 - Restriction on duplication and use of the software.
 - Restriction on sublicensing the software to unrelated third parties.
 - Licensor must replace software at little or no charge if lost or destroyed by the licensee.
 - Licensee must return or destroy the software at the end of the license terms.

Software Delivered with Hardware

- For example, purchasing a computer with the operating system pre-loaded
- Even if it's separately stated, the software likely can't qualify for the electronically delivered exemption
- Unless the hardware qualifies for exemption, the software probably won't
- This is more applicable to operating systems rather than software applications



California – SaaS delivered without TPP

- Per the California Department of Tax and Fee Administration’s Audit Manual, section 0421.03:
 - “...tax does not apply to charges for “Software as a Service,” or similar models, such as “Platform as a Service” or “Infrastructure as a Service,” in which there is not a transfer of title or possession of any tangible personal property in the transaction.”

Hawaii Clarifies Sales Tax Treatment of Software

- Hawaii issued an information release to clarify the treatment of sales of software with regards to their general excise tax (GET).
- For canned or prewritten software (or the license of such), the department considers it to be tangible personal property (TPP) regardless of form or method transferred and is taxed as such. Sales of TPP are taxed at 4%, but wholesalers have a rate of 0.5%.
- The department considers custom software to be a provision of services. Sales of services are subject to the 4% GET, but wholesalers have a rate of 0.5%.
- Additionally, when software is sold through a marketplace facilitator, the facilitator is considered the retail seller and is subject to the 4% GET rate. The marketplace seller is considered to have made the sale at wholesale.
- (Hawaii Department of Taxation, Tax Information Release No. 2021-06)

Streaming Company's Platform Credits Not Taxable in Colorado

- Colorado has issued a private letter ruling stating that “platform credits” offered by a company that offers video streaming services are not taxable.
- During video livestreams, viewers can send platform credits to the video's streamer to show support or garner attention.
- When a viewer sends platform credits, it receives nothing of substance in return.
- The streamer does not receive the platform credits or any dollar value conversion of the platform credits at that time. Rather, as part of a monthly payout from the company, the streamer is rewarded a cash amount for each platform credit used.
- Viewers can redeem platform credits for the ability to use third-party enhancements.
- The DOR stated that the platform credits are akin to gift cards. They are not taxable as tangible personal property (TPP).

Streaming Company's Platform Credits Not Taxable in Colorado (cont.)

- When a viewer redeems platform credits, that transaction is also not subject to sales tax.
- If the viewer were to receive anything taxable in exchange for redeeming the platform credits, that transaction would be taxable. However, viewers are not acquiring any taxable TPP or services.
- To the extent that platform credits compensate the video streamer, their redemption is in the nature of a non-taxable gratuity.
- Finally, the purchase of third-party enhancements is not taxable since the platform credits are not being used to purchase taxable TPP or services.
- While the third-party enhancements could potentially be described as computer programs or program upgrades, the distinction is immaterial. While Colorado taxes digital goods, computer software delivered electronically is explicitly excluded from taxation.
- (PLR 22-005, Colorado Department of Revenue, July 22, 2022)



Digital Goods and Digital Currencies

Digital Goods - Characterization

- Digital goods and streaming content may be characterized as any one of the following by a state:
 - Tangible Personal Property
 - Digital good or specified digital product
 - Service or information service
 - Potentially something else

Digital Goods – Characterization – State Examples

- Texas considers sales of Internet-delivered digital products, including computer programs and software licenses as taxable sales of tangible personal property.
- In New York, sales of digital products transferred electronically (i.e., downloaded music, ringtones, movies, books, etc.) are not subject to sales and use tax.

Digital Goods – Characterization – State Examples

- Wisconsin
 - The state is trying to tax SaaS services that have a messaging component as part of a bundled service.
 - Downloadable apps don't generally change the nature of SaaS, but Wisconsin is now debating whether they make a bundle taxable.
 - Wisconsin is arguing that SaaS is not a form of software but is rather a delivery platform to prewritten software.

Colorado Enacts New Legislation Codifying Treatment of Digital Goods as Tangible Personal Property

- On June 23, 2021, Colorado's Governor signed H.B. 1312, officially bringing the state's tax law in line with the state's practice of applying sales and use tax to digital goods.
- The new amendments to the Colorado Revised Statutes expand the definition of tangible personal property to include all goods, wares, and commodities, and specifically includes digital goods regardless of their method of delivery.
- Digital goods are defined as “any item of tangible personal property that is delivered or stored by digital means, including but not limited to video, music, or electronic books.”
- The state previously incorporated a similar definition of digital goods as tangible personal property in the Colorado Code of Regulations effective January 2021.
- (Colorado H.B. 1312; 1 Code Colo. Regs. §39-26-102(15))

Maryland Expands Tax on Digital Goods

- Effective March 14, 2021, Maryland's 6% sales and use tax on digital goods applies to the following (non-exclusive) digital products if obtained or delivered by electronic means:
 - E-books, newspapers, magazines, periodicals, or any other publication
 - A digital download or stream of a motion picture, music video, news and entertainment program, live event, sporting event, tutorial, etc.
 - A digitized sound file that may be downloaded onto a device and may be used to alert the user to a communication or information (ringtones)
 - A sale, subscription or license to access content online
 - A sale, subscription or license to use a software application
- Also effective March 14, 2021, the sale of canned or commercial off-the-shelf software obtained electronically is considered a digital good and is subject to Maryland sales and use tax. The sale of software as a service (SaaS) is also subject to sales and use tax.
- Effective July 1, 2022, Maryland exempts computer software or SaaS purchased for use solely in a commercial purpose in an enterprise computer system.
- (H.B. 932, Laws 2020, effective March 14, 2021 and *Business Tax Tip #29 Sales of Digital Products and Digital Code*, Maryland Comptroller, March 9, 2021; H.B. 791, effective July 1, 2022)

State of Connecticut Rules Online Learning Plans Not Taxable as Digital Goods

- On April 21, 2022, the Connecticut DOR issued Ruling No. 2022-2 determining that online learning plans are not taxable digital goods.
- The company provides learning plans through virtual learning and on-demand digital courses that offer video lessons.
- As stated in the ruling, “The learning plans that the Company offers on its Platform are not generally subject to sales and use taxes as digital goods because their true object is a nontaxable service that is related to education or training.”
- Connecticut imposes sales tax on retail sales of tangible goods, and digital goods are considered “tangible personal property.”
- The DOR noted that in some cases the learning plans may be considered taxable job-related training, computer training and or software training that are specifically enumerated as taxable services in Connecticut.
- (Connecticut DOR, Ruling No. 2022-2, effective April 21, 2022)



CryptoCurrency

Cryptocurrency Definition

- A cryptocurrency is a **digital currency, which is an alternative form of payment created using encryption algorithms.** The use of encryption technologies means that cryptocurrencies function both as a currency and as a virtual accounting system.

Blockchain Definition

- A blockchain is “**a distributed database that maintains a continuously growing list of ordered records, called blocks.**” These blocks “are linked using cryptography. Each block contains a cryptographic hash of the previous block, a timestamp, and transaction data..
- The purpose of the blockchain is **to share information amongst all parties that access it via an application.** Access to this ledger in terms of reading and writing may be unrestricted ('permissionless'), or restricted ('permissioned').

Cryptocurrency

- Another relatively recent development that states are beginning to explore is the taxation of cryptocurrency.
- IRS considers cryptocurrency to be property which is taxed similar to an asset.
- While many states have not yet provided guidance on the sales tax treatment of cryptocurrency, a number of states have provided some information on the topic.
- If payment for a taxable good or service is made in cryptocurrency, the fair market value of the taxable item must be determined and sales tax calculated appropriately. The sales tax must be remitted to the appropriate state (generally in US currency)

Minnesota Clarifies Sales Tax for Alternative Forms of Payment

- The Minnesota DOR provided updates to its fact sheet that covers Coupons, Discounts, Rewards, Rebates, and Other Forms of Payment.
- The fact sheet clarifies that cryptocurrency and other alternative forms of payment for buying goods and services should be treated as cash for tax purposes.
- (Minnesota Department of Revenue, Sales Tax Fact Sheet 167)

Kentucky Enacts Manufacturing Electricity Exemption for Mining of Cryptocurrency

- On July 1, 2021, Kentucky enacted a new sales tax exemption for electricity used or consumed in the commercial mining of cryptocurrency.
- The new law allows for commercial cryptocurrency mining operations to apply for an exemption certificate for purchases of electricity, which can also be used for the state's local utility gross receipts license taxes.
- The exemption is intended to encourage and expand cryptocurrency mining operations in the state, similar to previous tax exemptions for other manufacturers and industrial processors.
- This is a good example of a state adjusting its language around manufacturing exemptions to keep up with emerging technologies.
- (Kentucky House Bill 230, Effective July 2021)

Delaware Adds Cryptocurrency to Unclaimed Property Reporting Requirement

- Delaware’s Governor signed a bill on June 30, 2021 that adds “virtual currency,” including cryptocurrency, to the definition of property subject to reporting requirements for unclaimed property effective August 1, 2021.
- The act defines virtual currency as “a digital representation of value, including cryptocurrency, used as a medium of exchange, a unit of account, or a store of value that does not have legal tender status recognized by the United States.”
- Game related digital content, or currency that only exists within an electronic game, loyalty cards, and software governing the transfer of virtual currency are excluded from this definition.
- Currency is considered abandoned 5 years after the owner’s last indication of interest in the property and must be liquidated within 90 days prior to reporting and remitting the proceeds of the liquidation to the state.
- (Delaware S.B. 103)



Non-Fungible Tokens (NFTs)

Non-Fungible Tokens (NFTs)

- Merriam-Webster definition:
 - “a unique digital identifier that cannot be copied, substituted, or subdivided, that is recorded in a blockchain, and that is used to certify authenticity and ownership (as of a specific digital asset and specific rights relating to it)”
- NFTs can apply to far more items than you may think:
 - Subpoenas are served via NFT
 - Medical records can be stored on an NFT
 - An NFT could be a key to a car

Non-Fungible Tokens (NFTs)

- The IRS is silent on specific NFT guidance but is closely reviewing.
- Multistate Tax Commission, Streamlined Sales Tax Governing Board, and SALT working group of the National Conference of State Legislatures are educating each other.
- States and cities will not be sitting on the sidelines much longer

Non-Fungible Tokens (NFTs)

- Currently there are more questions than answers regarding NFTs.
- Guidance is severely lacking and the guidance that does exist is generally unsophisticated.
 - Pennsylvania added NFTs to a list of taxable items but didn't provide any additional guidance (REV-717, Pennsylvania DOR)
- Expect future guidance from states and cities. Audits may be retroactive.
- Characterization and sourcing will be big points of contention.

Washington Issues Interim Statement Regarding the Taxability of NFTs

- Purchases of NFTs are taxable in most cases and sellers of NFTs are subject to Washington B&O tax on gross proceeds, according to an interim statement provided by the Washington DOR.
- The DOR defines NFTs as “digital code on blockchain comprised of unique identification codes and metadata that distinguish them from one another.”
- One example explains the impact a bundled transaction can have on taxability of NFTs.
 - In the example, a band’s sale of digital music is considered digital code, and that code includes a concert ticket to an upcoming concert. Because it is sold in one package, the entire selling price is subject to retail sales tax and retailing B&O tax.
- The DOR hopes to develop more comprehensive and permanent guidance.
- (Washington State DOR, Interim statement regarding the taxability of non-fungible tokens (NFTs), July 1, 2022)

Wisconsin Issues Guidance on Tax Treatment of NFTs

- Wisconsin has issued guidance on the taxability of NFTs.
- Per the bulletin, the sale or purchase of an NFT may be taxable if the underlying product, good, or service is taxable in Wisconsin.
- The bulletin provides three illustrative examples:
 - If the NFT entitles a purchaser to download music or movies, the sale of the NFT is a taxable specified digital good.
 - If the NFT entitles a purchaser an admission to a sporting event, the sales of the NFT is a taxable admission.
 - If the NFT entitles a purchaser to a tangible piece of artwork, the sale of the NFT is taxable tangible personal property.
- (Wisconsin Tax Bulletin, October 2022 – Number 219)

Minnesota Adds NFT Clarifications to Digital Product Sales Tax Fact Sheet

- Minnesota has provided clarity on the taxability of NFTs.
- NFTs entitle the purchase of goods and services, according to the recently updated fact sheet, when NFTs are used to purchase taxable products. The NFTs are also subject to sales and use tax.
- Examples of some products that can be purchased with NFTs include but are not limited to digital products, admissions to events, and tangible personal property.
- The fact sheet also includes guidance on bundled transactions, sourcing, and nontaxable products.
- Individuals receiving or using payments of NFTs are encouraged to check the Minnesota DOR's website for further details.
- (Minnesota DOR, Digital Products Sales Tax Fact Sheet 177, updated August 2022)

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➤ Digital Advertising

Maryland Tax on Digital Advertising

- On February 12, 2021, the Maryland legislature overrode Governor Larry Hogan's veto of a new tax on digital advertising, making Maryland the first state in the country to adopt a tax on digital advertising.
- According to the legislation, digital advertising services include advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services. A “digital interface” is any type of software, including a website, part of a website, or application, that a user is able to access. (H.B. 732, Laws 2020)

Maryland Tax on Digital Advertising (cont.)

- Two cases were filed in challenging the Digital Advertising tax. One was filed in the Maryland Circuit Court in April 2021. The second was filed in the Federal District Court in February 2021.
- A Maryland Circuit Court judge ruled against the state and declared the state's digital advertising tax in violation of the U.S. Constitution on October 17, 2022.
- The case, brought by multiple Comcast subsidiaries and Verizon Media, argued that the tax infringed upon the Internet Tax Freedom Act (ITFA), the dormant commerce clause of the Constitution, and the First Amendment.
- The judge agreed, ruling that the tax on digital advertising violated the ITFA, as there is no similar tax for nondigital advertising in the state, and the First Amendment, by exempting news media from the tax.
- The Maryland Attorney General's office is reviewing their options.
- (Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia LLC et al. v. Comptroller of the Treasury of Maryland, C-02-CV-21-000509, Circuit Court for Anne Arundel County)

Maryland Tax on Digital Advertising

- The U.S. Chamber of Commerce filed a lawsuit in federal court challenging the constitutionality of the tax hours after the law was passed. (*U.S. Chamber of Commerce et al. v. Peter Franchot*, Case number 1:21-cv-00410 (U.S.D.C., D. Md.)).
- Relying on the Tax Injunction Act, the Court held that the U.S. Chamber could not seek to enjoin collection of the tax but could proceed with its challenge to a pass-through prohibition. (3/4/22)
- On December 4, 2022, the Court denies as Moot both parties motions and dismisses the challenge to the pass-through prohibition based on the state decision.
- If the state case is appealed and reversed, this case may be re-opened to evaluate the pass-through prohibition.

New Mexico Digital Advertising Proposal

- On August 30, 2022, New Mexico published proposed regulations regarding the taxation of digital advertising.
- Per a DOR statement: “Digital advertising is already subject to Gross Receipts Tax (GRT) in New Mexico. The proposed rules are intended to update regulations to reflect changes in technology and ensure that rules covering digital advertising are consistent with those covering other forms of advertising.”

New Mexico Digital Advertising Proposal (cont.)

- Per the proposed regulation, tax would apply to digital advertisements intended to be viewed only in New Mexico.
- Receipts would be sourced to the servers of companies “hosting the digital platform from which the advertising is accessed“
- Digital advertising services: Providers of digital advertising services are eligible for the deduction provided by Section 7-9-55 NMSA 1978. Receipts of a provider of digital advertising services are deductible when the receipts: (1) are from a national or regional advertiser not having its principal place of business in New Mexico, or that is not incorporated under the laws of New Mexico, or (2) are from an advertising agency which purchases the display of advertisements on the platform on behalf of, or for subsequent sale to, a seller defined in Paragraph (1) of Subsection E of 3.2.213.9 NMAC. However, the commissions of advertising agencies from performing services in this state may not be deducted. [3.2.213.9 NMAC, Rp 3.2.213.9 NMAC, 11/29/2022]



Exemptions

Use-Based Exemptions for Software

- States offer various different types of exemptions based on the use of a certain item.
- Some of these exemptions can apply to software sales and software providers
- Review the state's tax laws carefully to see if software is included in the exemption

Use-Based Exemptions for Software (cont.)

- Manufacturing Exemption
 - Many states offer an exemption for machinery and equipment used to manufacture items of tangible personal property for sale.
 - The definition of “manufacturing” varies from state to state
 - Software used in the manufacturing process may qualify for a manufacturing exemption
 - Typically for it to be included it must control the machinery not just provide reporting
 - In Connecticut, exempt software must be used exclusively to control or monitor an activity during the production process or testing/measuring materials and products being manufactured.

Use-Based Exemptions for Software (cont.)

- Research & Development Exemption
 - Some states provide an exemption for research and development activities
 - Research & development equipment and supplies may be included in a state's manufacturing exemption
 - The exemption may be separate from the manufacturing exemption
 - Software may qualify for the R&D exemption
 - In Iowa only operating software sold with exempt equipment can qualify for the R&D or Manufacturing exemption

Use-Based Exemptions for Software (cont.)

- High Tech Exemption
 - Typically applies to equipment (and often building materials) used to establish high tech service centers such as server farms or high tech developers
 - Texas has enacted a temporary state sales and use tax exemption for certain tangible personal property used in data centers that meet certain capital investment and new employment requirements. The exemption covers hardware, software and infrastructure items necessary and essential to the operation of a qualified data center. Local taxes still apply.



Provider, Delivery or Content Based Exemptions

- States may offer exemptions based on the method of delivery, who the provider is, or the type of content that is provided.
- Remote learning online courses are a good example of where this can occur.
- Examples of items that can affect the taxability:
 - Is the online course live instructor-led, self-study, on-demand, or a webcast replay?
 - Is the course provided by a qualified educational entity?
 - Is the course content instructional in nature?



Maryland Updates Digital Products Definition with New Exclusions

- On July 1, 2022, Maryland changed the definition of a digital product to make application of sales and use tax exclude certain products. Digital products no longer include the following additions:
 - “A product having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities where the purchaser holds a copyright or other intellectual property interest in the product, in the whole or in part, if the purchaser uses the product solely for commercial purposes, including advertising or other marketing activities
 - Computer software or software as a service purchased or licensed solely for commercial purposes in an enterprise computer system, including operating programs or application software for the exclusive use of the enterprise software system that is housed for maintained by the purchaser or on a cloud server, whether hosted by the purchaser, the software vendor, or a third party”
- (Maryland General Assembly, enacted under Article II, Section 17(c) of the Maryland Constitution – Chapter 535)



Sourcing

Sourcing

- Sourcing is dependent upon characterization. For interstate sales, if taxable as:
 - Tangible Personal Property
 - Generally destination
 - Consider subsequent use
 - Consider concurrent use
 - Location of hardware when IaaS or PaaS or HaaS
 - Services vary by state. May be:
 - Benefit
 - Performance
 - Billing address
 - Consider multi-state benefit

Sourcing (cont.)

- Sourcing is dependent upon characterization. For interstate sales, if taxable as:
 - Digital goods are not clearly defined. May be:
 - Destination
 - Benefit
 - Billing Address
 - Consider multi-state benefit

Sourcing (cont.)

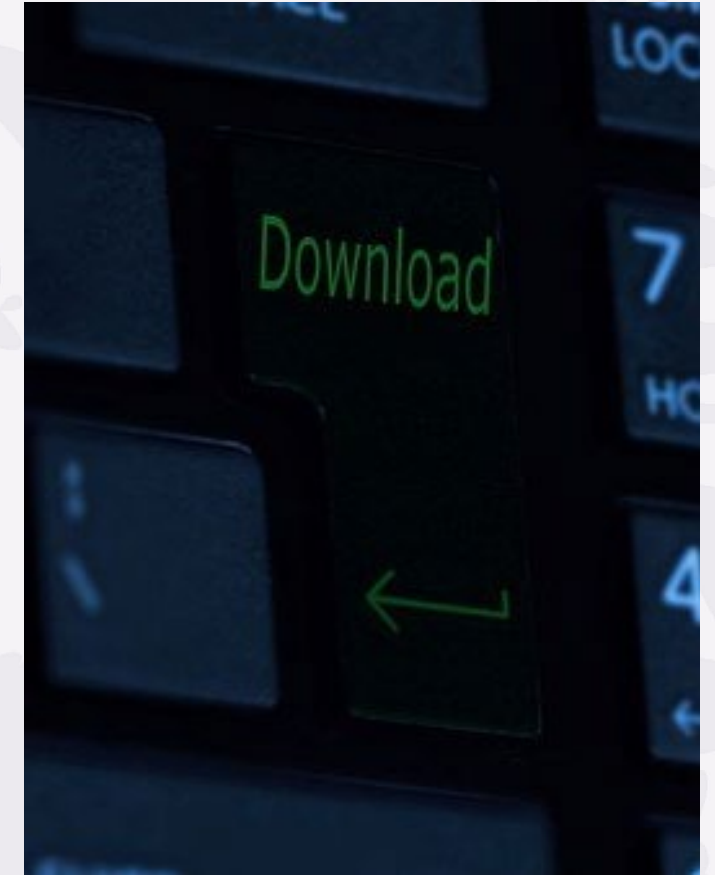
- What are the problems?
 - Concepts of destination and benefit are not easily applied to digital items.
 - The seller may have no idea where the receipt of the items takes place, or where the item is used.
 - From a purchaser perspective, location of use may not always be known – or may be at multiple locations.
- States don't provide much guidance
- Auditors typically check for reasonable approaches

Sourcing (cont.)

- Tangible: Sourced to point of delivery
- Electronically Delivered: Sourced to point of download
- Remotely Accessed: Source to user location generally
- “Computer-related services” sourced to where purchaser makes first use of service
- Streamlined Sales Tax Project destination sourcing rules
- Also under SSTP, allocation is allowed when both the purchaser and the seller agree on the allocation method

Sourcing (cont.)

- Electronically delivered software:
 - Challenges arise when the agreement permits multiple users to make a copy of the software and install it on multiple devices
 - Is “Use” at the server location or at the user location?
 - Trend towards user location but this is problematic for the seller to know if user locations are not required under the contract
 - Be careful of states that include software or digital products in their definition of tangible personal property



Sourcing (cont.)

- Remote storage (backup):
 - Is “Use” at location where the data is stored as a backup?
 - Is “Use” at the location where the equipment is located on which the original data exists?
 - Is “Use” at the location of the user who will retrieve the data?
 - Indiana – Online backup software not taxable since the true object was the storage service (Letter of Findings No. 04-20160317, Indiana Department of Revenue, October 26, 2016)
 - Chicago under Transaction tax is where the backup device is located (Personal Property Lease Transaction Tax Ruling #12)

Multiple Point of Use

- Purchase of a digital good, computer software, or a service that the digital good, computer software, or service will be concurrently available for use in more than one jurisdiction
- Claim exemption in state of “delivery” for MPU or Direct Pay
- Purchaser responsible for use tax accrual in states of use

Multiple Point of Use (cont.)

- Allocation or Apportionment
 - SST agreement - concept of multiple points of use. Provision was eliminated a number of years ago.
 - Although this concept was eliminated from the SST agreement, many states not only permit allocation or apportionment of the tax base, but require it
 - State statutes and regulations often do not provide an answer/approach. Rather, a “range” of acceptable answers is the norm. Consider Washington state:
 - The taxable amount is determined by the number of users in this state compared to users everywhere.

Multiple Point of Use (cont.)

- In allocating or apportioning the tax base:
 - Develop a Sensible and Uniform Approach
 - Uniform does not mean that all transactions are equal
 - A particular purchase should be allocated in the same manner to each state
 - How does one source between multiple states?
 - Based on expected usage?
 - Based on actual usage?
 - Based on a pro-rata split?
 - Based on “value” of the usage
 - Others?

Multiple Point of Use (cont.)

- Allocation or Apportionment
 - Most auditors will look for a sensible approach that assigns sales to locations where the service is being “received.”
 - State Authority Silent? Consider:
 - Complete Auto Transit, Inc.
 - Goldberg v. Sweet
 - Central Greyhound Lines, Inc. v. Mealy et al
 - Oklahoma Tax Commission v. Jefferson Lines

Massachusetts Rules Software Apportionment Rules Can Be Used for Abatement and Refunds

- On May 21, 2021, the Supreme Judicial Court of Massachusetts upheld an appeals court ruling that the Commonwealth's rules allowing for apportionment of software for sales tax can be used for abatement after the tax has already been paid.
- The case was filed by three software companies, who, upon being informed by their customer their licensed software was being used mostly outside of Massachusetts, applied for a refund of sales tax paid to the state.
- The companies were denied a refund by the Commissioner on the basis that they did not collect a direct pay permit or MPU certificate or apportion the tax at the time of sale, and that these were the only three methods for apportioning sales tax specified in the Code of Regulations.
- The Court ultimately sided with the taxpayers, ruling that the apportionment was a statutory right and the companies had otherwise used the correct administrative process for claiming a refund of overpaid tax.
- The Court also noted that, given the nature of software sales, it may be impossible for taxpayers to apportion the use of the software at time of purchase.
- (Oracle USA, Inc. v. Commissioner of Revenue)

Use Tax Accrual

- Keep in mind that if you make purchases of taxable digital goods and are not charged sales tax, you are responsible for remitting use tax on the purchases.



Invoice Presentation & Contract Provisions

Contract and Terminology Issues

- The importance of defining the components and using the correct terminology in the contract is critical.
- During product/service development, the tax department should be involved to help structure the offerings in the most tax advantageous ways.
- If it is determined that allocation of the contract to user location is to occur, be sure this is clearly defined in the contract.

Invoicing Issues

- Once the contract is executed and the effort was incurred to use the correct terminology and structure, it is critical that this is carried over to the invoice.
- Documentation of method of delivery and location of delivery for electronically delivered goods is required to support any potential exemptions and to assist in the sourcing.

Invoicing and Contract Best Practices

- If you only deliver software electronically, make sure that the invoice/contract doesn't say otherwise
- Use the terminology for software licensing only when that's what you're doing.
- Don't use a software license if you are providing SaaS or a service
- For SaaS, don't mention licenses or delivery
- For allocation (where users are located), will you contractually require the customer to specify where the users will be, or will you be silent on it?

Alabama Supreme Court Holds That All Computer Software is Taxable

- The Alabama Supreme Court held that all software, including custom software created for a particular user, is “tangible personal property” and therefore subject to Alabama sales and use tax, affirming the decision of a lower court.
- For purposes of Alabama sales and use tax, all software – whether canned or custom – is subject to tax. However, the Court noted that **nontaxable services sold in conjunction with software are not subject to tax if they are separately stated and invoiced.**
- These services include, but are not limited to, determining a particular software user’s needs, designing and programming new software for a particular user, modifying or configuring existing software programs to meet a particular user’s needs, installing software, and training users to operate software.
- Per the Court, **the relevant distinction is how the transaction is documented and invoiced**, which is left up to the seller and purchaser.
- In the case at hand, a healthcare software vendor/consulting firm installed computer software and accompanying equipment for a hospital. The hospital had subsequently petitioned the Alabama DOR for a refund of sales tax paid on the transaction.
- (*Russell County Community Hospital, LLC, d/b/a Jack Hughston Memorial Hospital v. Alabama Department of Revenue*, Alabama Supreme Court, No. 1180204, May 17, 2019)



Global Considerations

Minimizing Tax Consequences as a User for Global/National Software Contracts

- Can you claim direct-pay or multiple point of use?
- Where do you define where delivery occurred?
 - Delivered software uses ship to
 - Accessed software could be user location
 - Default if not otherwise clear is usually the billing address
- Do you want to make your vendor allocate based on user locations?
- Requirements for separation or bundling



Specificity of U.S. Rules

- Note that the rules in the U.S. pertaining to the taxation of software, cloud and services are specific to the U.S.
- If you do business in other countries, pay attention to the rules for those countries
- The EU and Europe are moving forward with collection requirements
 - As of January 1, 2015, B2C telecommunications, broadcasting and electronically supplied services are taxed at the place where that person is established, has a permanent address or usually resides
 - Establishment of MOSS (Mini One-Stop Shop) in EU to simplify cross-border VAT compliance

Licensing Digital Goods Abroad

- For most European countries, if the transaction is B2C, the seller needs to collect at dollar #1.
- For B2B transactions, it depends on who the contract is with.
 - It comes down to the contracting and what is deemed the place of supply.
- If it's a U.S. business and it's a B2B transaction, there is no registration requirement for a non-U.S. business even though you're purchasing from a non-U.S. buyer.

Resources

- ezMATRIX – Taxability Matrix for Software Related Transaction
- <https://www.industrysalestax.com/>
- SST Digital Goods Sourcing Workgroup
- MTC Digital Goods Project -
<https://www.mtc.gov/Uniformity/sales-tax-on-digital-products.html>

Thank you for attending!



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