Introduction

Carolynn S. Kranz

Carolynn is the founder and Managing Member of Industry Sales Tax Solutions, LLC, which offers a subscription database containing the sales and use taxability of software related transactions, digital content and cloud services; and the Managing Member of Kranz & Associates, PLLC, a boutique law firm specializing in state and local tax consulting. Carolynn specializes in state and local tax matters on a multi-state basis.

Carolynn holds a law degree from Widener University School of Law and a Bachelor’s Degree from Widener University. Carolynn is a CPA, a member of the District of Columbia and the Pennsylvania Bar Associations, and also a member of various professional organizations. Carolynn was recognized by State Tax Notes in its monthly State Tax Spotlight, which regularly profiles a person or organization influential in the state and local tax world. Carolynn is a frequent speaker on multi-state sales and use tax matters for clients, businesses, and a number of professional organizations. She also authored LexisNexis’ State Tax Guide to Digital Content and Cloud Services, 1st, 2nd, 3rd, 4th & 5th Editions; and is a frequent author on state tax issues.
Agenda

- Understanding Tax Risk
- Nexus
- Characterization
- Sourcing
- Exemptions for Multi-state Use
Understanding Sales
Tax Risk
The Risk is Out There

– Financial Statement Drivers - ACS 450 (Formerly SFAS 5)
  • What are your long-term business goals (IPO, Sell, etc.)

– Governmental Exposure on Audit
  • Sales Tax
    – Nexus
    – Characterization = Taxability
    – Sourcing
Sales and use taxes constitute approximately 33% of most states’ revenue.

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There are 45 states plus the District of Columbia and Puerto Rico that impose a sales and use tax. The states of New Hampshire, Oregon, Montana, Alaska, and Delaware do not impose a state level sales and use tax.

* * * * *

Most state sales tax rates range from four to six percent. Local taxes, which are often imposed in addition to the state sales tax range from .125 to 5 percent.
Sales Tax Decision Making Process

- Does the taxpayer have **nexus** in the state, or is the taxpayer registered?
- Is the transaction a taxable transaction?
- Which state has jurisdiction over the transaction?
- Are there any applicable exemptions to the transaction (i.e., customer exemptions)?
Having sales in a state does not create nexus. Nexus historically required some form of physical presence, which can be any of the following:

- Owning or leasing property in a state.
- Having employees based or working in a state.
- Delivering goods in a company owned or leased vehicle.
- Soliciting sales through the use of an employee, dependent or independent contractor.
- Installing or repairing property in a state through the use of an employee, dependent or independent contractor.
- Conducting training sessions in a state.
- Attending trade shows in a state (although some states specifically exempt attendance at trade shows).

The future of nexus is changing.
Other Nexus Considerations

- Click Through / Affiliate Nexus
- Use Tax Reporting Requirements
- Economic Nexus Proposals
- Federal Legislation Related to Remote Sellers
In a 5-4 Decision, Justice Kennedy (joined by Thomas, Gorsuch, Ginsburg, Alito) held that:

- *Quill* and *National Bellas Hess* are overruled
- The physical presence rule is unsound, is an incorrect interpretation of the Commerce Clause, and restricts the states’ authority to “collect taxes and perform critical public functions”

Majority concluded that the following features of South Dakota’s law minimized the burdens on interstate commerce:

- Included a transactional safe harbor
- Did not apply retroactively
- South Dakota was a full member of the Streamlined Sales and Use Tax Agreement (SSUTA)
Transactional Safe Harbor

- South Dakota’s transaction safe-harbor of an annual threshold of 200 sales or $100,000 in sales was sufficient
  - States argued that the first sale triggered the collection responsibility and Justice Kennedy did not respond
  - Should the threshold be the same for California as South Dakota?
  - Can states require small businesses making few sales collect in all cases?
## Winners and Losers

<table>
<thead>
<tr>
<th>Winners</th>
<th>Losers</th>
</tr>
</thead>
<tbody>
<tr>
<td>States</td>
<td>Online retailers</td>
</tr>
<tr>
<td>Localities</td>
<td>Start-ups</td>
</tr>
<tr>
<td>Brick and mortar retailers</td>
<td>Marketplace providers</td>
</tr>
<tr>
<td>Software compliance companies</td>
<td>Foreign sellers (?)</td>
</tr>
<tr>
<td></td>
<td>Service providers</td>
</tr>
</tbody>
</table>
## Economic Nexus Provisions

<table>
<thead>
<tr>
<th>State</th>
<th>Threshold</th>
<th>Effective / Enforcement Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>$250,000 and one or more nexus-creating activities</td>
<td>January 1, 2016 / October 1, 2018</td>
</tr>
<tr>
<td>Connecticut</td>
<td>100 retail sales and regular or systematic solicitation of sales</td>
<td>December 1, 2018</td>
</tr>
<tr>
<td>Georgia</td>
<td>$250,000 or 200 transactions or comply with use tax notice/reporting requirements</td>
<td>January 1, 2019</td>
</tr>
<tr>
<td>Hawaii</td>
<td>$100,000 or 200 transactions</td>
<td>July 1, 2018</td>
</tr>
<tr>
<td>Illinois</td>
<td>$100,000 or 200 transactions</td>
<td>October 1, 2018</td>
</tr>
<tr>
<td>Indiana</td>
<td>$100,000 or 200 transactions</td>
<td>July 1, 2017 / Law is Currently Stayed</td>
</tr>
<tr>
<td>Iowa</td>
<td>$100,000 or 200 transactions</td>
<td>January 1, 2019</td>
</tr>
<tr>
<td>Kentucky</td>
<td>$100,000 or 200 transactions</td>
<td>July 1, 2018</td>
</tr>
<tr>
<td>Louisiana</td>
<td>$100,000 or 200 transactions</td>
<td>January 1, 2019</td>
</tr>
<tr>
<td>Maine</td>
<td>$100,000 or 200 transactions</td>
<td>October 1, 2017</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$500,000 and 100 transactions for retailers with software in state (apps, cookies, etc.)</td>
<td>October 1, 2017</td>
</tr>
<tr>
<td>Minnesota</td>
<td>100 retail sales or 10 retail sales totaling $100,000 and regular or systematic solicitation of sales</td>
<td>October 1, 2018</td>
</tr>
<tr>
<td>Mississippi</td>
<td>$250,000 and purposefully or systematically exploiting the market</td>
<td>December 1, 2017</td>
</tr>
<tr>
<td>State</td>
<td>Threshold</td>
<td>Effective / Enforcement Date</td>
</tr>
<tr>
<td>------------------</td>
<td>---------------------------------------------------------------------------</td>
<td>------------------------------</td>
</tr>
<tr>
<td>North Dakota</td>
<td>$100,000 or 200 transactions</td>
<td>October 1, 2018</td>
</tr>
<tr>
<td>Ohio</td>
<td>$500,000 for retailers with software or content distribution networks in state</td>
<td>January 1, 2018</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>$10,000 or comply with use tax notice/reporting requirements</td>
<td>January 1, 2018</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>$10,000 or comply with use tax notice/reporting requirements</td>
<td>March 1, 2018</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>$100,000 or 200 transactions</td>
<td>August 17, 2017</td>
</tr>
<tr>
<td>South Dakota</td>
<td>$100,000 or 200 transactions</td>
<td>Pending resolution of litigation</td>
</tr>
<tr>
<td>Tennessee</td>
<td>$500,000 and regular or systematic solicitation</td>
<td>Pending resolution of litigation and approval by General Assembly</td>
</tr>
<tr>
<td>Vermont</td>
<td>Regular, systematic, or seasonal solicitation of sales and either $100,000 or 200 transactions</td>
<td>July 1, 2018</td>
</tr>
<tr>
<td>Washington</td>
<td>$10,000 (different standards for marketplaces and referrers)</td>
<td>January 1, 2018</td>
</tr>
<tr>
<td>Wyoming</td>
<td>$100,000 or 200 transactions</td>
<td>October 1, 2018</td>
</tr>
</tbody>
</table>
# Use Tax Notice & Reporting

<table>
<thead>
<tr>
<th>State</th>
<th>Transactional Notice(s)</th>
<th>Annual Report to Purchasers</th>
<th>Annual Report to Department</th>
</tr>
</thead>
<tbody>
<tr>
<td>Colorado</td>
<td>Starting July 1, 2017</td>
<td>January 31, 2018</td>
<td>March 1, 2018</td>
</tr>
<tr>
<td>Kentucky X</td>
<td>Starting July 1, 2013</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Louisiana X</td>
<td>Starting July 1, 2017</td>
<td>January 31, 2018</td>
<td>March 1, 2018</td>
</tr>
<tr>
<td>New York</td>
<td>Effective 1/1/2019 – check bill for dates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oklahoma</td>
<td>Starting October 1, 2010</td>
<td>February 1, 2017</td>
<td>N/A</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>Starting August 17, 2017</td>
<td>January 31, 2018</td>
<td>Non-colllecting retailers: February 15, 2018 Retail Sale Facilitators: January 15, 2018</td>
</tr>
<tr>
<td>South Dakota X</td>
<td>Starting July 1, 2011</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Vermont</td>
<td>Starting July 1, 2017</td>
<td>January 31, 2018</td>
<td>January 31, 2018</td>
</tr>
</tbody>
</table>

X = no penalties are specified for noncompliance
Characterization
Imposition of Sales & Use Tax

• Each states rules regarding the taxability of products and services differ. In general, sales and use tax is imposed on all sales of tangible personal property, unless otherwise exempt, and only specifically enumerated services (those services specifically listed as taxable).

• A “sale” is commonly defined as any transfer of title or possession, exchange or barter, conditional or otherwise, in any form or by any means whatsoever, of tangible personal property or services for a consideration. A sale of tangible personal property generally includes a lease or rental.
Characterization

• What are you selling?
  – Tangible personal property
  – Software
  – Service
  – Digital Good
  – Something else
• How is it delivered?
  – Tangible form
  – Electronically delivered
  – Electronically accessed
  – Electronically streamed
• What does the Agreement state you are selling?
  – Auditors and courts heavily rely on the contractual language in characterizing the item being purchased. If a software license agreement is executed, it will be difficult to argue that you are not licensing software.
• What does the Invoice state you are selling?
  – Does it document delivery method?
“Tangible Personal Property”

• Most states tax sales of tangible personal property and enumerated services. Emerging trend to tax “digital goods” and various bills for taxing digital services.

  – “Tangible personal property’ means personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses. ‘Tangible personal property’ includes electricity, water, gas, steam, and prewritten computer software.” SSUTA, Appendix C.
The majority of states that impose a sales and use tax still only tax those services specifically enumerated as taxable. Determining if the sale is taxable can be a daunting task.

- Laws and interpretive guidelines are often outdated.
- There is often a lack of clear guidance.
- Categorization can have significant impact:
  - Reduced rates
  - Temporary imposition
  - Reduced tax bases
  - Applicability of exemptions
  - Sourcing
Characterization - SaaS

• Examples of State Departments of Revenue which have taken numerous differing approaches in characterization:
  – *Taxable as sale / rental of Prewritten or Canned Computer Software*
    • AZ, MA, NY, PA**, TN**, UT*
      – * UT is an SST state – SaaS should NOT be taxed as prewritten computer software.
      – ** PA & TN have legislatively enacted language that “remotely accessed software” is the sale of canned or prewritten computer software.
  – *Taxable as the sale of a service*
    • Computer Service
      – CT
    • Data processing service
      – TX
    • Communications service
      – SC
  – *Expressly enumerated as taxable*
    • WA
Characterization – SaaS

• Nontaxable / Exempt (cont.)
  – *Not an enumerated service*
    • IA**, KS, MI*, MO, NE, NJ, WI
      – *Michigan exemption is based on decision by Michigan Supreme Court in Auto Owners.*
      – **Effective 1/1/2019, SaaS is subject to tax.
  – Statutory exemption
    • ID, IN*, VT
      * Effective 7/1/2018, SaaS is statutorily exempt in Indiana
  – No specific position
    • Prewritten or computer software exempt when “delivered” electronically and the state does not tax service which may capture this category
      – CA, VA
Characterization – IaaS

State taxing authorities have taken various approaches in characterizing IaaS:

- **Non-taxable service:**
  - Examples: Florida, Nebraska, New Jersey, New York, South Carolina, Tennessee, and Wyoming

- **Taxable as the sale of a service:**
  - Computer service: Connecticut
  - Data processing service: Texas

- **Taxable as lease/rental of tangible personal property:**
  - Utah
Sourcing
Sourcing

- Sourcing is dependent upon characterization. For interstate sales, if taxable as:
  - Tangible Personal Property
    - Generally destination
    - Consider subsequent use
    - Consider concurrent use (prewritten computer software)
  - Services
    - Varies by state. May be:
      - Benefit
      - Performance
      - Consider multi-state benefit
  - Digital Goods
    - Not clearly defined. May be:
      - Destination
      - Benefit
      - Consider multi-state use
Allocation or Apportionment

- Many states not only permit allocation or apportionment of the tax base, but require it.
- State statutes and regulations often do not provide an answer/approach. Rather, a “range” of acceptable answers is the norm. Consider Washington state:
  - The taxable amount is determined by the number of users in this state compared to users everywhere.
- Most auditors will look for a sensible approach that assigns sales to locations where the service is being “received.”
- State Authority Silent? Consider:
  - Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977);
  - Goldberg v. Sweet, 488 U.S. 252 (1989);
  - Central Greyhound Lines, Inc. v. Mealy et al., 334 U.S. 653 (1948)
Allocation or Apportionment

• In allocating or apportioning the tax base:
  – Develop a Sensible and Uniform Approach
    • Uniform does not mean that all transactions are equal, but rather that a particular purchase should be allocated in the same manner to each state (unless a particular state has a different sourcing regime).
  – How does one source between multiple states?
    – Based on expected usage?
    – Based on actual usage?
    – Based on a pro-rata split?
    – Based on “value” of the usage (management versus line employees)?
    – Others?
What is a seller’s obligation to obtain data and collect sales tax for one transaction from multiple states?

- What information is known to the seller at the time of sale?
  - What is on the invoice?
  - What is in the contract?’
- Consider obtaining an affidavit from your customer attesting to where use will be.
- Does the state permit the seller to obtain an exemption certificate?
Purchaser Considerations

- What is a purchaser’s obligation to remit use tax for one transaction to multiple states?
  - What if the seller charged tax from one state on the entire transaction?
    - Was the tax legally imposed?
    - Which state had the right of first assessment?
  - May have to consider refunds.
  - May have to consider use tax for rate differential.
  - May have to consider subsequent use.
Exemptions for Multi-State Use
Multiple Points of Use

Minnesota

• Minnesota situses the sale of electronically delivered software and digital goods based on the location of receipt. Minnesota defines "receive" and "receipt" as:
  – Taking possession of tangible personal property, making first use of services, or **taking possession or making first use of digital goods or the computer software delivered electronically, whichever occurs first.**

• Minnesota’s multiple points of use provision does not provide an exemption from sales and use tax; rather it only affords the business purchaser the option to apportion use tax to multiple taxing jurisdictions if all the requirements of the statute are met.

• Minn. Stat. § 297A.668, Subd. 6a provides that a business purchaser that has not received authorization to pay the tax directly to the commissioner may use an exemption certificate indicating multiple points of use if:
  1. the purchaser knows at the time of its purchase of a digital good, computer software delivered electronically, or a service that the good or service will be concurrently available for use in more than one taxing jurisdiction; and
  2. the purchaser delivers to the seller the exemption certificate indicating multiple points of use at the time of purchase.

• Upon receipt of the fully completed exemption certificate indicating multiple points of use, the seller is relieved of the obligation to collect, pay, or remit the applicable tax and the purchaser is obligated to collect, pay, or remit the applicable tax on a direct pay basis.
Multiple Points of Use

Ohio

- In Ohio a consumer, other than a direct pay permit holder, that purchases computer software electronically, or a service for use in business, that is expected to be utilized concurrently in more than one taxing jurisdiction shall deliver a multiple points of use exemption certificate to the vendor. On receipt of the certificate the vendor is relieved of its collection and payment obligations.

- Vendors may use a regular unit or blanket exemption certificate and insert “Multiple Points of Use” as the statutory reason and attach a listing of the apportionment to the exemption certificate or use a Multiple Points of Use Exemption Certificate.

- Unlike Minnesota, Ohio does not require the purchaser to provide the exemption certificate to the seller at the time of the sale in order to apportion the tax base. The Ohio provisions actually address how a Seller should apportion the base when a Purchaser does not provide the exemption certificate at the time of sale.
Multiple Points of Use

New York

• New York does not have a multiple points of use exemption certificate.

• However, if electronically delivered software or a service for use in business, is expected to be utilized concurrently in more than one taxing jurisdiction it has been our experience that auditors will generally accept such documentation and apply the appropriate apportionment percentage.
Multiple Points of Use – Tennessee

- Tennessee has created a policy resulting in two different methods for sourcing prewritten computer software based solely upon whether the software is delivered to the purchaser or merely accessed by the purchaser
  - Delivered – Sitused to installation location
  - Accessed – Sitused to user location
- Purchaser of “remotely accessed software” may issue a Seller a “Remotely Accessed Software Direct Pay Permit”
Multi-State Benefit

Texas

• Tex. Admin. Code 3.330(f) provides as follows:

  (f) Service benefit location—multi-state customer.

  (1) To the extent a data processing service is used to support a separate, identifiable segment of a customer's business (other than general administration or operation of the business) the service is presumed to be used at the location where that part of the business is conducted.

  (2) If that part of the business is conducted at locations both within and outside the state, the service is not taxable to the extent it is used outside Texas.

• A multi-state customer purchasing data processing services for the benefit of both in-state and out-of-state locations is responsible for issuing the “Texas Sales & Use Tax Exemption Certificate”
Questions?

Carolynn S. Kranz
Industry Sales Tax Solutions
Kranz & Associates, PLLC

ckranz@industrysalestax.com /
ckranz@saltattorneys.com
(215) 837-9767