



March 29, 2007

**Via Email**

Mr. Scott Peterson  
Executive Director  
Streamlined Sales and Use Tax Governing Board  
4205 Hillsboro Pike  
Suite 305  
Nashville, Tennessee 37215

**Re: Request for Initiation of Interpretative Rulemaking Process**

Dear Mr. Peterson:

Pursuant to Section 902 of the Streamlined Sales and Use Tax Agreement (the "Agreement") and Rule 902.1 of the Streamlined Sales Tax Governing Board's Rules And Procedures, on behalf of the Software Finance and Tax Executives Council (SoFTEC), I request that the Streamlined Sales Tax Governing Board initiate its interpretative rulemaking process and promulgate interpretative rules under Sections 309 and 310A of the SSUTA regarding the sourcing of payments made in connection with software subscriptions and recurring payment licenses. A copy of our proposed interpretative rule is attached.

SoFTEC is a trade group providing software industry focused public policy advocacy in the areas of tax, finance and accounting. Our member companies have long been interested in uniform rules governing their state sales and use tax obligations and have followed closely the work of the Streamlined Sales Tax Governing Board (the "Governing Board"). We applaud your recent promulgation of uniform sourcing interpretative rules for a variety of software and related transactions. Our view is that additional sourcing interpretative rules are needed to cover transaction types not included in the recently enacted rules; hence, we make the instant request.

**1. Summary of Proposed Interpretative Rules:**

SoFTEC asks that the Governing Board promulgate interpretative rules regarding the sourcing of payments attributable to software subscriptions and recurring payment licenses. Rules for the sourcing of transactions are found generally in Sections 309 and 310 of the Agreement. The recently promulgated interpretative software sourcing rules cover general software transactions, computer related services and software post-sale support agreements; they do not specifically cover the sourcing of subsequent payments made in connection with software subscriptions and recurring payment licenses.

**A. Software Subscriptions:**

A software subscription is a type of transaction under which a purchaser licenses a type of software that requires continual updates in order to remain useful. The software

vendor will sell the purchaser a copy of the underlying software along with a right to receive the updates for a specific period of time. When the time expires, while the purchaser remains entitled to use the copy of the software, it is no longer entitled to receive the updates. The vendor offers the purchaser the opportunity to renew the right to receive updates for a given period of time. An example of a type of software that is typically marketed using the subscription model is anti-virus software. In order to remain effective against newly developed virus threats, the software must be periodically updated with information about new threats. Many companies license a copy of the software along with a one-year subscription to the updates with the update subscriptions renewable annually.

SoFTEC requests that the Governing Board promulgate an interpretative rule giving guidance on how software vendors source the software subscription renewal payments. Our proposed rule provides that the vendor should source the subscription renewal payments to the same location as it sourced the initial license payment, unless the vendor has information that the software has been moved to a different location. If the vendor has not received information indicating that the software has moved it would not be bad faith for the vendor to source the subscription renewal payments to the same location as it sourced the initial software license fee. If the vendor receives information that the location of the software has moved, it should source the subscription renewal payment to the new location.

## **2. Recurring Payment Software Licenses:**

A recurring payment software license is one that requires the purchaser to make recurring payments in order to retain the right to use the software. Many times, software is licensed for a fixed period of time under terms that require periodic payments. At the end of the term, the software will cease to function. Other times software may be licensed under terms that allow the purchaser to use the software for as long as it wants so long as it makes periodic payments.

If the purchaser fails to make a payment, the software ceases to function. Software vendors might enforce these sorts of licenses through the use what are known as software “keys.” When the purchaser makes its recurring payment, the vendor supplies the purchaser with a code that must be entered into the software in order to keep the software functioning. If the code is not entered prior to the expiration of the period, the software will shut down.

These types of licenses are to be distinguished from situations where a purchaser will license software on a perpetual basis but enter into an arrangement with the vendor to pay the license fee in installments. In these situations, the purchaser’s right to use the software is not contingent on the making of the future payments (although the vendor might be in a position to electronically repossess the software if the purchaser fails to make an installment payment).

SoFTEC proposes that recurring payments under a recurring payment software license arrangement be sourced to the same location as the initial payment, unless the vendor has received information that the software has been moved to a different location. If the vendor has not received information that the software has moved to a new location, it would not be bad faith for the vendor to source the recurring payment to the same location as it sourced the initial payment. If the vendor receives information that the software has been moved to a new location, it should source the software to such new location.

Further, we believe that the sourcing regime of Section 310A, which deals with sourcing retail sales is more appropriate than the regime of Section 310B, which deals with leases and rentals. Section 310B is geared towards leases and rentals of tangible personal property and assumes that the lessor or rentor has an incentive to keep track of the location of its property and to monitor movements from one location to another. These assumptions are grounded on the fact that the vendor will generally expect that its property will be returned at the end of the lease or will need to know where the property is in case it needs to repossess it in the event of a default.

However, software is different and these assumptions do not hold true. Software vendors rarely need to reclaim their software at the end of a lease or to repossess the copy in the event of a default. Most software marketed under a recurring payment license will cease to operate at the end of a lease or on the failure to make a required payment. For this reason, our proposed sourcing rule for recurring payment licenses is under Section 310A and not Section 310B.

## **2. Conclusion:**

We thank you and the Governing Board for the opportunity to submit this request for in initiation of its rulemaking process and look forward to working with it and the State and Local Advisory Council as the process moves forward. If you or any member of the Governing Board has any questions, I can be reached at (202) 331-9533 or [mnebergall@softwarefinance.org](mailto:mnebergall@softwarefinance.org).

Respectfully submitted,



Mark E. Nebergall  
President  
Software Finance and Tax Executives Council

## **Proposed Sourcing Rule for Software Subscriptions and Recurring Payment Licenses**

**[Amend Existing Rule 309.1 as follows]**

### **Rule 309.1. Sourcing Certain Transactions.**

Sections 309, 310 and 311 of the Streamlined Sales and Use Tax Agreement (SSUTA) contain the general sourcing regime. Rules 309.1, 309.2, 309.3, ~~and 309.4~~ and 309.5 describe the application of Sections 309, 310 and 311 of the SSUTA to prewritten software transactions, to computer related services, ~~and~~ sourcing software post-sale support agreements, software subscriptions and recurring payment software licenses. Retail sales of software, or services with respect to such software, other than computer pre-written software, are not covered by Rules 309.1, 309.2, 309.3, ~~and 309.4~~ and 309.5. For purposes of Rules 309.1, 309.2, 309.3, ~~and 309.4~~ and 309.5, “location” means a geographic situs within a particular jurisdiction. Under Section 309 of the SSUTA, the provisions of Rules 309.1, 309.2, 309.3, ~~and 309.4~~ and 309.5 do not affect the obligation of a ~~P~~purchaser or lessee to remit tax on the use of the product to the tax jurisdiction of that use.

**[Proposed New Rule 309.5]**

### **Rule 309.5. Sourcing Software Subscriptions and Multiple or Recurring Payment Software Licenses:**

(1) The initial retail sale of a software subscription or a software license that requires multiple or recurring license payment shall be sourced in accordance with Section 310A of the SSUTA.

Example 1: Seller electronically delivers to Purchaser a copy of prewritten computer software on a subscription basis. The software is a product designed to detect online threats. In order to remain effective, the software must be constantly updated with new threat definitions. The subscription provides the Purchaser with electronically delivered updates for a one year period. The Purchaser may renew the subscription annually. The Seller has no information as to the location where the software was electronically delivered. However, the Purchase Order discloses a “ship to” address. Seller sources the sale to the “ship to” address shown on the Purchase Order as such address constitutes a “location indicated by instructions for delivery to the purchaser” under Section 310A(2).

Example 2: Seller delivers to purchaser a copy of prewritten computer software. The license is for a 3 year period and requires the purchaser to make an initial payment and 2 additional annual license payments. Vendor ships a copy of the software on disk to purchaser in State A. Seller sources the initial license payment to the location to which it shipped the software under Section 310A(2).

- (2) a. Sourcing a subsequent license payment made in connection with a software license that requires multiple license payments or the renewal of a software subscription to the same location where the initial payment was sourced will not constitute bad faith so long as the seller has not received information from the purchaser indicating a change in the location of the underlying software.
- b. If the seller receives information from the purchaser indicating that the location of the underlying software has changed, a subsequent payment made in connection with a software license that requires multiple or recurring payments or renewal of a software subscription shall be sourced to such new location.

Example 3: Same facts as in Example 1, above, except the Purchaser renews the software subscription for a second year. The Purchase Order for the renewal discloses a different “ship to” address than the Purchase Order for the initial sale of the subscription. The different “ship to” location on the renewal Purchase Order constitutes the receipt by the Seller of information indicating that the location of the underlying software has changed. Seller sources the renewal to the new address.

Example 4: Same facts as in Example 2, except that after the software was delivered to purchaser, unbeknown to the seller, purchaser installs the software on a computer located in State B. Seller never receives any information that the software is located in any state other than the one to which it originally shipped it. Seller sources the second payment to State A. Because seller has not received any information indicating that the location of the software has changed, Seller’s sourcing of the second license payment to State A does not constitute bad faith.

Example 5: Seller sells to purchaser prewritten computer software under a perpetual license for \$3 million. Seller agrees to finance the license fee over a 3-year period under which the purchaser will make three equal annual payments. Seller sends purchaser an invoice that includes the first annual payment plus 100 percent of the sales tax due on the transaction. Seller thus collects and remits all of the tax due with respect to the transaction at the time of the sale. The subsequent payments are not recurring payments within the meaning of Rule 309.5(2) and no sourcing is necessary.