Business Advisory Council Compliance Subcommittee Report

To: Compliance Review and Interpretations Committee

From: BAC Compliance Subcommittee

Re: Preliminary report on 2011 Annual Recertification - Second Group of States

Date: October 21, 2011

Below is the list of compliance concerns the BAC would like to raise with the second grouping of states. Issues already addressed in the report issued by the Governing Board's staff are not included (*i.e.,* duplicated) in this report.

Georgia

Continued Temporary Regulation - This is not a specific compliance issue; however, Regulation 560-12-1.20.38 is still an emergency regulation. Is there an issue with making the rule permanent?

Indiana

Access to Prewritten Software - The Indiana Department of State Revenue has issued rulings, *e.g.,* Revenue Ruling #2009-03 ST (released 4/29/2009), taking the position that prewritten software that is licensed for use and available from a remote server is taxable. Indiana's attempt to tax *access* to prewritten software (and any associated hardware) from a customer merely *accessing* the prewritten software that is not delivered (*i.e.,* downloaded) to the customer as a sale of "tangible personal property" is not compliant with the SSUTA. While the definition of "tangible personal property" specifically includes "prewritten software," § 333 of the SSUTA *excludes* computer software, which prewritten software is a component of, from the term "products transferred electronically." This is an important distinction because, as pointed out in Rule 332.2.B.4, the term "transferred electronically" is broader than the term "delivered electronically" that is used in computer related definitions. That rule specifies that just accessing a product can be considered something "transferred electronically;" however, this provision cannot apply to prewritten software because § 333 of the SSUTA excludes it from being a product "transferred electronically." It also, logically, does not fit in as tangible personal property based on the SSUTA sourcing provisions for tangible personal property. When prewritten software is only accessed by a purchaser, there is no "[t]aking possession of the tangible personal property" as specified § 311.A of the SSUTA (defining when something is "received"). Further, if it is found that Indiana can tax access to prewritten software based on it being "transferred electronically," the requirements in § 332.D of the SSUTA must be met. Absent Indiana having a law (*i.e.,* statute), the tax on such software only reaches transactions where the purchaser: 1) has a right of permanent use, 2) has no obligation to make continued payments and 3) is an end user. Accordingly, while Indiana may choose to tax access to prewritten software by specifically imposing a tax on the sale of such product, Indiana cannot do it via the SSUTA's definition of tangible personal property and remain compliant with the SSUTA.

Iowa

No additional issues.

Michigan

Access to Prewritten Software - The Michigan Department of Treasury has opined that prewritten software that is licensed for use and available from a remote server is taxable. A letter from Terry McDonald, Manager, Technical Services Division, dated April 20, 2009 states in a taxpayer's inquiry that:

> "It is the department's determination that a right to access/use prewritten computer software is analogous to a license to use prewritten computer software. Therefore, the purchase of a license for the use of prewritten computer software or the purchaser of the right to access or use prewritten software in Michigan is subject to Michigan tax.

Michigan's attempt to tax *access* to prewritten software (and any associated hardware) from a customer merely *accessing* the prewritten software that is not delivered (*i.e.*, downloaded) to the customer as a sale of "tangible personal property" is not compliant with the SSUTA. While the definition of "tangible personal property" specifically includes "prewritten software," § 333 of the SSUTA *excludes* computer software, which prewritten software is a component of, from the term "products transferred electronically." This is an important distinction because, as pointed out in Rule 332.2.B.4, the term "transferred electronically" is broader than the term "delivered electronically" that is used in computer related definitions. That rule specifies that just accessing a product can be considered something "transferred electronically;" however, this provision cannot apply to prewritten software because § 333 of the SSUTA excludes it from being a product "transferred electronically." It also, logically, does not fit in as tangible personal property based on the SSUTA sourcing provisions for tangible personal property. When prewritten software is only accessed by a purchaser, there is no "[t]aking possession of the tangible personal property" as specified § 311.A of the SSUTA (defining when something is "received"). It appears Michigan has attempted to address this issue by stating it is only imposing a "use tax" on the use of the software in the state. As there is no actual possession of the tangible personal property in Michigan, the tax of such "use" is not appropriate. Further, if it is found that Michigan can tax access to prewritten software based on it being "transferred electronically," the requirements in § 332.D of the SSUTA must be met. Absent Michigan having a law (*i.e.*, statute), the tax on such software only reaches transactions where the purchaser: 1) has a right of permanent use, 2) has no obligation to make continued payments and 3) is an end user. Accordingly, while Michigan may choose to tax access to prewritten software by specifically imposing a tax on the sale of such product, Michigan cannot do it via the SSUTA's definition of tangible personal property and remain compliant with the SSUTA.

New Jersey

No additional issues.

North Carolina

No additional issues.

Ohio

No additional issues.

South Dakota

No additional issues.

Tennessee

No additional issues.

Utah

Access to Prewritten Software - Utah sales and use tax statutes define "tangible personal property" as including "prewritten computer software, regardless of the manner in which the prewritten computer software is **transferred**." (Emphasis added.) In addition, Utah's has special sourcing provisions applicable to computer software that apply where "a purchaser uses computer software and there is not a transfer of a copy of that software to the purchaser" that conflict with Sections 311.A and 310.A.2 and A.3 of the agreement. The BAC believes Utah's statutory scheme imposes tax on *access* to prewritten software (and any associated hardware) from a customer merely *accessing* the prewritten software that is not delivered (*i.e.*, downloaded) to the customer as a sale of "tangible personal property" is not compliant with the SSUTA. While the definition of "tangible personal property" specifically includes "prewritten software," § 333 of the SSUTA *excludes* computer software, which prewritten software is a component of, from the term "products transferred electronically." This is an important distinction because, as pointed out in Rule 332.2.B.4, the term "transferred electronically" is broader than the term "delivered electronically" that is used in computer related definitions. That rule specifies that just accessing a product can be considered something "transferred electronically;" however, this provision cannot apply to prewritten software because § 333 of the SSUTA excludes it from being a product "transferred electronically." It also, logically, does not fit in as tangible personal property based on the SSUTA sourcing provisions for tangible personal property. When prewritten software is only accessed by a purchaser, there is no "[t]aking possession of the tangible personal property" as specified § 311.A of the SSUTA (defining when something is "received"). Further, if it is found that Utah can tax access to prewritten software based on it being "transferred electronically," the requirements in § 332.D of the SSUTA must be met. Absent Utah having a law (*i.e.*, statute), the tax on such software only reaches transactions where the purchaser: 1) has a right of permanent use, 2) has no obligation to make continued payments and 3) is an end user. Accordingly, while Utah may choose to tax access to prewritten software by specifically imposing a tax on the sale of such product, Utah

cannot do it via the SSUTA's definition of tangible personal property and remain compliant with the SSUTA.

Wisconsin

No additional issues.

Wyoming

No additional issues.