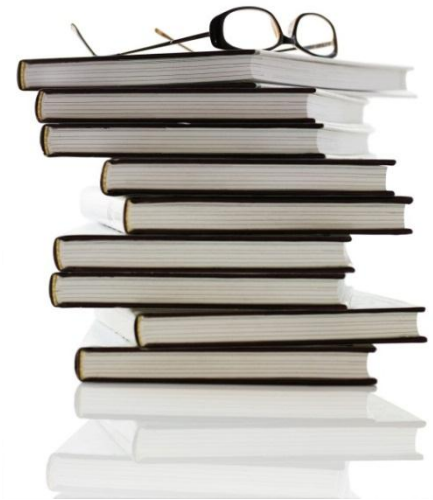


Sales Tax Issues for Computer Software and Cloud Computing

Mary Pat Kohberger, Deloitte Tax LLP

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Agenda

- What Are Cloud Computing Services?
- Cloud – Transaction Tax Nexus Issues
- Cloud – Transaction Tax Taxability Issues
- Cloud – Transaction Tax Sourcing Issues

A bright blue sky filled with numerous white, fluffy clouds of various sizes and shapes, scattered across the frame. The clouds are soft and appear to be drifting in the wind.

What are Cloud Computing
Services?

Cloud Computing: Definition and Characteristics

Definition of the Cloud

Cloud computing is a model for enabling convenient, on-demand network access to a shared pool of configurable computing resources (e.g. networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction.

Enables

Delivery of computing as a Service not a product
Creates the ability to abstract the physical from the logical
Allows tasks to be dynamically allocated across resources

Cloud Characteristics

Cloud computing has the following four key characteristics

Pay-as-You-Go
/ Grow

Payment is variable
based on the actual
consumption of the users

Highly
Abstracted

Hardware and related
infrastructure is highly
abstracted from the users

Immediately
Scalable

Usage, and therefore cost,
can be scaled up or down with
no contract or penalties

Multi-Tenant

Multi-Tenant Architectures allows
numerous enterprises to
subscribe to the computing
capabilities while retaining
privacy and security

A blue sky with scattered white clouds. The text is overlaid on the lower-left portion of the image.

Cloud - Transaction Tax Nexus Issues

Cloud – Transaction Tax Nexus Issues

Traditional Sales/Use Tax Nexus Based on Entity's activities:

A Seller must have physical presence in the taxing state to be required to collect sales/use tax. *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992)

A seller's activities will be subject to use tax collection if the seller has physical presence in the taxing state, even if the seller's activities in the state have no relation to the transaction being taxed. *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977)

Agency Nexus:

In-State activities performed on behalf of the seller by third parties and/or related parties could result in Agency nexus for the Seller. *Scripto v. Carson*, 262 U.S. 207 (1960)

Cloud – Transaction Tax Nexus Issues

The “click-through” nexus law:

New York enacted law in 2008 to create a rebuttable presumption of agency sales tax nexus for vendors with certain third-party e-commerce relationships, including:

- Vendors who solicit sales through “associates” programs with state residents via website link referrals
- Where a commission or other consideration is paid to a state resident for the sale or referral and
- The vendor has gross receipts of more than \$10,000 from New York customers as a result of the referrals

Cloud – Transaction Tax Nexus Issues

Other states which have passed “click-through” and/or affiliate sales tax nexus legislation:

- Arkansas
- California
- Connecticut
- Georgia
- Illinois *
- Maryland
- North Carolina
- Rhode Island

* Ruled unconstitutional; Performance Marketing Association, Inc. v Hamer, Ill. Cir. Ct. (Cook County), May 7, 2012

Cloud – Transaction Tax Nexus Issues

States with guidance about in-state use of third-party servers include:

- California
- Massachusetts
- New Mexico
- New York
- Ohio
- Pennsylvania
- Vermont
- Washington
- Texas

Cloud – Transaction Tax Nexus Issues

Federal legislation has been introduced to require use tax collection by remote sellers:

- The Main Street Fairness Act, (see also S.1452), H.R. 2701;
- The Marketplace Equity Act, H.R. 3179;
- The Marketplace Fairness Act, S. 1832

A background image of a bright blue sky filled with numerous white, fluffy clouds of various sizes and shapes, scattered across the frame.

Cloud Transaction Tax Taxability Issues

Cloud – Transaction Tax Taxability Issues

- Sale of (Downloaded) Prewritten Software
- Access to Prewritten Software (SaaS)
 - Server location can matter
 - Constructive Possession or Control matters
 - Beware of bundling issues as prewritten software or hardware may be included in the cloud computing service arrangements
 - There is little clear guidance from the states and these business models are rapidly changing

Cloud – Transaction Tax Taxability Issues

Attribute	Installed Software	SaaS
Physical Possession – server software	Executable file loaded to Customer's server	Executable file remains on Vendor's server
Constructive Possession	Customer's users control functioning of application	Customer's users control functioning of application
Software Administration and Maintenance	Customer installs software updates & upgrades, archives data, restores crashes to server software	Vendor installs software updates & upgrades, archives data, restores crashes to server software
Infrastructure and Hardware Maintenance	Customer maintains, powers and secures the host server and the user's PCs and devices	Vendor maintains, powers and secures the host server
Form of Agreement Between Vendor and Customer	Software License Agreement	Service Level Agreement or Subscription Agreement

Cloud – Transaction Tax Taxability Issues

Taxability Treatment of Digital Goods/Services

Most states tax only enumerated services

- Data processing
- Information services
- “Digital Automated Service”

Cloud – Transaction Tax Taxability Issues

Taxability Treatment of Digital Goods/Services

SSTA member states provide separate definitions for prewritten software and digital goods.

SSTA digital goods include:

- Digital audio works e.g., ringtones, music
- Digital audio-visual works e.g., movies
- Digital books

Streaming Digital Products: Some SSTA states impose sales tax on the sale of streaming digital products



Cloud - Transaction Tax Sourcing Issues

Cloud – Transaction Tax Sourcing Issues

To which state is the transaction sourced?

Software applications or digital goods: state where accessed/downloaded by “user”

- Hosted services:
 - “Benefit received”
 - “Principal place of business”
 - “Point of delivery”
- Global contracts often do not address sourcing

Cloud – Transaction Tax Sourcing Issues

SSTA General Sourcing Hierarchy

Presuming no bad faith issues:

- *Best:* address provided by customer's instructions
- *Next best:* address for customer in seller's business records
- *Next to last:* customer's address obtained during consummation of the sale
- *Last:* address of seller's server

Cloud – Transaction Tax Sourcing Issues

States typically hold digital products purchasers responsible for tax when the vendor has not charged it. Sellers may not have collected tax because:

- Seller may not have established nexus for sales and use tax purposes in the purchaser's state.
- Seller may have established nexus for sales and use tax purposes but (erroneously) does not realize it or have the systems to handle sales tax collection.
- Seller may have established nexus for sales and use tax purposes but (erroneously) has not researched, or does not understand, proper taxability of the digital product offering.
- Seller may not be required to collect tax when the Streamlined Sales Tax Project sourcing hierarchy is applicable.

Questions?

Contact

Mary Pat Kohberger
Director, Chicago
312 486-3825, mkohberger@deloitte.com

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