

# Tax Issues Surrounding the Purchase of Software

*Presented by*

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# TODAY'S DISCUSSION TOPICS

- State Tax Issues for Sellers of Software in the Cloud
  - Nexus & Jurisdictional Issues
  - Sales Tax on Software SaaS?
  - Corporate Apportionment Issues
  
- State Tax Issues for Purchasers of Software
  - Use Tax Responsibility in New York
  - Out-of-State Allocation Possibilities

NEXUS

# THE ALL-IMPORTANT TERM

What does it  
**mean?**



Why is it  
**important?**



# CONSTITUTIONAL NEXUS *THE COMMERCE CLAUSE*

➤ *Quill v. North Dakota*  
(1992)

➤ Let's get physical



# NEW RULES ON THE HORIZON? *MARKETPLACE FAIRNESS ACT*



- Grants states authority to compel online retailers to collect taxes
- Applies only to sellers with more than \$1 million remote sales annually

# NEW RULES ON THE HORIZON? *MARKETPLACE FAIRNESS ACT*

- But only AFTER they have simplified their sales tax laws
  - Option #1
    - Join the Streamlined Sales Tax Project
  - Option #2
    - Follow simplification mandates, such as uniform sales tax base and software to manage sales tax compliance

# AFFILIATE NEXUS ISSUES

- Can a third party's activity in a state confer nexus on an out-of-state seller?
  - Yes. Affiliate or Click-Through Nexus!
    - *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960)
    - *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987)
    - NY's Amazon Litigation: Use of Web Affiliates
  - Several states now impose some sort of click-through or affiliate nexus, including Arkansas, California, Colorado, Connecticut, Georgia, Illinois (currently unconstitutional), Kansas, Minnesota, Missouri, New York, North Carolina, Oklahoma, Pennsylvania, Rhode Island, Texas and Vermont.

# SOFTWARE TAXABILITY ISSUES *OVERVIEW OF STATE SALES TAXES*

## ➤ Central Issues

1. Custom vs. Canned
2. Tangible vs. “Electronic”
3. In-State vs. Out-of-State
4. Software Maintenance Contracts
5. Cloud Computing or SaaS

## ISSUE #1

# *CUSTOM VS. CANNED*

### ➤ General Standard

#### ▪ The New York Rule



- Created for the specifications of a specific user
- Separate Stating and the Cheeseboard Rule

## ISSUE #2

# TANGIBLE VS. ELECTRONIC

- **What's the Issue?**
- **Electronic Delivery Taxable (33):** AL, AZ, CT, DC, HI, IL, IN, KS, KY, LA, MA, ME, MI, MN, MS, NC, ND, NE, NJ, NM, NY, OH, PA, RI, SD, TN, TX, UT, VT, WA, WI, WV, WY
- **Electronic Delivery Nontaxable (13):** AR, CA, CO, FL, GA, IA, ID, MD, MO, NV, OK, SC, VA

## ISSUE #3

# IN-STATE VS. OUT-OF-STATE



- What state's tax rules apply?
  - General Rule: For software and digital goods, the state where the end user is located typically controls
  - But what happens when users are located across various states? Or what if a service is performed for a business with locations in multiple jurisdictions (e.g., software-based accounting services, accounts payable, payroll, etc.)?
    - Principal place of business approach.
    - Reasonable estimates of user locations

## ISSUE #3

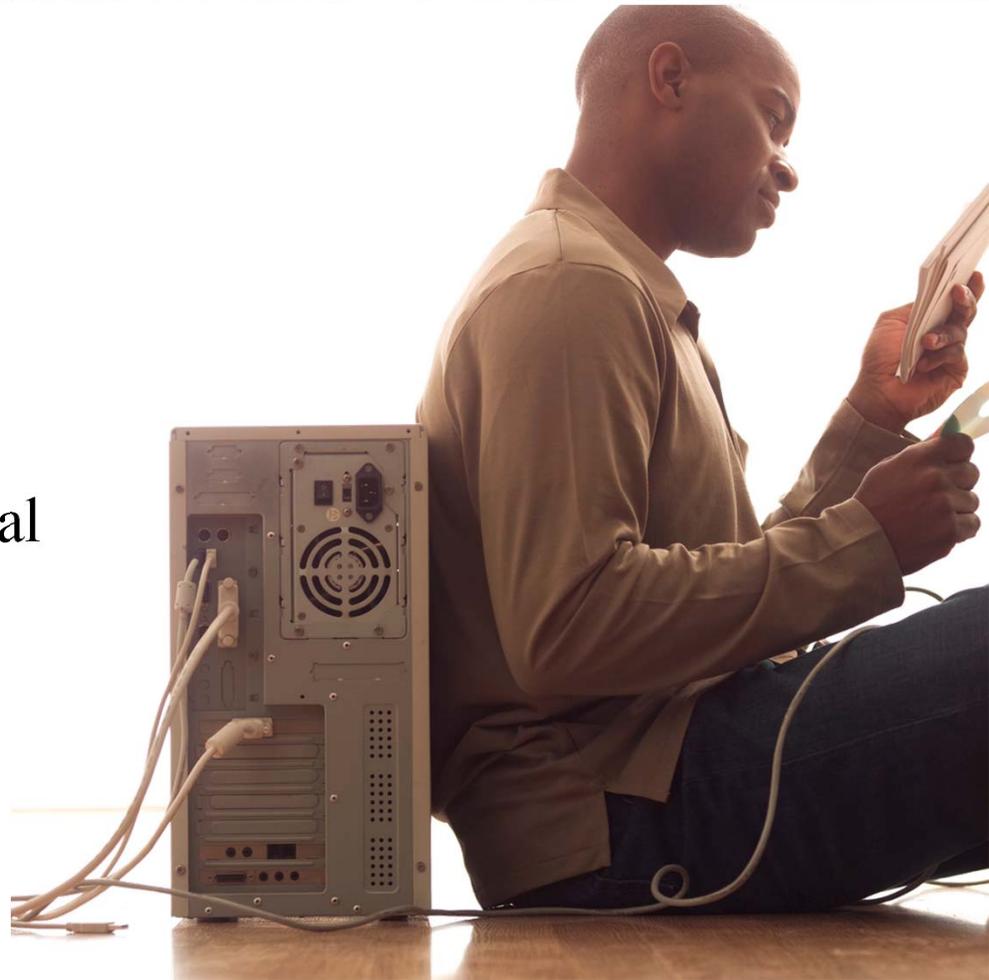
# IN-STATE VS. OUT-OF-STATE

- Multiple Points-of-Use (“MPU”) Exemption Certificates
  - The following states have some type of MPU exemption: Colorado, Massachusetts, Minnesota (but only after mid-2013), Ohio and Washington
  - Unfortunately, several states that previously offered the exemption later repealed it: Indiana, Iowa, Kansas, Kentucky, Nebraska, New Jersey, North Dakota, South Dakota
  - Some states will still accept the MPU certificates informally
  - NY accepts information from the purchaser regarding use

## ISSUE #4

# SOFTWARE MAINTENANCE SERVICES

- Taxability of Software Maintenance Services
- Distinction Between Mandatory and Optional Services
- Watch out for upgrades!



## ISSUE #5

# WHAT IS CLOUD COMPUTING?

- National Institute of Standards & Technology (NIST) Definition

“Model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g. networks, servers, storage, applications and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction”

- Core Idea

- Cloud computing allows users with remote access to software, storage capabilities, etc.
- Includes SaaS, PaaS, IaaS

- See Noonan’s Notes Articles on this Issue in Materials

## QUESTION

You just purchased and used the on-line version of TurboTax to prepare your own tax return. What did you buy?

- Software
- Tax return preparation service
- Malpractice in a box
- None of the above

# CLOUD COMPUTING *TAXABILITY ISSUES*

## ➤ Central Issues

- Is there a taxable good or service?
  - Some states treat as simple license of software
  - Others classify as nontaxable service

## ➤ Is there a sale or use

- i.e., does “possession” get transferred?

## ➤ Where is the sale taxed?

# MULTISTATE SURVEY

**Cloud Computing Taxable (15):** AZ, CT, DC, HI, IN, NM, NY, OH, PA, SD, TX, UT, VT, WA, WV

**Cloud Computing Exempt (31):** AL, AR, CA, CO, FL, GA, IA, ID, IL, KS, KY, LA, MA, MD, ME, MI, MN, MO, MS, NC, ND, NE, NJ, NV, OK, RI, SC, TN, VA, WI, WY

# CORPORATE APPORTIONMENT ISSUES IN THE CLOUD

- Move to Single-Factor Apportionment
- TPP = Sourced to Customer Location
- Services = Sourced to Where Service is Performed
- Move to Market or Customer-Based Sourcing
- Cloud? Somewhere in between?

# STATE TAX ISSUES FOR PURCHASERS

- Use Tax Responsibility for NY Company
  - Use Tax is Due if Sales Tax not Charged!
  - NY's Current Position = SaaS is Taxable
- Out-of-State Allocation Potential

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# CONCLUSION



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