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Sales and Excise Tax: Developments in State Taxation of Digital and 'Cloud' Products and On-line Services

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Introduction

- Overview of Digital and Cloud Products and Services
- Federal Legislation
- Nexus Developments
- Theories for State Assertions of Taxation:
  - Tangible Personal Property (*i.e.*, software)
  - Taxable Service (*e.g.*, Telecommunications Service, Computer and Data Processing Service, Cable Service, Protective Service)
- Defenses:
  - Nexus
  - Federal Preemption: The Internet Tax Freedom Act
  - The True Object Test
  - Nontaxable Under Statutory Definitions

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Overview of Digital and Cloud Products and Services

What is the Product?

- Digital Products
- Information Service
- Software:
  - Prewritten / Custom
  - Software as a Service (“SaaS”)
- Platform as a Service (“PaaS”)
- Infrastructure as a Service (“IaaS”)

What is the Product?

- Definitions from the Streamlined Sales and Use Tax Agreement:
  - **Prewritten Computer Software** (Appendix C, Part II)
    - "'Computer software,' including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser."
    - "'Prewritten software' includes software that was designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold sold to a person other than the specific purchaser."
    - "A member state may exempt 'prewritten computer software' 'delivered electronically' or by 'load and leave.'"
  - **Specified Digital Products** (Appendix C, Part II)
    - "Electronically transferred" digital audio-visual works, digital audio works, and digital books.

What is the Product?

- **Information Services** (Lexis, Westlaw, Checkpoint)
  - Monthly subscription
  - Access via the internet using a password
- **Software as a Service**: Allows customers to use a provider's applications running on a cloud infrastructure. Customers have no control over the application capabilities or cloud infrastructure.
- **Platform as a Service**: Allows customers to use a provider's cloud infrastructure to deploy acquired or customer-created applications. Customers control the application, but have no control over the underlying infrastructure.
- **Infrastructure as a Service**: Allows customers to use a provider's cloud infrastructure (servers, storage, networks and operating systems).

Federal Legislation

Federal Legislation

- Internet Tax Freedom Act permanently extended.
- The Digital Goods and Services Tax Fairness Act of 2015
  - House Bill: 19% chance of being enacted*
  - Senate Bill: 6% chance of being enacted
- Remote Transactions Parity Act of 2015
  - 10% chance of being enacted
- The Marketplace Fairness Act of 2015
  - 1% chance of being enacted

* Percentages from govtrack.us

Nexus Developments

U.S. Supreme Court

- ***Direct Marketing Assn. v. Brohl, et al.***, No. 13-1032 (U.S. Mar. 3, 2015).

- Concurrence by Justice Kennedy questions the continued validity of *Quill*.
  - "[I]t is unwise to delay any longer a reconsideration of the Court's holding in *Quill*."
  - *Quill*'s holding "should be left in place only if a powerful showing can be made that its rationale is still correct."

Alabama: "Sue us."

- Alabama Regulation: Direct Challenge to *Quill*
  - Ala. Admin. Code r. 810-6-2-.90.03
    - "[O]ut-of-state sellers who lack an Alabama physical presence but who are making retail sales of tangible personal property into the state have a substantial economic presence in Alabama for sales and use tax purposes and are required to register for a license with the Department and to collect and remit tax."
  - Julie P. Magee, Alabama Department of Revenue Commissioner:
    - "All sorts of things were constitutional or unconstitutional until they weren't anymore. Sue us."

South Dakota

- South Dakota SB106
  - "[A]ny seller selling tangible personal property, products transferred electronically, or services for delivery into South Dakota, who does not have a physical presence in the state . . . shall remit the sales tax and shall follow all applicable procedures and requirements of law as if the seller had a physical presence in the state."
  - A seller must have:
    - $100,000 or more of gross revenue from South Dakota sales; or
    - 200 or more separate transactions with South Dakota customers.

South Dakota

- On April 28, 2016, South Dakota filed a complaint in the State's Circuit Court against Wayfair Inc., Systemax Inc., Overstock.com Inc. and Newegg Inc.
  - The State's complaint acknowledges that "a declaration in the State's favor will require abrogration of the United States Supreme Court's decision in *Quill* . . . and ultimately seeks a decision from the United States Supreme Court to that effect in this case."
- On April 29, 2016, American Catalog Mailers Association and NetChoice filed a complaint for a declaratory judgment against the State.
- South Dakota addresses many of the issues that concerned the Supreme Court in *Quill:*
  - Prospective only.
  - Cites to Streamlined Sales and Use Tax Agreement to support that compliance burden is diminished.

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Taxation of the Cloud: Theories for State Assertions of Taxation

Theories for State Assertions of Taxation

- **Streaming Video/Audio Services**: Legislation; Rental Tax (Alabama); Amusement Tax (Chicago); Computer and Data Processing Services; Multichannel Video Programming Service; Tangible Personal Property
- **On-Demand / Pay-Per-View**: Communications Services Tax (Florida); Tangible Personal Property
- **Other Cloud-Based Services**:
  - Legislation (Chicago, Washington)
  - Telecommunications Service
  - Security Service
- **Software**: Constructive Possession (Tennessee, Utah, New York)

Streaming Services

- As streaming services have become more popular, states have begun enacting legislation, releasing guidance or attempting to assert tax under old statutes.
  - **Alabama**: Proposed (and then withdrew) amendments to a regulation that would have subjected on demand programming and streaming services to the State's rental tax. Nevertheless, the Department has indicated that it will continue to assert that the State's rental tax applies to such services.

Streaming Services

Chicago

- **Chicago Municipal Code 4-156-020(G)**: "It shall be presumed that all amusements are subject to tax."
  - Previously interpreted to apply only to amusements witnessed in person.
- **Amusement Tax Ruling No. 5** (Effective July 1, 2015): "The amusement tax applies to charges paid for the privilege to witness, view or participate in an amusement. This includes . . . charges paid for the privilege to witness, view or participate in amusements that are *delivered electronically*." (emphasis in original).
  - Only applies to rentals (streaming or downloaded) of videos, music and/or games. Does not apply to sales.
- Challenged as exceeding the Finance Department's regulatory authority and as discriminatory under the Internet Tax Freedom Act. *See Labell v. City of Chicago*, Docket No. 2015-CH-13399 (Ill. Cook County Chancery Ct.).

Streaming Services

Connecticut

- **Ruling No. 2015-5** (Nov. 3, 2015). The Department issued a ruling explaining that subscription fees to stream digital content over the Internet are taxable as computer and data processing services.

- The Department explained that, because taxable computer and data processing services include "retrieving or providing access to information," services providing access to digital content are subject to tax.

Streaming Services

Kentucky

- **Netflix, Inc. v. Dep't of Revenue**, Order No. K-24900 (Ky. Bd. of Tax Appeals Sep't 23, 2015), appeal pending. The Board found that Netflix's streaming services are not taxable multichannel video programming services for purposes of the State's Gross Revenues Tax, Excise Tax and Utility Tax.
- "Multichannel video programming services" are defined as "programming provided by or generally considered comparable to programming provided by a television broadcast station" and includes cable service.
- The Board found that Netflix's services are not comparable to TV and/or cable services because Netflix does not provide any live programming or any programming with a set time schedule, and any comparable "on demand" service is only an incidental part of the services provided by TV and cable companies.

Streaming Services

Florida

- **Technical Assistance Advisement No. 14A19-005** (Dec. 18, 2014).
- Sales and rentals of digital video content (streaming or downloaded) are not subject to *sales* tax.
- *Rentals* of digital video content (streaming or downloaded) are subject to the State's communications services tax as a "video service," which includes pay-per-view and digital video services.
- *Sales* of digital video content (streaming or downloaded) are *not* subject to the State's communications services tax because they qualify as an information service.

On-Demand / Pay-Per-View

Louisiana

- ***Jefferson Parish v. Cox Communications, Louisiana, L.L.C.***, 167 So. 3d 156 (La. Ct. of App. 2014).
  - The Court of Appeals affirmed the District Court's decision and held that the taxpayer's sales of video on-demand and pay-per-view programming were sales of nontaxable cable services and not tangible personal property (*e.g.*, computer software).
  - The Louisiana Supreme Court denied review.

Cloud-Based Services

Washington

- "Digital products" means digital goods and digital automated services. RCW 82.03.192(9).
- "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." RCW 82.03.192(6)(a).
- "Digital automated service" is defined as "any service transferred electronically that uses one or more software applications." RCW 82.03.192(3)(a).
- Data processing services are not subject to sales tax.

Cloud-Based Services

Washington

- **Determination No. 14-0307** (Sep't 23, 2014) (released Feb. 29, 2016). An Administrative Law Judge ("ALJ") found that the taxpayer's e-mail related services, which customize customers' high volume emails, are subject to sales tax as digital automated services because the primary object of the services is "the customization, personalization, transmission, storage and reporting of personalized emails" and the services "use one or more of Taxpayer's software applications."
- The ALJ rejected the taxpayer's argument that the services are protected from taxation under the Internet Tax Freedom Act because the ALJ found that (i) the taxpayer does not offer e-mail, but an e-mail service that "merely uses e-mail provided by third parties" and (ii) the service does not provide "personal storage capacity" because the e-mail services are not sold to individual customers.

Cloud-Based Fax Service

Washington

- **Determination No. 14-0307** (con't.). The ALJ also found that the taxpayer's on-line fax services, which allow customers to send and receive facsimiles via e-mail, are subject to sales tax as telecommunications services.
- "Faxing services have long been held to constitute telecommunications."
- The ALJ explained that "[f]axing services are *not* excluded from the sales taxable definition of telecommunications as information services or data processing services." (emphasis in original).

Cloud-Based Security Service

New York

- **TSB-A-15(47)S** (Nov. 18, 2015). The Department found that the taxpayer's cloud-based security services, which blocked malware, phishing, and other high-risk sites and locations, was subject to sales tax as a "protective service."
- New York imposes sales tax on "[p]rotective and detective services, including, but not limited to, all services provided by or through alarm or protective systems of every nature, including, but not limited to, protection against burglary, theft . . . or any other malfunction of or damage to property . . . whether or not tangible personal property is transferred in conjunction therewith."
- "A service designed to prevent unauthorized access to or use of a customer's information technology (IT) assets is subject to sales tax . . . as a protective service, if the IT assets are located in New York."

Software

- Taxability of Software Analysis:
  - Is it a sale of software or a service?
    - Does the vendor use its software to input and/or process data, etc. to provide a service?
    - Or is the customer using the software?
  - Is there delivery, use or possession of software in the State?
    - Often addressed through legislation or regulations.

Software

- Some states have enacted legislation to address new technology.
  - **Tennessee**: Effective July 1, 2015, "use of computer software" includes "the access and use of software that remains in the possession of the dealer who provides the software or in the possession of a third party on behalf of such dealer."
  - Specifies that the statute shall not "be construed to impose a tax on any services that are not currently subject to tax . . . such as, but not limited to, information or data processing services, including the capability of the customer to analyze such information or data provided by the dealer; payment or transaction processing services; payroll processing services; billing and collection services; Internet access; the storage of data, digital codes, or computer software; or the service of converting, managing, and distributing digital products."

Software

Utah

- **Utah State Tax Commission**, Appeal No. 10-2086 (July 15, 2015). An Administrative Law Judge ("ALJ") upheld the imposition of sales tax on remotely accessed software.
- In 2009, the statutory definition of "tangible personal property" was revised to exclude a "product that is transferred electronically." At the same time, a provision was added to explicitly impose sales tax on a product that is transferred electronically.
- The ALJ explained that, pursuant to the statutory changes, the use of prewritten computer software over the Internet is not taxable as a sale of tangible personal property, but rather is subject to tax as a product that is transferred electronically.
- The ALJ noted that, if the software was not considered "transferred electronically" because it was not downloaded, the transaction would then be subject to tax as a sale of tangible personal property.

Software

- States are still attempting to use old statutes to assert that charges for remote access software and certain types of services that were traditionally considered to be nontaxable information services are taxable as sales of pre-written computer software.
  - **New York**: Sales of access to software are taxable because customers gain "constructive possession" of the software.
    - "When a purchaser remotely accesses software over the Internet, the seller has transferred possession of the software because the purchaser gains constructive possession of the software and the right to use or control the software." New York State Department of Taxation and Finance Tax Bulletin, TB-ST-128 (Aug. 5, 2014).
    - A distinction is drawn between situations in which the vendor uses its software and inputs customer information, and situations in which the customer uses the vendor's software and inputs its own information. *See* TSB-A-15(1)S (Jan. 15, 2015).

Software

New York

- **TSB-A-15(25)S** (June 3, 2015).
- Sales of video games and video game add-ons, whether downloaded or remotely accessed, are subject to sales tax as sales of pre-written computer software.

Software

New York

- **TSB-A-16(8)S** (Mar. 15, 2016).
- Fees for tablet-based health monitoring products are subject to sales tax as charges for prewritten computer software.
  - The Department explained that the transactions constitute transfers of prewritten computer software because the product allows caregivers access to Petitioner's web portal, where caregivers can remotely use Petitioner's software to create care plans for the users.

SaaS, PaaS, IaaS

Chicago

- **Personal Property Lease Transaction Tax Ruling No. 12** (Effective Jan. 1, 2016): If a lessee (customer) pays a lessor (provider) "primarily for the ability to use the provider's computer to input, modify or retrieve data or information, the charge is primarily for the customer's use or control of the provider's computer and is taxable."
- Tax applies to charges for: (i) performing legal research or similar on-line database searches; (ii) obtaining information or data that not customized (*e.g.*, stock prices, economic statistics); (iii) cloud computing, cloud services, hosted environment, software as a service, platform as a service, or infrastructure as a service.
- Tax does not apply to charges: (i) that are subject to the amusement tax; (ii) for individualized/custom reports; (iii) for on-line storage; (iv) where the predominate charge is for the information transferred rather than the use of the computer; (v) for passive access to information (*i.e.*, stock ticker tape); (vi) proprietary information *(i.e.*, access to newspapers or magazines).

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Taxation of the Cloud: Taxpayer Defenses

Defenses

- Nexus
- Federal Preemption: The Internet Tax Freedom Act
- The True Object Test
- Nontaxable Under Statutory Definitions

Defenses

Nexus

Due Process Clause

- Proposed federal legislation, the Alabama regulation and the South Dakota legislation to overturn *Quill* are primarily focused on overcoming the Commerce Clause restraints imposed by *Quill*.
- The Due Process Clause should also be considered.
- Unlike the Commerce Clause, Congress (and the states) cannot legislate around the Due Process Clause.

Due Process Clause

- In *Quill*, the United States Supreme Court, for the first time, articulated a distinction between the states' ability to tax under the Due Process Clause and under the Commerce Clause.
- The Court found that North Dakota could require the taxpayer to collect and remit sales tax under the Due Process Clause but not under the Commerce Clause.
- In the aftermath of *Quill*, the Due Process Clause standard appeared to be almost insignificantly low, however, recent decisions by the United States Supreme Court have breathed life into the Due Process Clause.

Due Process Clause

- The Due Process Clause sets the outer boundaries of a state's jurisdiction over an out-of-state entity.
- To satisfy due process, a state may only exercise jurisdiction over an out-of-state defendant that has certain "minimum contacts" with the state, such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice." *See, e.g.*, *International Shoe v. Washington*, 326 U.S. 310 (1945).
- Under the Due Process Clause, jurisdiction may be found over an out-of-state corporation where (i) the suit arises out of or relates to the corporation's contacts with the state ("specific jurisdiction") or (ii) the corporation's continuous corporate operations within the state are so substantial and of such a nature as to justify suit against it on unrelated causes of action ("general jurisdiction").

Due Process Clause

- ***Goodyear Dunlop Tires Operations, S.A. v. Brown***, 564 U.S. 915 (2011).
  - Foreign subsidiaries of Goodyear that had no presence in North Carolina and did not take any affirmative action to cause their tires to be shipped to North Carolina could not be subject to general jurisdiction by the State because allowing "a small percentage" of their tires to be distributed in the State by other Goodyear affiliates fell "far short of the continuous and systematic general business contacts" necessary for North Carolina to "entertain suit against them on claims unrelated to anything that connects them to the State."
- ***J. McIntyre Machinery, Ltd.v. Nicastro***, 564 U.S. 873 (2011).
  - In a plurality decision, the U.S. Supreme Court reversed the New Jersey Supreme Court's decision and held that, under the Due Process Clause, the State's courts could not exercise jurisdiction over a foreign manufacturer that "at no time had [] advertised in, sent goods to, or in any relevant sense targeted the State."

Due Process Clause

- ***Daimler AG v. Bauman***, 134 S. Ct. 746 (2014).
  - The U.S. Supreme Court reversed the Ninth Circuit, which had found jurisdiction over Daimler based on an agency theory, and explained that "[t]he Ninth Circuit's agency theory [which rested primarily on its observation that the California subsidiary's services were 'important' to Daimler] . . . appears to subject foreign corporations to general jurisdiction whenever they have an in-state subsidiary or affiliate, an outcome that would sweep beyond even the 'sprawling view of general jurisdiction' we rejected in *Goodyear*."
- ***Walden v. Fiore***, 134 S. Ct. 1115 (2014).
  - The U.S. Supreme Court reversed the Ninth Circuit again and explained that "[f]or a State to exercise jurisdiction consistent with due process, the defendant's suit-related conduct must create a substantial connection with the forum State," and that "[t]he inquiry whether a forum State may assert specific jurisdiction over a nonresident defendant focuses on the relationship among the defendant, the forum, and the litigation."

Defenses: Nexus

- ***American Business USA Corp. v. Dep't of Revenue***, No. 4D13-1472 (Fla. Dist. Ct. App. Nov. 12, 2014). The Florida District Court of Appeals held that an assessment of sales tax on a Florida-registered Internet company for sales of flowers that were never stored in or brought into Florida violated the Commerce Clause of the U.S. Constitution as the transactions in question did not have a substantial nexus with the State.
- The company collected Florida sales tax on sales to in-State customers, but not on sales to out-of-State customers.
- The court observed that the company's only connection with Florida was that it was registered in the State, and the only interaction the out-of-state customer had with Florida was by shopping for flowers on a website operated by a company incorporated in Florida.
- The court found that "[m]erely registering in a state does not give the taxing state the right to assess sales tax on transactions without any other facts to constitute 'substantial nexus.'"
- Oral arguments were held on November 5, 2015.

Defenses

Federal Preemption: The Internet Tax Freedom Act ("ITFA")

Internet Tax Freedom Act

- The ITFA prohibits states from imposing tax on Internet access and "discriminatory taxes on electronic commerce."
- The definition of "Internet access" is very broad.
  - "Internet access" defined as "a service that enables users to access content, information, electronic mail, or other services offered over the Internet and may also include access to proprietary content, information, and other services as part of a package of services offered to consumers" and includes "a homepage, electronic mail and instant messaging . . . , video clips, and personal electronic storage capacity, that are provided independently or not packaged with Internet access."
- A "discriminatory tax," is defined, in part, as "any tax imposed by a State or political subdivision thereof on electronic commerce that . . . imposes an obligation to collect or pay tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means."
  - Illinois: *Performance Marketing Association*

ITFA: Discriminatory Tax

Illinois

- ***Performance Marketing Association v. Hamer***, 998 N.E.2d 54 (Ill. 2013).
  - The Illinois Supreme Court found that the State's affiliate nexus provisions were expressly preempted by the ITFA.
  - The court concluded that the statute imposed a discriminatory tax on electronic commerce under the ITFA because it imposed a use tax collection obligation on out-of-state sellers who contracted with persons in Illinois for online performance marketing services and that such obligation was not similarly imposed on out-of-state sellers who contracted with persons in Illinois to provide print or broadcast based (offline) performance marketing services.
- ***Labell v. City of Chicago***, Docket No. 2015-CH-13399 (Ill. Cook County Chancery Ct.).

Defenses

The True Object Test

Defenses: True Object Test

- As more and more services are provided through the cloud, the true object test is an effective (and increasingly important) tool to analyze the taxability of cloud-based product offerings, which inherently include elements of taxable software and nontaxable services.

Defenses: True Object Test

Tennessee

- A line of case law has developed making it "clear" that "the issue of whether a service is taxable as a telecommunications service does not turn on whether or not a service provides the transmission of information, but whether communication between users of the service was the primary purpose of the service." *IBM Corporation v. Farr.*
- ***Prodigy Services Corp. v. Johnson***, 125 S.W.3d 413 (Tenn. Ct. of App. 2003).
- ***Level 3 Communications v. Roberts***, No. M2012-01085-COA-R3-CV, 2013 Tenn. App. LEXIS 628 (Tenn. Ct. of App. Sept. 20, 2013), *appeal denied* Feb. 13, 2014.
- ***IBM Corporation v. Farr***, Tenn. Ct. App., No. M2012-01714-COA-R3-CV, 2013 Tenn. App. LEXIS 639 (Tenn. Ct. of App. Sept. 24, 2013), *appeal denied* Feb. 13, 2014.

Defenses: True Object Test

Tennessee

- Similarly, several letter rulings apply the true object test and explain that, while the new statutory provision defining "use of computer software" "modernizes taxation of computer software in this state, it has no effect on the taxation of services." The letter rulings distinguish between situations where the customer desires the use of the underlying software (taxable) and situations where the vendor simply uses software to deliver the product to the customer (nontaxable).
  - Letter Ruling No. 16-02 (Mar. 8, 2016)
  - Letter Ruling No. 16-01 (Jan. 26, 2016)
  - Letter Ruling No. 15-08 (Dec. 17, 2015)
  - Letter Ruling No. 15-04 (Oct. 19, 2015)

Defenses: True Object Test

Massachusetts

- **LR No. 16-1** (Jan. 8, 2016). The company provided an on-line employee recognition program that required the use of software by customers to monitor the program and nominate employees for awards.
- The company charged customers for the consulting, startup, website design and related program management services and transaction fees.
- The Department found that those charges are not subject to sales tax because the object of the transaction is to obtain a rewards program and management of the program, which includes numerous services performed by the company's employees, as well as the provision of reports of individual and personal information unique to the company's customers.

Defenses: Nontaxable Service

New York

- **TSB-A-16(3)S** (Feb. 22, 2016). Petitioner embeds software on a customer's website and uses it to gather information about visitors to the website, such as how the customers come to the website, what type of device they are using, and what they do while on the site.
- Petitioner then makes this information available to customers on Petitioner's Dashboard portal on the Internet.
- The Department found that Petitioner's service is not subject to sales tax because it is an information service that is personal or individual in nature and is not substantially incorporated into reports furnished to others.
- The Department noted that the Dashboard software that Petitioner makes available to its customers to view the information is incidental to Petitioner's information service and therefore, is not taxable.

Defenses: Nontaxable Service

- **TSB-A-16(6)S** (Feb. 25, 2016). Petitioner provides solutions for sending, receiving and tracking large digital files via the Internet.
- Petitioner stores the subscriber's uploaded and sent files for a certain number of days after which time the files automatically expire and are deleted from Petitioner's server. Petitioner performs encryption and virus scanning at the server to ensure the safe transfer of the file.
- The Department found that Petitioner is providing a nontaxable bridging service because it allows customers the means by which files can be transferred through Petitioner's web portal but not the underlying telecommunications to connect to Petitioner's website.
- Although Petitioner accomplishes part of the bridging service by giving customers access to prewritten software, the software is used for the limited purpose of uploading documents and providing recipients' e-mail addresses, and the rest of the service is accomplished using other means.

Defenses: Nontaxable Service

California

- ***Lucent Technologies, Inc. v. State Bd. of Equalization***, 193 Cal. Rptr. 3d 323 (Ct. App. 2015). The Court of Appeal held that the company's sale of software was exempt from sales tax as a technology transfer agreement and upheld the attorney's fees awarded to the company by the lower court because the position of the State Board of Equalization ("SBE") was "not substantially justified."
- The SBE argued that, because the company transferred the software using tangible mediums, the sale was subject to tax.
- "Ascribing such tremendous consequences to the manner in which a software program is transmitted-when that manner is wholly collateral to the subsequent use of the licenses regarding that software and when that manner is so easily manipulated by the buyer and seller-is an absurd result."
- The court noted that the case was "factually and legally indistinguishable" from a previous case and explained that the SBE "is not free to require taxpayers to bear the cost of a litigation strategy aimed at taking a third, fourth, or fifth bite at the apple."

Defenses

Nontaxable Under Statutory Definitions

Defenses: Nontaxable Under Statutory Definitions

Indiana

- **Revenue Ruling No. 2014-01 ST** (Oct. 30, 2015).
- The Department found that membership fees paid to an Internet retailer that provides members benefits such as free/discounted shipping, free access to videos, music and eBooks (*e.g.*, Amazon Prime membership fees) are not subject to sales tax.
- The Department explained that the membership fee is not subject to sales or use tax because no property is transferred for consideration upon the purchase of the membership fee. The membership fee simply entitles a member to access many different features and benefits.

Defenses: Nontaxable Under Statutory Definitions

Michigan

- ***Thomson Reuters (Tax & Accounting) Inc. v. Dep't of Treasury***, No. 313825 (Mich. Ct. App. May 13, 2014) (unpublished).
  - In Michigan, tangible personal property includes "prewritten computer software," which is defined as computer software that is delivered by any means.
  - The Department asserted that *Checkpoint*, an online tax and accounting research program that provides subscribers access to a wide collection of information, was taxable as prewritten computer software.
  - The Court of Appeals reversed the Court of Claims and held that sales of subscriptions to *Checkpoint* were not taxable as sales of tangible personal property.
  - The court applied the "incidental to service test" and found that, regardless of whether there was a transfer of tangible personal property, any such transfer was incidental to the service provided.

Defenses: Nontaxable Under Statutory Definitions

- ***Auto-Owners Insurance Co. v. Dep't of Treasury***, No. 321505 (Mich. Ct. of App. Oct. 27, 2015).
  - The Michigan Court of Appeals affirmed the Court of Claims' holding and found that the taxpayer's use of remote access software was not subject to the use tax as "prewritten computer software."
  - The Michigan Court of Claims found that remote access software could not be taxed as "prewritten computer software" because there was no "delivery" of the software. Moreover, the court found that there was no "use" because Auto-Owners could only access the underlying software, it had no control over the software. Further, the court found that, even if it was prewritten computer software that was used by Auto-Owners, such use was incidental to the services provided by the third-party providers and therefore, would not be taxable

Defenses: Nontaxable Under Statutory Definitions

- The Court of Appeals found that the Court of Claims incorrectly determined that all software remained on a third-party server and improperly narrowed the scope of the term “deliver” to preclude electronic delivery.
- Nevertheless, the court held that “the Court of Claims correctly determined that the mere transfer of information and data that was processed using the software of the third-party businesses does not constitute delivery by any means of prewritten computer software” because “[i]n that situation, no prewritten computer software is delivered, and only data resulting from third-party use of software is delivered.”
- The court distinguished between (i) transactions where the user remotely accessed software and never had access to any of the computer codes and (ii) transactions where software was downloaded onto the user’s computer or required a desktop agent installed on the user’s computer.
- In the latter case, the court applied the incidental to service test to determine that such transactions were not subject to tax.

Defenses: Nontaxable Under Statutory Definitions

- **Notice to Taxpayers Regarding *Auto-Owners* (Jan. 6, 2016)**
  - The Department will apply *Auto-Owners* to all open tax years.
  - "If only a portion of a software program is electronically delivered to a customer, the 'incidental to service' test will be applied to determine whether the transaction constitutes the rendition of a nontaxable service rather than the sale of tangible personal property. However, if a software program is electronically downloaded in its entirety, it will be taxable."

Defenses: Nontaxable Under Statutory Definitions

New York

- ***Matter of Sungard Securities Finance LLC***, DTA No. 824336 (ALJ Feb. 6, 2014); (Tax App. Trib. Mar. 16, 2015). The ALJ found that the taxpayer's services were not sales of prewritten computer software because: (i) title and rights to the software remained exclusively with the taxpayer; (ii) the taxpayer did not transfer, sell or license its system to its customers in tangible or electronic form; (iii) customers did not have access to the software; (iv) customers could not modify the software in any manner; and (v) the services were only available during certain specific hours when the taxpayer's employees were available.
- The ALJ noted that "[i]t would appear entirely inconsistent for one who purchases prewritten software, either outright or by license to use, to be limited in the hours during which it can access and use the same."
- The Department also assessed tax on other services. Those portions of the assessment were upheld by the ALJ and the Tribunal. The Department did not appeal the ALJ's determination regarding the taxability of its ASP services and therefore, the Tribunal did not address that issue.

Defenses: Nontaxable Under Statutory Definitions

Wyoming

- **Computer Sales and Services** (revised Aug. 1, 2014).
- Providing a platform where customers can access hosted software via an internet connection, such as the most common cloud computing service models of SaaS, PaaS and IaaS, is not taxable provided the customer does not receive any tangible personal property or enumerated service embedded within the service;
- Charges to access web hosted sites are not taxable because the site maintains control over the software and possession does not pass to the customer; therefore, a sale has not transpired since there is no transfer of possession or control of tangible personal property;
- Online data storage fees are not taxable provided the host provider does not perform any data manipulation and does not have the ability to access individual computers in Wyoming for the purpose of alteration because, in order for a taxing event to occur, the sale, lease or service must transpire within Wyoming's taxing jurisdiction and there must be an exchange of property or service for consideration.

Defenses: Nontaxable Under Statutory Definitions

New Jersey

- **Technical Bulletin No. TB-72** (July 3, 2013). The Department explains the application of the sales and use tax to cloud computing services, including Software as a Service ("SaaS"), Platform as a Service ("PaaS"), and Infrastructure as a Service ("IaaS").
  - The Department explains that generally such services are not taxable sales of tangible personal property because:
    1. They only provide the customer with access to the software and the software is not "delivered electronically;" and / or
    2. They do not provide for the transfer of tangible personal property or for taxable services to any property owned by the customer.

Defenses: Nontaxable Under Statutory Definitions

Florida

- **Technical Assistance Advisement No. 14A19-001** (Mar. 13, 2014). The Department found that providing storage capacity within the taxpayer's server/computer equipment, Infrastructure as a Service ("IaaS"), and data transfer services are information services that are not subject to sales tax or the communications services tax.
- The Department explained that the charges for those services are not subject to sales tax because the customer is not purchasing or being granted a license to use tangible personal property.

Defenses: Nontaxable Under Statutory Definitions

Illinois

- **General Information Letters: ST 15-0020-GIL** (Mar. 18, 2015); **ST 15-0013-GIL** (Mar. 16, 2015); **ST 15-0015-GIL** (Mar. 16, 2015).
- With respect to the Retailers' Occupation Tax and Service Occupation Tax, "[t]he Department is currently evaluating the taxability of Software as a Service (SaaS), cloud computing, computer software Application Service Providers (ASPs) and similar types of transactions. The Department has found that there is no universal agreement regarding the nature of these transaction. When the Department makes a determination regarding the taxability of these transactions, that determination will operate prospectively only."

Defenses: Nontaxable Under Statutory Definitions

Kansas

- **Private Letter Ruling No. P-2015-001** (Mar. 25, 2015). The Department explained that retail sales of access codes, subscription cards, and point or dollar cards to remotely access software, virtual goods, and third party networks, from which digital content could be accessed or directly downloaded, were not taxable either on the initial sale or upon redemption because the sales were not for the delivery of prewritten computer software.

Questions?

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