

Proposed Sourcing Rule for Software Term Licenses and Subscriptions

[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 term licenses, and software subscriptions. Retail sales of software, or services with respect to such software, other than computer prewritten 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 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 Term License and Subscriptions:

- (1) **Definitions:** As used in this section
 - (a) the term “software subscription” means a transaction requiring additional payments for updates to prewritten computer software and
 - (b) the term “software term license” means a transaction where the purchaser’s right to continue to use prewritten software is dependant on periodic payment.
- (2) **Initial Payments:** Initial payments made in connection with a software term license or subscription 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: Same facts as in Example 1 except the Purchaser is a consumer who downloads the software from the Internet and uses a credit card to pay for the software and the subscription to the updates. During the consummation of the sale, seller receives no information regarding the location to which the software and the subscription will be delivered, but does receive the Purchaser's credit card billing address. Seller sources the transaction to the Purchaser's credit card billing address because it is a location indicated by an address for the purchaser obtained during the consummation of the sale under Section 310A(4) and because the Seller has no delivery or other address in its business records that would permit sourcing under either Section 310A(2) or (3).

Example 3: Seller delivers to purchaser a copy of prewritten computer software. The license is for a 1-year period and requires the purchaser to make payments to renew the license. If the purchaser does not make an annual payment, the purchaser must terminate use of the software and the software may cease to function. Seller ships the software on a disk to purchaser in State A. Seller sources the initial license payment to State A, the location to which it shipped the software, as determined under Section 310A (2).

(3) **Subsequent payments:** The following rules apply if the seller sourced the initial payment under Section 310A (2):

- a. 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 term license or renewal of a software subscription shall be sourced to such new location.
- b. If the seller has not received information from the purchaser indicating a change in the location of the underlying software, sourcing a subsequent license payment made in connection with a software term license or the renewal of a software subscription to the same location where the initial payment was sourced will not constitute bad faith.

Example 4: 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 5: Same facts as in Example 4 except that the Purchase Order for the renewal discloses a different "bill to" address than the Purchase Order for the initial sale of the subscription. The "ship to" address on the Purchase order remains the same. A change in the "bill to" address on the Purchase Order does not constitute the receipt of information from the purchaser indicating that the location of the underlying software has changed. The Seller sources the renewal payment to the same location as the initial payment.

Example 6: Same facts as in example 2 except that the Purchaser has moved and has a new credit card billing address. The Purchaser uses the credit card and the new address when renewing the software subscription for a second year. In the interim, Seller has received no information concerning the location of the software. Because the initial payment was not sourced under Section 310A(2), Seller's use of the new credit card address for sourcing the renewal payment would not constitute bad faith under Section 310A(4).

Example 7: Same facts as in Example 3, except that after the software copy was delivered to purchaser in State A, the 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. Purchaser renews the license at the end of the first year and seller sources the renewal 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 license renewal payment to State A does not constitute bad faith.

Example 8: 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 made in connection with a software term license or subscription within the meaning of Rule 309.5(2) and no sourcing is necessary.