

This document provides the background and discussion relating to the amendments to Section 312, Multiple Points of Use, that were adopted April 16, 2005.

MPU Discussion Paper - Sourcing Computer Software

- **Part I**, Issues and Summary of Process
- **Part II**, Amendment to Section 312 relating to the use of MPU to purchase computer software delivered in tangible form
- **Part III**, Amendment to Section 312 to expand the use of the MPU to situations where the purchaser does not provide the MPU

Part I – Issues and Summary of Process

Section 312 as adopted November 12, 2002

Section 312 of the Agreement requires a business purchaser of a digital good, services or electronically delivered computer software to deliver to the seller a Multiple Points of Use Exemption Form (“MPU”) when the purchaser knows at the time of the sale that the digital good, service or electronically delivered software will be available for use concurrently in more than one jurisdiction. Upon receipt of the MPU, the seller is relieved of any obligation to collect sales or use tax on the transaction and the buyer is charged with responsibility for allocating the digital good, services or software among the various jurisdictions where it will be used and remitting the corresponding amount of tax.

Issues: Industry representatives expressed concerns with the provisions of Section 312 with respect to sales of software and related services. They proposed the following two amendments to the sourcing rules in Section 312.

1. Apply the rules in section 312 to all software transactions, regardless of the method of delivery.
2. Include a rule defining the responsibilities of the seller in situations where the purchaser is required to deliver an MPU to the seller but fails to do so.

These concerns were first discussed at the Chicago meeting in November 2004. Minnesota, was asked to write a discussion paper for presentation at the next Project meeting in January 2005. A paper was written by Judy Niccum, Minnesota, with the assistance of Bill Riesenberger, Ohio, Matt Tomalis, FTA, Mark Nebergall, Software Finance & Tax Executives Council (SOFTEC), and Robert Kattan, IBM, and was presented at the January 2005 Project meeting in Phoenix, Arizona. The paper detailed the issues and arguments for and against adopting the industry proposals.

Since most states were not prepared to comment on the proposals at the January meeting it was decided that a survey be sent to all states to get input. The results of that survey were presented at the SSTP meeting in Atlanta, Georgia in March 2005 (see summary attached at the end of this paper). Prior to the March meeting COST submitted a proposal to amend Section 312 to adopt the industry proposals at the April 16, 2005 meeting of Implementing States.

A small group of state and business representatives was set up to iron out issues so that the Project could vote on the proposed amendments in a teleconference to be held April 7, 2005. State representatives included Marshall Stranburg, Florida, Richard Dobson, Kentucky, Tom Kimmett, Pennsylvania, Bill Riesenberger, Ohio, Bruce Johnson, Utah, Matt Tomalis, FTA, and Judy Niccum, Minnesota. Business representatives included Steve Kranz, COST, Jeff Friedman, Southerland, Asbill & Brennan, Mark Nebergall, SOFTEC, Bruce Regis, Microsoft, Barbara Barton, EDS Corporation,Carolynn lafrate, Comcast, Robert Kattan, IBM, Susan Haffield, PricewaterhouseCoopers and Steve Olivier, ChevronTexaco.

State and business representative held a series of teleconferences to address the issues surrounding the proposals. These discussions resulted in the presentation of substitute amendments to Section 312 which were voted on and passed with amendments at a Project teleconference on April 7, 2005. Final proposals were then submitted and approved by the Implementing States on April 16, 2005.

Part II - Computer Software Delivered in Tangible Form

Proposal - Apply the rules in section 312 to all software transactions, regardless of the method of delivery.

Section 312 allowed the use of an MPU for electronically delivered computer software, but not for software delivered in a tangible form. Industry argued that a purchaser of computer software who takes delivery on a tangible storage medium has the same ability to use the software in multiple jurisdictions as does a purchaser who takes delivery electronically.

States were surveyed and asked whether they were in favor of amending the rules to allow use of the MPU for all computer software regardless of the form in which the software was delivered. Twenty-six states and the District of Columbia responded to that survey with 15 states in favor of amending the rule and 12 against.

During the small group teleconferences, states expressed concern that allowing the use of the MPU for software sold in tangible form would create a revenue loss for software purchased in their state. This concern was addressed by

reaching an understanding that if software is purchased for use in multiple jurisdictions, tax will be apportioned to each jurisdiction as if the sale had originally been made there. Paragraph A3 was added to clarify this point. In addition, it was agreed that an MPU would not be allowed for the purchase of computer software received at a business location of the seller.

For consistency and clarification, paragraph headings were changed from letters to numbers and “MPU Exemption Form” was changed to “an exemption certificate claiming multiple points of use” throughout the section.

The amendment to Section 312 adopted April 16, 2005 by the Implementing for this issue is as follows:

Section 312: Multiple Points of Use

A. Notwithstanding the provisions of Section 310, a business purchaser that is not a holder of a direct pay permit that knows at the time of its purchase of a digital good, computer software delivered electronically, or a service that the digital good, computer software delivered electronically, or service will be concurrently available for use in more than one jurisdiction shall deliver to the seller in conjunction with its purchase a form disclosing this fact (“Multiple Points of Use or MPU” Exemption Form) an exemption certificate claiming multiple points of use or meet the requirements of subsections (B) or (C). Computer software, for purposes of this section includes, but is not limited to computer software delivered electronically, by load and leave, or in tangible form. Computer software received in-person by a business purchaser at a business location of the seller is not included.

1. Upon receipt of the MPU Exemption Form an exemption certificate claiming multiple points of use, the seller is relieved of all obligation to collect, pay, or remit the applicable tax and the purchaser shall be obligated to collect, pay, or remit the applicable tax on a direct pay basis.
2. A purchaser delivering the MPU Exemption Form an exemption certificate claiming multiple points of use may use any reasonable, but consistent and uniform, method of apportionment that is supported by the purchaser’s business books and records as they exist at the time of the consummation of the sale the transaction is reported for sales or use tax purposes.
3. A purchaser delivering an exemption certificate claiming multiple points of use shall report and pay the appropriate tax to each jurisdiction where concurrent use occurs. The tax due will be calculated as if the apportioned amount of the digital good, computer software or service had been delivered to each jurisdiction to which the sale is apportioned pursuant to A(2).

4. The ~~MPU Exemption Form~~ exemption certificate claiming multiple points of use will remain in effect for all future sales by the seller to the purchaser (except as to the subsequent sale's specific apportionment that is governed by the principles of Section 312, subsections A(2) and A(3)B) ~~and the facts existing at the time of the sale~~) until it is revoked in writing.

Part III – MPU Exemption Form

Proposal - Include a rule defining the responsibilities of the seller in situations where the purchaser is required to deliver an MPU to the seller but fails to do so. When the purchaser knows that the software will be used in more than one jurisdiction, Section 312 mandates the delivery of an MPU and shifts the burden for all taxability determinations to the purchaser. If the seller does not receive an MPU and otherwise does not know that the software will be used in multiple jurisdictions, the general sourcing hierarchy of Section 310 comes into play thus sourcing the sale to a single location.

The preferred scenario is that the purchaser will fulfill its obligation to provide the seller with the MPU form. However, in some situations, the seller may be willing to undertake the purchaser's obligation to remit the correct amount of tax to the applicable jurisdictions. This scenario contemplates that the seller will have received sufficient information from the purchaser to accurately collect and remit the tax to the appropriate jurisdictions.

Industry proposed amending Section 312 to add a new subsection E as follows:

- E. If an MPU Exemption Form is not delivered to the seller by the purchaser, the seller:
 - 1) may use written information obtained from the purchaser at the time of consummation of the sale which will support any reasonable but consistent and uniform method to collect and remit the applicable tax, or may collect the tax according to Section 310(A);
 - 2) in the absence of information from the purchaser and in the absence of the seller's bad faith, is relieved of any obligation to collect or remit tax on that transaction. The purchaser is solely responsible for the tax.

Proposed Section 312(E)(1) would permit the seller, at its option, to undertake this obligation and use the information received from the purchaser to make the apportionment. The proposed new section also makes it clear that if the seller is unwilling to apportion, the seller retains the option to source the transaction under Section 310(A).

Proposed Section 312(E)(2) contemplates the scenario where both the buyer and the seller know that the product or service which is the object of the transaction will be used in more than one jurisdiction, but the purchaser refuses to provide an MPU and does not provide the seller with information which would enable the seller to collect and remit the applicable tax. Under this scenario, the seller would be exempt from collecting or remitting any tax with respect to the transaction. Exempting the seller from tax collection under this narrow circumstance puts the seller in the same position it would have been in had the purchaser fulfilled its obligation to give the seller an MPU. The obligation to remit the applicable tax with respect to the transaction would remain with the purchaser where it belongs.

States expressed serious concerns about these industry proposals. The following four questions relating to this proposal were asked in the February survey:

1. **How do you interpret the current rules in Section 312, when the seller is aware that a service or software will be concurrently available for use in more than one jurisdiction, but the purchaser does not provide an MPU?** All 26 states and the District of Columbia responding to the survey indicated that the seller must source the sale according to the rules in 310(A), thus sourcing the sale to a single location.
2. **Are you in favor of modifying Section 312 to allow sellers the option to collect sales tax based on information provided by the purchaser when the purchaser does not provide an MPU?** Only six states answered yes to this question with 21 states voting no.
3. **If you answered yes to #2 above, and the seller chooses not to collect sales tax based on the information provided by the purchaser, do you think that the seller is obligated to source under Section 310(A)?** All six states answering yes to #2 also said yes to this question.
4. **Are you in favor of modifying Section 312 to require sellers to collect sales tax based on information provided by the purchaser? (This would be consistent with the rules for Direct Mail Sourcing in Section 313.)** The responses to this question were nearly evenly split with 14 states saying yes to this question and 13 states saying no.

The small group discussions and discussion from the April 4, 2007 Project teleconference resulted in general concerns from states about the potential for businesses and sellers to collaborate to avoid paying taxes and concerns about the lack of time for states to determine the dollar impact of the proposed changes. Specific concerns addressed and conclusions were:

Timing for payment of tax. Industry proposed that the sale be apportioned based on the purchaser's books and records, but not necessarily at the time the sale is consummated. Industry argued that the purchaser may not know until some time after the sale where the software will be concurrently available for use so the determination should be left open until that information is available. States countered that the apportionment must be made based on information available to the seller at the time of sale. Allowing for a delay in reporting tax places an additional burden on the seller.

Conclusion: The sale will be sourced based on records as they exist at the time the transaction is reported for sales or use tax purposes. State's made a commitment to review this provision again at a later date.

Apportionment. States expressed concern about allowing the seller sole responsibility for determining the correct apportionment when the purchaser does not provide an MPU. Industry was concerned with being required to source to multiple jurisdictions when the purchaser does not provide an MPU.

Conclusion: Discussion resulted in a compromise where the seller may work with the purchaser to produce the correct apportionment, provided it is supported by the business records of the seller and purchaser as they exist at the time the transaction is reported for sales or use tax purposes. In addition, the purchaser must certify to the accuracy of the apportionment, but the seller has the option of not accepting the certification.

Sourcing absent an MPU. States and industry were concerned with how to source when it is clear the product will be used in multiple jurisdictions, but no MPU is provided and the purchaser does not certify as to the accuracy of a determined apportionment. There was discussion about setting a default rule so that such transactions would always be sourced the same way (similar to the provisions of the Direct Mail sourcing rules).

Conclusion: Discussion resulted in allowing the seller to collect and remit the tax based on the appropriate provision in Section 310. It was pointed out that, with the exception of software that is required to be sourced to the seller's location because it is picked up in person at the seller's location, any of the sourcing rules in 310 could apply.

Credit for taxes paid. Industry asked for clarification in the rule that purchaser's can claim a credit for sales or use taxes legally due and paid to other jurisdictions. For clarification a paragraph E was added.

The following amendment was passed at the April 7, 2005 Project teleconference and adopted by the Implementing states at the April 16, 2006 meeting.

- B. Notwithstanding subsection A, when the seller knows that the product will be concurrently available for use in more than one jurisdiction, but the purchaser does not provide an exemption certificate claiming multiple points of use as required in subsection A, the seller may work with the purchaser to produce the correct apportionment. The purchaser and seller may use any reasonable, but consistent and uniform, method of apportionment that is supported by the seller's and purchaser's business records as they exist at the time the transaction is reported for sales or use tax purposes. If the purchaser certifies to the accuracy of the apportionment and the seller accepts the certification, the seller shall collect and remit the tax pursuant to subsection A(3). In the absence of bad faith, the seller is relieved of any further obligation to collect tax on any transaction where the seller has collected tax pursuant to the information certified by the purchaser.
- C. When the seller knows that the product will be concurrently available for use in more than one jurisdiction and the purchaser does not have a direct pay permit and does not provide the seller with an exemption certificate claiming multiple points of use exemption as required in subsection A, or certification pursuant to subsection B, the seller shall collect and remit the tax based on the provisions of Section 310.
- D. A holder of a direct pay permit shall not be required to deliver a MPU Exemption Form ~~an exemption certificate claiming multiple points of use~~ to the seller. A direct pay permit holder shall follow the provisions of subsections ~~(B)~~ A(2) and A(3) of this section in apportioning the tax due on a digital good, computer software, or a service that will be concurrently available for use in more than one jurisdiction.
- E. Nothing in this section shall limit a person's obligation for sales or use tax to any state in which the qualifying purchases are concurrently available for use, nor limit a person's ability under local, state, federal, or constitutional law, to claim a credit for sales or use taxes legally due and paid to other jurisdictions.

Summary of Responses to the Computer Software and Related Services Survey

March 15, 2005

Twenty-six states and the District of Columbia responded to the Computer and Related Services survey: **Alabama, Arizona, Arkansas, District of Columbia, Georgia, Indiana, Iowa, Kansas, Kentucky, Massachusetts, Michigan, Minnesota, New Jersey, New York, North Carolina, North Dakota, Ohio, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin and Wyoming**

Software delivered in tangible form

Section 312 currently allows the use of the MPU for purchases of “computer software delivered electronically,” but is silent on software delivered in tangible form.

Are you in favor of amending the rules to allow use of the MPU for all computer software regardless of the form in which the software is delivered?

Yes - 15 states

No - 12 states

Sourcing computer software and related services

1. How do you interpret the current rules in Section 312, when the seller is aware that a service or software will be concurrently available for use in more than one jurisdiction, but the purchaser does not provide an MPU? Does it mean that:
 - A. **the seller must source the sale according to the rules in 310(A), thus sourcing the sale to a single location - 27 states**
 - B. the seller is not obligated to collect any sales tax since the purchaser was obligated to provide an MPU _____
 - C. Other, please explain
2. Are you in favor of modifying Section 312 to allow sellers the option to collect sales tax based on information provided by the purchaser when the purchaser does not provide an MPU?

Yes – 6 states

No – 21 states

3. If you answered yes to #2 above, and the seller chooses not to collect sales tax based on the information provided by the purchaser, do you think that the seller is obligated to source under Section 310(A)?

Yes – 6 states

No

4. Are you in favor of modifying Section 312 to require sellers to collect sales tax based on information provided by the purchaser? (This would be consistent with the rules for Direct Mail Sourcing in Section 313.)

Yes – 14 states

No – 13 states

Note – The section on Software Maintenance Contracts from the original survey is not included.