NYU 29th Institute on State & Local Taxation

Sales Tax & SSTP Update

December 13, 2010

Presented By: James F. Buresh
Loren L. Chumley
Susan K. Haffield
Carolynn S. Iafrate
Nancy T. Stanislawski

Agenda

- Fiscal Update and Legislative Themes
- Nexus
- Computer Software, Access and Related Services
- Digital Goods and Services
- Sales for Resale & Sales Price Challenges
- Services and Bundled Transactions
- Printed Materials
- Planes, Trains & Automobiles
- Trends in the Alternative Energy Area
- Streamlined Sales Tax Update

Fiscal Update and Legislative Themes

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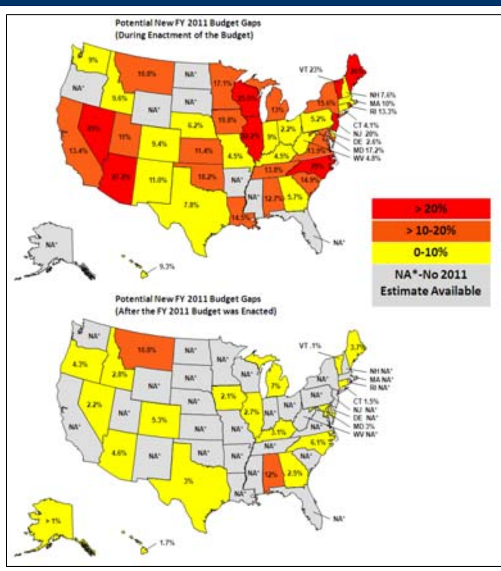
State Budgets – It's Still the Economy



- **<u>FY 2010</u> - States enacted $23.9 billion in increased taxes and fees with an additional $7.5 billion in other revenue measures such as a change in tax rate or fee schedule. Budget cuts totaled $22 billion in addition to the $31.3 billion in cuts made mid-year in 2009.**
- **<u>FY 2011</u> - States proposed only $3.1 billion in new taxes and fees. Could this be the result of election year politics…**
- **<u>FY 2012</u> – States still face $127 billion in unresolved budget gaps.**
- **<u>Post Election</u> - gloves off? Many states will need to address both 2011 budget gaps and 2012 budgets**

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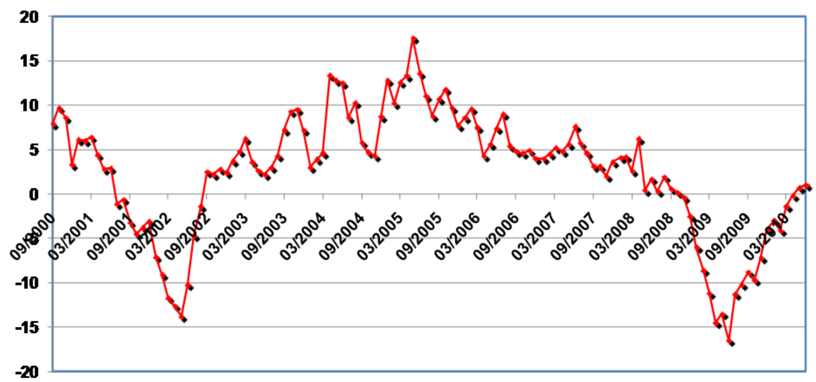
State Tax Revenues

2000-2010



Legislative Themes in light of Budget Crisis

- **Amnesty Programs**
  - Programs completed in 2009: AL; AZ; CT; DE; HI; LA; ME: MD: NJ: VT: and VA
  - Programs completed in 2010: FL, IL, NV, PA
- **Nexus proposals ("Amazon Tax" or "Click thru")**
- **Elimination of Vendor Compensation Sin/excise taxes**
- **Tobacco, alcohol, soda, snacks**
- **Expanded gambling/lotteries**
- **Base broadening**
  - Taxation of services
  - Taxation of digital goods and services

Nexus

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Spreading the News: Click-Through Nexus

- ***Amazon.com / Overstock.com*, N.Y.S. 2d, 2009 WL 69336 (Jan. 12, 2009)**
- **New York was the first state to pass legislation creating a presumption that sales by out-of-state retailers were taxable as a result of participating in an affiliate program where:**
  - Remote seller enters into an agreement with a NY resident whereby the NY resident directly or indirectly refers NY customers to a remote seller by an Internet link in exchange for a commission; and
  - Remote seller's cumulative gross receipts to NY customers, from NY resident's referral, exceeds $10K during preceding four quarters
- **Presumption is rebuttable:**
  - Remote seller establishes that only activity performed by NY resident is a link, and none of NY resident's representatives solicit sales for remote seller
  - Remote seller must establish both prohibition against such activities and compliance with the prohibition

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Spreading the News: Click-Through Nexus

- **Other States' Reactions**
  - Similar legislation enacted in NC and RI in 2009
  - Legislation vetoed in CA and HI in 2009
  - Other states that have considered or are considering such legislation in 2010 include: CA, CO, CT, FL, IA, IL, MD, MN, MS, NM, OK, TN, TX, VA, VT, and WI
  - CO legislation amended to remove click-through, but enacted onerous reporting requirements for out-of-state vendors and commonly-controlled group affiliate nexus
  - CA and TN considering legislation modeled after CO commonly-controlled group affiliate nexus and reporting requirements
  - RI proposal to repeal 2009 enactment

Overview of Colorado HB 1193

- **STATUTORY REQUIREMENTS IMPOSED ON OUT-OF-STATE RETAILERS**
  - Provide purchaser with notice at time of sale about use tax reporting and payment obligations;
  - File an annual report with the State for each Colorado purchaser disclosing each purchaser's total dollar amount during the previous calendar year; and
  - Provide annual notification, in writing, to each Colorado purchaser (via 1st class mail) stating that Colorado requires the purchaser to file a sales/use tax return and pay any tax due, and list for each purchase, the relevant dates, amounts, and category of the purchase.

Overview of Colorado HB 1193

- **SIGNIFICANT PENALTIES FOR NONCOMPLIANCE**
- **If non-collecting retailer fails to meet reporting and notification requirements, retailer is subject to significant penalties:**
  - $5 for each failure to provide required notification at time of purchase;
  - $10 for each failure to provide required annual purchaser notification and report; and
  - $10 for each failure to file individual annual purchaser report with State.
- **How are those penalties collected – civil action or tax assessment?**

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Similar "Copycat" Legislation

- **Other jurisdictions likely to enact a version of HB 1193:**
- **Oklahoma recently enacted legislation (HB 2359)**
- **Considered in Tennessee (SB 1741/HB 1947) and still pending in California (AB 2078)**
- **Approximately 284 local Colorado jurisdictions, with different use tax laws, will those local jurisdictions in Colorado enact their own version of State notice and reporting requirements?**
- **Colorado and Oklahoma claim they will allow the use of generic notification statements as other states impose their notification requirements – how will that be done when the notices require specific references to the state tax agency's website?**

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Oklahoma's Legislation (HB 2359)

- **Unlike Colorado, Oklahoma's law only requires two notices:**
  - Notice is required on the Internet site or catalog, as applicable
  - Notice is also required on the invoice
- **It also requires tax preparers at the time of preparing a taxpayer's income tax return to advise their clients of the use tax responsibility**
- **On the positive side, the law does offer some incentives. It offers another amnesty to remote sellers that agree to collect Oklahoma's sales/use tax for three years and provides up to $500 reimbursement for new remote sellers signing up to use a certified service provider to collect Oklahoma's tax**

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Click-Through Nexus Litigation

- **New York**
  - Amazon.com and Overstock.com have challenged New York's legislation on grounds that their activities in the state did not create nexus under the Dormant Commerce Cause and that the affiliate program was simply advertising
  - Court dismissed taxpayer's complaint and granted NY's motion for summary judgment; matter on appeal – oral argument heard Nov. 2, 2009

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Click-Through Nexus Litigation

- **Amazon v. North Carolina DOR**
  - Amazon.com LLC filed a federal lawsuit alleging the North Carolina Dep't of Revenue's attempts to obtain names, address, and purchases of customers violates the First Amendment of the US Constitution, Article I, §§ 4, 5 of the Washington State Constitution, and federal Video Privacy Protection Act, 18 USC § 2710
  - Suit filed on April 19 in federal district court in the Western District of Washington
  - Declaratory judgment sought to confirm above federal and state constitutional violations and federal statutory violation
  - American Civil Liberties Association (ACLU) also filing suit

Colorado Forced Notification Litigation

- **Direct Marketing Association filed suit 6/30/2010**
  - Violates Commerce Clause
    - Notice and reporting requirements are tantamount to the use tax collection burden found unconstitutional in *Quill* absent physical presence of retailer;
    - Overbroad notice and reporting requirements impose excessive burdens on interstate commerce in relation to the local benefits;
    - Application only to out-of-state retailers facially discriminates against interstate commerce (and is not a compensatory tax);
    - Legislative intent was protectionist.
  - Violates First Amendment
    - Compels retailers to engage in commercial speech.

Federal Streamlined Legislation

- **Main Street Fairness Act finally introduced July 1, 2010 by Rep. Delahunt (MA) – HR 5660**
  - Placeholders for controversial issues – vendors compensation and communications services tax simplification
  - Are states' attempts to circumvent Quill through click-through nexus and reporting requirements undermining SST effort?
  - Should states efforts to continue such circumvention be addressed in the MSFA?

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Computer Software, Access and Related Services – Hot Cases & Issues

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Does a Square Peg Fit in a Round Hole

- **With new technology models evolving, states are making every attempt to tax these new models under existing provisions. Consider the following:**
  - Application Service Providers ("ASP")
    - An entity that retains custody over (or "hosts') software for use by third parties. Users of the software hosted by the ASP typically will access the software via the Internet. The ASP may or may not own or license the software, but generally will own and maintain the hardware and networking equipment required for the user to access the software. The ASP may charge the user a license fee for the software (in instances where the ASP owns the software) and / or a fee for maintaining the software / hardware used by its customer.

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Does a Square Peg Fit in a Round Hole

- **And the following:**
  - Software as a Service ("SaaS")
    - This term is often used interchangeably with ASP – one could draw the distinction between the two in that under the SaaS model a services agreement is almost always executed, whereas in the ASP model, the customer may execute a software license agreement or a services agreement.

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Does a Square Peg Fit in a Round Hole

- **And the following:**
  - Cloud Computing
    - Captures all of the above and a variety of other services which are performed utilizing the internet. There is no "one" definition of cloud computing – it is a manner of performing a service.
    - Need to focus on the object of the transaction:
      - Data Processing
      - Information Service
      - Digital Goods
      - Software
      - Disaster Recovery

Recent Developments

New York

- TSB-A-10(28)S, TSB-A-10(4)C
- Voicemate

North Carolina

- Effective January 1, 2010, sales of prewritten computer software are taxable, regardless of method of delivery. Note that there is an exception for software that meets any of the following criteria

  (a) it is designed to run on an enterprise server operating system;

  (b) it is sold to a person who operates a datacenter and is used within the datacenter;

  (c) it is sold to a person who provides cable service, telecommunications service, or video programming and is used to provide ancillary service, cable service, internet access service, telecommunications service, or video programming.
- ASPs continue to be exempt, even with the January 1, 2010 change to tax electronically delivered software.
- Effective January 1, 2010, the sale of digital goods are subject to sales and use tax. These items include: an audio work; an audiovisual work; a book, a magazine, a newspaper, a newsletter, a report, or another publication; and a photograph or a greeting card.

Recent Developments

Louisiana

- Rev. Ruling 10-001 (3/23/2010)

Missouri

- Filenet Corporation v. Director of Revenue, No. 07-0146 (8/20/2010)

Pennsylvania

- Dechert LLP v. Pennsylvania

Vermont

- Technical Bulletin 54

Computer Software and Services - Hot Issues

- **Services Necessary to Complete Sale**
  - Florida
  - Texas
  - Virginia
- **Fabrication Labor / Services to TPP**
  - Minnesota
  - New Jersey
    - NJ Proposed Regulation

Digital Goods and Services

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Digital Goods

- **Offshoot of Streamlined requirements**
  - Required to explicitly impose tax on digital goods or electronically transferred items
  - Required to use Streamlined definitions
  - Prohibition against taxing digital as TPP

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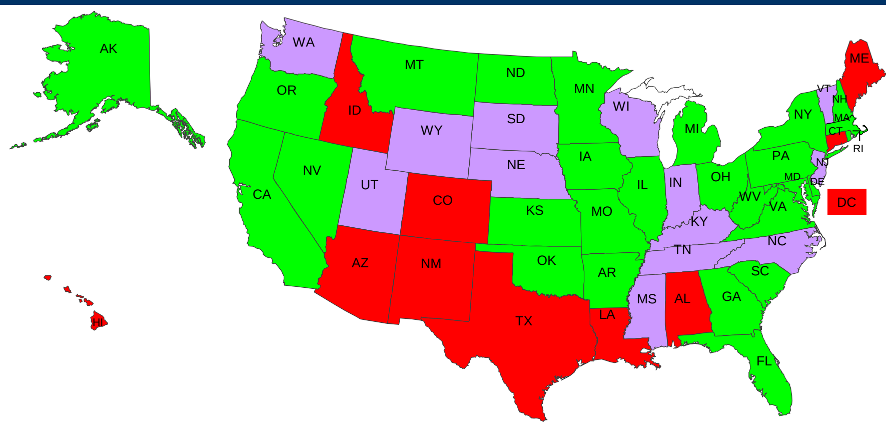
States of Confusion – Digital Goods Taxability



Digital Goods Taxed by DOR Position or Case law	Digital Goods Non-Taxable	Digital Goods Taxed by Statute

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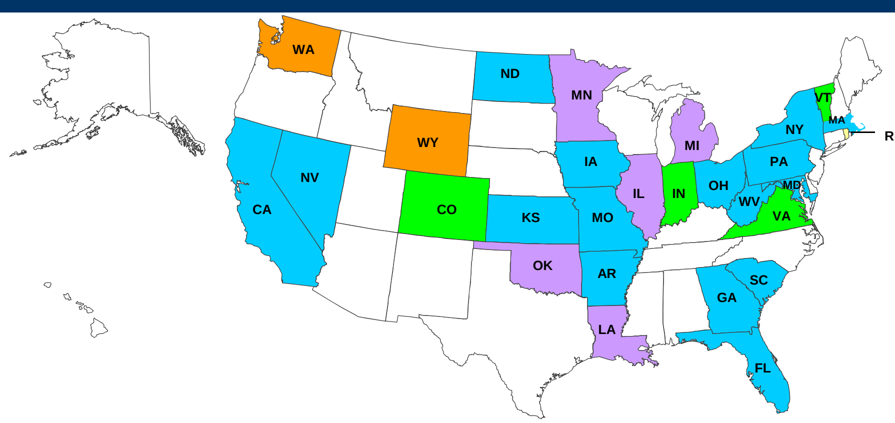
Summary of Digital Goods Legislative Activity – 2010



Enacted digital goods legislation in 2010	Failed digital goods legislation in 2010	Pending digital goods legislation in 2010	Digital goods issues being discussed	States that are likely to consider digital goods legislation in 2011

Sales for Resale and Sales Price Challenges

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Recent Developments

Treatment of complimentary items given to customers

- **Logan's Roadhouse, Inc. v. State of Alabama Dept of Revenue**, No. CV-09-1930, Alabama 10th Jud. Cir.Ct., 4/2/10

  Peanuts given to restaurant customers are eligible for sale for resale exemption

- **IL ST 10-0093-GIL, 10/11/10**

  Complimentary meals and drinks for customers are subject to use tax based on the cost price of the items

- **Wisconsin** DOR position

  "Buy one, get one free" may be subject to use tax depending on presentation on the invoice/receipt

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Recent Developments

Third party reimbursements

- **Northern X-Ray Company v. Commr of Revenue,** Minnesota Tax Court No. 7945 R, December 8, 2009

  Honoring a manufacturer's price discount did not constitute a third party reimbursement. Original sale for resale transaction honored

Reusable items

- **Brinker Missouri, Inc, v Director of Revenue,** Supreme Court of Missouri, Dkt. No. SC 90463, 8/31/10

  Chairs, tables, cutlery, used by customers in a restaurant did not qualify as a 'temporary use' so no sale for resale exemption for these items was granted

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Recent Developments

Separately stated service charges

- **Aramark Uniform & Career Apparel, LLC** Iowa Ruling 2010-300-2-0243

  Separately stated charges for garment "ruin" and garment "maintenance" are not part of the sale price because they were not the sale of TPP; even thought it may represent a replacement charge

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Services and Bundled Transactions

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Taxation of Services -- Maine

- **Originally to take effect on January 1, 2010 – Sales and use tax imposed on various services**
  - Admissions, amusements and entertainment
  - Installation, repair and maintenance of specified items
    - Does not include equipment at a manufacturing facility or commercial vehicles
  - Personal property services
    - Largely confined to services for individuals
    - Excludes certain commercial services
  - Transportation and courier services
  - Transmission and distribution of electricity
- ***Signatures obtained to place a question on the June 28, 2010 ballot on whether to approve this law – REJECTED by voters.***

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New York – Information Services

- **New York Advisory Opinion TSB-A-10(20)S, 5/6/10)**
  - Litigation support services are determined to be non-taxable information services.
- **New York Advisory Opinion TSB- A- 10(32)S, 7/23/10)**
  - Data feed services were determined to be taxable information services.

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Printed Materials

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Printed Materials

- ***Dillard's Inc. v. Kennedy, La. Ct. App., 1st Cir., Dkt. No. 2009 CA 1423, 5/7/10)***
  - A corporation that operates retail department stores in several states including Louisiana was not liable for use tax on catalogs that it contracted an out-of-state printer to print and mail to its credit card customers and stores in Louisiana.
- **In the Matter of Yellow Book of New York, Inc. v. Commissioner of Taxation and Finance, et al., N.Y. S.Ct., App. Div., 3rd Dept., Dkt. No. 506697, 7/22/10)**
  - The taxability of published and distributed telephone directories containing both advertisements and telephone and address information to state residents and businesses free of charge through various distributors, was dependant upon the carrier used to distribute them.
- ***Virginia Public Document Ruling No. 10-72, 5/18/10***
  - A Virginia advertiser that provides direct mail marketing services for businesses in Virginia was found not liable for tax on the purchase of printed materials from an out-of-state printer.

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Planes, Trains & Automobiles…..

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Planes, Trains & Automobiles….

- ***Irwin Industrial Tool Co. v. Illinois Department of Revenue*** **(Ill. Supreme Ct. 9/13/2010)**
  - The Illinois Supreme Court upheld the appellate court's decision, who determined that there was substantial nexus between the aircraft purchased and hangared out of state and Illinois, such that the Department could tax the company's use of the plane in Illinois based on the entire purchase price of the plane rather than the actual use of the plane in Illinois. The appellate court determined that there was substantial nexus between the aircraft purchased and hangared out of state and Illinois, such that the Department could tax the company's use of the plane in Illinois based on the entire purchase price of the plane rather than the actual use of the plane in Illinois.

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Trends in the Alternative Energy Area

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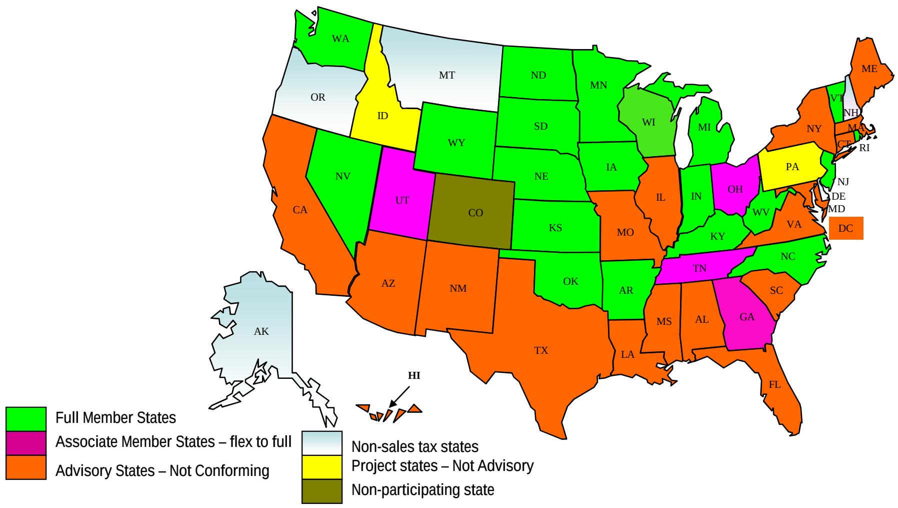
Trends in the Alternative Energy Area

- **States weigh in on solar/wind and alternative energy related exemptions under current or new provisions**
- **States expand or renew renewable/alternative energy exemptions:**
  - California
  - Wyoming
- **Others focus on exemptions or rule on specific energy sources/uses:**
  - AZ – solar
  - MA – wind (M and E)
  - MO – wind
  - NY – wind
  - PA – solar

Streamlined Sales Tax Effort

Streamlined State Status 01-01-11



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Streamlined Sales Tax

- **Twenty full-member states**
  - Georgia full membership contingent - to be effective January 1, 2010
- **Current issues**
  - Vendor compensation
  - Telecommunications issues
  - Sourcing Services
- **What to watch**
  - Movement on federal legislation

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Streamlined Statistics

- **Statistics:**
  - Companies registered – 1,139 as of 9/30/2010
  - 190 are Model 1 and 1,149 are Model 4
  - Revenue - $679M collected from 10/1/2005 to 9/30/2010
- **Amnesty still exists for Ohio, Tennessee and Utah and will be effective in Georgia as of 1/1/2011.**

Questions?

Contact Information

- **James F. Buresh**
  [jimburesh@mac.com] (818)706-1323
- **Loren L. Chumley**
  [lchumley@kpmg.com] (615) 248-5565
- **Susan K. Haffield**
  [susan.haffield@us.pwc.com] (612) 596-4842
- **Carolynn S. Iafrate**
  [csiafrate@industrysalestax.com] (610) 458-7227
- **Nancy T. Stanislawski**
  [nancy.stanislawski@wtas.com] (213) 593-2363

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DECEMBER 13-14, 2010
GRAND HYATT, NEW YORK CITY

Sales Tax Update

James F. Buresh, Esq.
Deloitte Tax LLP
Los Angeles, California

Loren L. Chumley, Esq.
Principal
KPMG LLP
Nashville, Tennessee

Susan K. Haffield, CPA
Partner
PricewaterhouseCoopers LLP
Minneapolis, Minnesota

Carolynn S. Iafrate, CPA, JD
Chief Operating Officer
Industry Sales Tax Solutions
Exton, Pennsylvania

Nancy T. Stanislawski, Esq.
Managing Director
WTAS LLC
Los Angeles, California

UPDATE SUMMARIES BY STATE – NYU[i]

I. SIGNIFICANT CASES, RULINGS, AND LEGISLATION

A. COLORADO

Nexus: Vendor nexus presumption

Effective March 1, 2010, Colorado enacted legislation creating a rebuttable presumption that out-of-state retailers that do not collect Colorado sales tax are doing business in-state if they are part of a controlled group of corporations that has a component member that is a retailer with a physical presence in the state. The presumption may be rebutted by showing that for the calendar year the component member that is a retailer with physical presence in the state did not engage in any constitutionally sufficient solicitation in Colorado on behalf of the retailer that does not collect Colorado sales tax.

By January 31st of each year, the out-of-state retailer that does not collect sales tax is required to notify the state and its in-state customers that they have to pay Colorado sales or use tax. The mailing shall also include: (1) the total amount paid by the purchaser for Colorado purchases made from the retailer in the previous year and (2) if available, the dates of purchases, the amounts of each purchase, and the category of each purchase, including, if known by the retailer, whether the purchase is exempt or not exempt from taxation. In addition, by March 1st, the retailer must file an annual statement for each purchaser with the Department of Revenue showing the total amount paid for Colorado purchases for the prior year. Unless the retailer can show reasonable cause, a penalty of $5 is imposed for each failure to provide notice to the Colorado purchaser that sales tax is due and a penalty of $10 for each failure to send notification of all of the purchaser's purchases during the prior year. The retailer may also be subject to a subpoena issued by the Executive Director to compel the retailer to furnish the information requested. (Colorado L. 2010, H1193)

B. OKLAHOMA

Effective June 9, 2010, Oklahoma enacted changes affecting nexus, retailers, and vendors. Now, a retailer will be engaged in the business of selling tangible personal property for use in Oklahoma if: (1) the retailer holds a substantial ownership interest in (or in whole or substantial part owns) a retailer maintaining a place of business in Oklahoma, and sells the same or substantially similar line of products as the related Oklahoma retailer and does so under the same or substantially similar business name or the Oklahoma facilities or Oklahoma employees of the related Oklahoma retailer are used to advertise, promote or facilitate sales by the retailer to consumers; or (2) the retailer holds a substantial ownership interest in (or in whole or substantial part owns) a business that maintains a distribution house, sales house, warehouse, or similar place of business in Oklahoma that delivers property sold by the retailer to consumers. The law creates a rebuttable presumption that a retailer that is part of a controlled group of corporations, having a component member that is a retailer engaged in business in Oklahoma, is a retailer engaged in business in Oklahoma. The component member may show that it did not engage in those activities on behalf of the retailer during the calendar year. If the retailer is otherwise doing business in Oklahoma, the processing of orders electronically, including via the Internet, does not relieve the retailer from the duty to collect tax from the purchaser. Further, any retailer that makes sales of tangible personal property to purchasers in Oklahoma by mail, telephone, the Internet, or other media, and has contracted with the entity to provide and perform installation or maintenance services for the retailer's purchasers in Oklahoma is a retailer for purposes of the use tax.

Effective October 1, 2010, retailers making sales of tangible personal property from a place of business outside Oklahoma for use in Oklahoma that are not required to collect use tax, must notify customers on their retail website or through their catalog and invoices that use tax is imposed and must be paid by the purchaser on the storage, use, or other consumption of the tangible personal property in Oklahoma. Retailers cannot advertise that there is no tax due on purchases made from the retailer for use in Oklahoma. To encourage compliance, the Oklahoma Tax Commission will implement an outreach program that will help retailers ascertain whether they must register and collect Oklahoma use taxes. The Commission will refrain from seeking payment of uncollected use taxes from an out-of-state retailer who registers to collect and remit applicable use taxes on sales made to purchasers in Oklahoma prior to registration, provided that the retailer was not registered in Oklahoma in the twelve months prior to June 9, 2010. No assessment will be made for uncollected use taxes and associated penalties and interest on sales made during the period the retailer was not registered in Oklahoma, provided that registration occurs before July 1, 2011, and that the retailer remains registered and continues to collect and remit use taxes for at least 36 months. In addition, state tax return preparers assisting their clients in preparing individual income tax returns must advise them of their obligation to remit use taxes by reporting them on the use tax remittance line on the individual income tax return or by filing a consumer use tax return. (Oklahoma L. 2010, H2359)

C. NORTH CAROLINA

Amazon.com has filed suit in North Carolina to stop the state's Department of Revenue from demanding that it turn over the names and addresses of its North Carolina customers, as well as the amount they have spent since 2003. The case, which is to be heard in Seattle and is being argued by Amazon on privacy grounds, comes after North Carolina passed legislation last year similar to Colorado and Oklahoma. The ACLU has joined the suit, arguing that the request for personally identifying information violates the customer's Constitutional rights. Amazon has dropped its affiliates program in North Carolina in response to the state's actions. (*Amazon.com LLC v. Lay*, Dkt. No. 2:10-cv-oo664-MJP, Dist. Ct. of Western Wash., 2010)

D. NEW YORK

The New York Department of Taxation and Finance issued a memorandum concerning the narrowed definition of vendor for sales tax purposes. Retroactive to June 1, 2009, and applicable to sales or uses occurring on or after that date, an in-state affiliate that only provides accounting or legal services or advice, or directs the activities of the seller (including but not limited to, making decisions about strategic planning, marketing, inventory, staffing, distribution or cash management on behalf of an out-of-state seller in New York State) will not make the out-of-state seller a vendor for sales tax purposes. (New York Technical Service Bureau Memorandum TSB-M-10(12)S, 8/19/10)

E. <u>WYOMING</u>

Manufacturing machinery exemption denied for foundation materials on exempt machinery

An oil refinery was denied the manufacturing machinery tax exemption for materials purchased and used to construct embedded concrete foundations for exempt machinery used in manufacturing. Although the foundations could be considered attachments or adjuncts and were necessary to the operation of the exempt machinery, which would ordinarily allow them to qualify for the exemption, they were real property rather than tangible personal property and thus the exemption did not apply. Under the statute, only tangible personal property is eligible for the exemption. An article is real property if it is "buried or embedded." Because the foundation materials were "placed in the ground – buried – and firmly fixed in a surrounding mass – embedded," the materials were real property that did not qualify for the manufacturing machinery exemption. The materials were not exempt as "real property" because they were tangible personal property when purchased and thus subject to tax. (*Sinclair Oil Corporation v. Wyoming Dept. of Revenue*, Supreme Court of Wyoming, Dkt. No. S-09-0231, 8/26/10)

II. NEXUS

A. <u>NEW HAMPSHIRE</u>

New procedure under private customer information protection statutes

In response to the dispute between New Hampshire and Massachusetts created by the *Town Fair Tire Centers* case, the New Hampshire Department of Revenue Administration has created Form A-305 to facilitate a foreign state's request for private customer information. The form is essentially meant to prevent retailers in New Hampshire from having to question their customers about whether they live in another state or plan to use the property purchased in a state with a sales tax. A foreign state must submit a Form A-305 to the Department of Revenue Administration, and if the Department of Justice determines that the foreign state's sales and use tax statutes meet New Hampshire's customer information protection statutes, the Department of Revenue Administration will return an approved Form A-305 to the foreign state. This approved Form A-305 satisfies the "written confirmation of intent to collect use tax" requirement in the customer information protection statutes. (New Hampshire Technical Information Release No. 2010-004, 5/14/10)

B. <u>NEW MEXICO</u>

Nexus: Drop shipment orders

An out-of-state company with no facilities, employees, or advertisements in New Mexico received customer orders for tangible personal property at its out-of-state office. The company purchased property from vendors and had the property directly shipped to its customers in drop shipments. The company held title to the property only as long as the property was in transit; transfer of title occurred upon delivery to the customer. The Department ruled that the company did not incur any tax liability on its gross receipts received from New Mexico sales, as the brief ownership period over the delivered property was not sufficient to trigger nexus. However, if any of the company's vendors had nexus with New Mexico, their gross receipts would be subject to the gross receipts tax absent an applicable statutory deduction or exemption. (New Mexico Taxation and Revenue Dept. Ruling No. 401-09-5, 12/03/09)

Nexus: Retailer selling through independent sales agents doing business

An out-of-state retailer sells tangible personal property through independent sales agents located both in and out of New Mexico and charges the sales agents an annual fee to view a web page that charts their personal sales. The Department ruled that the retailer was selling tangible personal property in New Mexico through its independent sales agents, and thereby was engaging in business in New Mexico. The Department also concluded that when the retailer sells a license to use the web page to independent sales agents located in New Mexico, the retailer had gross receipts from licensing property employed in New Mexico, and these gross receipts were subject to New Mexico's gross receipts tax. This ruling replaces Ruling 420-99-1, issued on July 23, 1999. (New Mexico Taxation and Revenue Dept. Ruling No. 401-10-8, 4/20/10)

C. UTAH

Nexus: Direct mail sellers informed of recipient's location must collect tax

Effective July 1, 2010, if a direct mail seller receives information indicating the location of the recipients to which the advertising and promotional direct mail is delivered, the seller must collect and remit sales and use tax to Utah in accordance with the information the purchaser provides. (L. 2010, HB 349)

III. COMPUTER SOFTWARE, ACCESS CHARGES AND RELATED SERVICES

A. ARIZONA

Software used in newspaper publishing not exempt from transaction privilege tax

Software used in newspaper publishing was found not to be exempt from transaction privilege tax. The Taxpayer created and licensed software used in newspaper publishing but did not report transaction privilege tax on sales or licenses of its software to publishers. It argued that newspaper publishers were *per se* manufacturers and that its software should be exempted as machinery and equipment used directly in the printing job done by the publishers. However, the Director determined that the machinery and equipment exemption did not apply to software used in newspaper publishing because the taxpayer's software had more to do with presentation of content than the transformation of paper and had nothing to do with the actual printing process. Following the Arizona Court of Appeals' "ultimate function" and "integrated rule" tests, the Director reasoned that the taxpayer's software was functionally related to the design of newspapers rather than their printing. Therefore, even if newspaper printing were considered manufacturing, the taxpayer's software was not "directly used" in the manufacturing process and could not qualify for exemption as machinery and equipment. (Arizona DOR Director's Decision No. 200800211-S, 1/22/10)

B. FLORIDA

Sales tax on prepackaged software that is customized

The licensing of a proprietary software program that the developer includes in the delivery of a customized package website for lead generation and e-commerce which includes updates, supplements, Internet-based activities and support services is not subject to tax in Florida. Because the developer customizes the original vault copy of the program into software packages made to each customer's specifications and only provides the software via electronic means, the licensing of the software is not subject to sales tax as the sale of tangible personal property. If the developer sold tangible personal property, such as hardware or canned software delivered in tangible form, and the software service was part of the sale of this tangible personal property, then the software would be included in the taxable sale price. (Florida Technical Assistance Advisement 09A-044, 9/2/09)

Customizable software not necessarily custom software

A Florida-based corporation develops, markets, and provides training and support services for its computer software, which is used by lawyers to manage their legal files and billing for services. The software is generally sold as canned or prepackaged software that is fully useable without modification and is marketed as "customizable to meet your needs without custom programming." The Department found that the company does not complete a detailed analysis in selecting or preparing the programs for each customer, which means the software is subject to sales tax as canned or prepackaged software. However, in the instances where the Taxpayer modified certain software specifications and functions to meet particular customer specifications and sold that software apart from other tangible personal property, those sales were not subject to sales or use tax. Also, if the software is delivered in electronic form and not in a tangible form, then the software is not subject to sales and use tax by itself. Finally, annual software license renewals are subject to sales or use tax if the initial transaction was subject to the tax. (Florida Technical Assistance Advisement No. 10A-010, 2/16/10)

C. GEORGIA

Nontaxable software included in determining whether exemption threshold is met

A company purchased electronically-delivered computer software that was not subject to sales tax. The Court of Appeals found that these purchases qualify as purchases of computer equipment and should be included with taxable tangible software and hardware in determining whether the $15 million per calendar year threshold has been met for purposes of qualifying for the high-technology exemption or refund on purchases of computer equipment. The court was persuaded that the legislature showed its intent not to exclude items that were not listed when it chose to specifically list items in the statute that do not qualify for the exemption. In addition, the definition of computer equipment includes any computer software, not just tangible software, and the high-technology exemption statute does not state that only purchases that have been subject to sales tax are to be used in determining whether the threshold has been met. As such, both taxable and nontaxable computer software are to be considered in determining whether the $15 million exemption threshold has been met. (*Choicepoint Services, Inc. v. Graham*, Dkt. No. A100A0234, Ga. Ct. App., 7/15/10)

D. **<u>IOWA</u>**

Computer software downloaded over the Internet

A company sells software to purchasers over the Internet through downloads. These transactions are not subject to tax under § 423.3, which exempts tangible personal property if purchased by electronic means. Even if assistance by a representative of the company was needed at the purchaser's location to install software by downloading the software over the Internet, copying the software to a portable USB drive, and installing it on various machines at the site using load-and-leave procedure, it would not render this purchase taxable. This is because the "substance of the transaction" was delivered electronically to the purchaser. Physical delivery of the software to various machines does not rob the initial transaction of its exempt character. (Iowa Policy Letter; Computer Software, 3/31/10)

E. **<u>KANSAS</u>**

Separately stated data conversion service charges exempt

A company provides data conversion services as an adjunct to its sale and installation of other software programs. Although the sale or use of canned data conversion software is taxable, charges for modifying or enhancing canned data conversion software are exempt if the charges are separately stated on the invoice and the modifications or enhancements are developed and designed specifically for that customer. In addition, running data conversion software for a customer is not considered to be part of the charges for configuring or setting up the customer's software if the charges for data conversion are separately stated and the customer does not acquire title to or the right to use the data conversion software. (Kansas Private Letter Ruling P-2010-005, 8/19/10)

F. **<u>LOUISIANA</u>**

Taxability of electronically delivered software and digital and media products

Based on the 1994 Louisiana Supreme Court decision in *South Central Bell Telephone Company v. Barthelemy*, which held that computer software is considered tangible regardless of form of delivery, Louisiana's sale, use, or lease tax is due on the purchase of products, computer software and applications, or stored media and/or other materials delivered electronically into Louisiana to be accessed from in-state or out-of-state providers or vendors. Taxable transactions include, but are not limited to, remotely accessed software, information materials, and entertainment media or products, whether as a one-time use or through ongoing subscription, and whether capable of only being viewed, or being downloaded when that transfer requires payment of consideration in any form. Any consideration paid for electronic receipt or access to data, information, materials, media or other form of communications that are converted to readable, viewable, or usable form by browsers or software installed on mobile hardware or system hardware located in Louisiana is subject to sales, use, or lease tax in the state. (Louisiana Revenue Ruling 10-001, 3/23/10)

G. **<u>MISSOURI</u>**

True object test for electronic scanning of documents onto CDs

A professional printing and copying company provides conversion of paper documents into electronic format, whereby documents are scanned and imported onto CDs. The business charges a fee-per-page and an additional $15 per CD. The Court applied the "true object test" and concluded that the physical CDs provided to the customers are merely incidental to the purchase of the nontaxable document automation service since the customers are really buying the conversion of their paper documents into electronic format. The tangible personal property is "merely incidental" to a nontaxable service, and its existence will not transform the entire transaction into a taxable retail sale. As such, the company was not liable for sales tax on the CDs sold to its customers. (*Western Blue Print Co. v. Director of Revenue*, Supreme Court of Missouri, Dkt. No. SC 90172, 4/20/10)

H. NEW YORK

Transfer of prewritten software

The taxpayer provides its client with prewritten software which is installed on servers in Tennessee, invoiced to a client in Tennessee, and used by the client in New York and other locations across the United States. Even though the prewritten software is modified to the client's specifications, it remains prewritten software subject to tax as tangible personal property. If the charge for custom modification is reasonable and separately stated on the invoice, then the separately stated charge for custom modification is not subject to tax. The fact that the code embodying the software is installed on servers in Tennessee is irrelevant because the code can be used by the client elsewhere without receiving the code in a tangible medium or downloading it. The accessing of taxpayer's software by the client's employees constitutes a transfer of possession of the software, because the client gains constructive possession of the software and gains the "right to use, or control or direct the use of" the software. As a result, the taxpayer should collect tax from the client based on where the software is being used. (New York Advisory Opinion TSB-A-10(28)S, 7/2/10)

Online network access is taxable as a sale of prewritten software

The taxpayer, which charges its customers to access its online network in order to establish a telephone call center with off-site personnel, is not selling telephony and telecommunications because it doesn't provide transmission of sound or data or charge for the use of telecommunications equipment. Instead, the charges for access to the online network are subject to sales and use tax as receipts from the sale of prewritten computer software. The network consists of software that is accessed by the customers over the Internet or dedicated communications circuits. It allows Certified Independent Agents (CIAs) to select work times, manage and answer calls on behalf of customers, and securely access a customer's computer system to process orders. Customers also use the software to post work schedules and to monitor and supervise CIAs. Access to the software is a transfer of possession of the software that constitutes a taxable event in New York if the CIA or customer is located in New York. Further, the taxpayer's charges to customers and CIAs for network application training may be subject to tax if the training consists of software-driven modules if the software is not designed to customer specification. Fees charged to CIAs for billing and collection services may be taxable if the CIA performs telephone answering services for customers located in New York. (New York Advisory Opinion TSB-A-10(4)C, 5/27/10)

Customized retail analysis reports subject to sales tax

A taxpayer located in New York sold web-based reports that assessed tenant viability for shopping centers around the country. The only information that the taxpayer possessed about each customer was each one's credit card billing information and the location for which it desired analysis. Because these analyses are essentially reports generated from a common database of demographic information, they are taxable as the electronic furnishing of an information service. Only reports delivered to customers within New York are subject to New York State and local sales taxes. Taxpayer bears the responsibility of reasonably allocating its sales between in-state and out-of-state sales, which can be fulfilled through an additional statement in each purchase request that either affirms that the report will be accessed by the customer at the furnished billing address or provides the address information where the report will be accessed. (New York Advisory Opinion No. TSB-A-09(55)S, Petition No. S090417A, 12/7/09)

Source code purchased in bulk sale taxable as purchase of software

The taxpayer sold licenses to customized versions of point-of-sale software to retailers and had purchased the assets of another business that consisted of $12,000 in furniture and fixtures and $1.3M in software. The court found that the bulk sale of source code did not qualify as a transfer of intellectual property because source code was software and the taxpayer had identified it as software on its balance sheet and agreement of sale with the other company. The court also ruled the software did not qualify for an exemption as machinery or equipment for use or consumption directly or predominantly in the production of tangible personal property because the purchased software was used in the production of custom software, which is excluded from the definition of tangible personal property. The ruling does leave open the possibility that source code purchased for the production of canned or pre-written software could qualify for exemption as machinery or equipment. (*In the Matter of the Petition of Automation, Inc. d/b/a PC America*, State of New York Tax Appeals Tribunal, Dkt. No. 822409, 10/8/09)

I. <u>PENNSYLVANIA</u>

Taxability of canned software

In affirming the Commonwealth Court's decision, the Pennsylvania Supreme Court held that canned computer software constitutes tangible personal property subject to sales tax, regardless of delivery method. A legal services provider requested a refund for sales taxes paid for purchases of licenses to use canned software programs, asserting that a license to use software did not constitute tangible personal property and therefore was not subject to tax. In rejecting the taxpayer's argument, the court did not follow the Commonwealth Court's application of the "true object" test or the "essence of the transaction" test. Instead the court relied on the rules of statutory construction. Pennsylvania clearly and unambiguously imposes sales tax on licenses to use or consume tangible personal property. Canned software is not specifically included in the definition of tangible personal property but the court found that its absence does not compel a conclusion that canned software does not constitute tangible personal property because the definition contains the phrase "including, but not limited to" which ensures that the list is not limited to those specifically named.

Moreover, the fact that canned software is not listed does not render the statute ambiguous, though the court acknowledged that that statute was unclear. As such, it examined the legislative history and administrative interpretations for guidance. The court found that prior to 1997 the definition of "sale at retail" included "computer programming services" which encompassed custom software programming and custom computer programs, but not canned computer programs. As a result, when the legislature later eliminated sales tax on "computer programming services," it did not eliminate the tax on canned computer software. The Department of Revenue bolstered this interpretation when it issued a policy statement declaring that "the sale at retail or use of computer hardware and canned software…remains subject to Sales and Use Tax as the sales at retail or use of tangible personal property…" The wording expresses the Department's position that canned software was subject to sales and use tax even prior to the repeal of the tax on custom software. Accordingly, the court held that canned software constituted tangible personal property and thus was subject to tax. **(***Dechert LLP v. Commonwealth of Pennsylvania*, 12 MAP 2008, Supreme Court of Pennsylvania, Middle District, 7/20/10)

J. TEXAS

Sale for resale exemption for custom software delivered to out-of-state franchise locations

The Texas Court of Appeals withdrew its original decision that a convenience store franchiser was entitled to a refund of sales tax assessed on its purchase of custom financial software for resale and delivery to its franchise stores that were located outside of Texas. The issue has been remanded to the trial court. Under the original decision, the court found that the software qualified for the sales for resale exemption because it was tangible personal property and its transfer was integral to the provision of data processing services (i.e., the taxable service) provided by the company to its franchisees. On rehearing, the Comptroller argued that the software could not be allocated between software for franchisee stores and software for company stores because the software licensing agreement provided for a single charge for a single license rather than a price per copy. As such, the use of the software by the company and its stores would subject the entire purchase to sales tax based on divergent use. The court agreed that this threshold issue needed to be determined at the trial court level before it could be decided whether a refund was warranted. On the issue of whether sales tax assessed on the franchiser's purchase of store software for its out-of-state company stores should be refunded, the court did not alter its original decision to remand the case to the trial court for further proceedings because the record did not conclusively establish whether the software was used in or outside of Texas. (*7-Eleven, Inc. v. Combs*, Court of Appeals of Texas, 3rd Dist., Dkt. No. 03-08-00212-CV, 4/22/10)

K. WASHINGTON

Sales and use tax exemption for data centers

Effective April 1, 2010, sales to qualifying businesses of eligible server equipment to be installed without intervening use in an eligible computer data center, plus any installation charges, are exempt from sales and use tax. Sales to qualifying businesses of eligible power infrastructure, including labor and services rendered in respect to constructing, installing, repairing, altering, or improving such infrastructure are also exempt. A “qualifying business” is a for-profit business entity that is the owner or lessee of an eligible computer data center. An “eligible computer data center” is a one located in a rural county that has at least 20,000 square feet dedicated to housing servers. Construction of the data centers must commence after March 31, 2010 but before July 1, 2011. The facility, which may house more than one building or business, must have a total combined square footage of at least 100,000 square feet. “Eligible server equipment” is original server equipment installed in an eligible computer data center on or after April 1, 2010, and replacement server equipment. “Eligible power infrastructure” means all fixtures and equipment necessary or the transformation, distribution, or management of electricity required to operate the equipment. The exemption expires April 1, 2018. (L. 2010, S6789)

L. <u>WISCONSIN</u>

Sales of services related to software

Sales of services by a company that provides a software-supported customer management service and 24/7 Internet and phone-based customer support for that software are not subject to sales or use tax in Wisconsin. The Application Service fees charged by the company to permit persons at different locations to access the same software through remote access by telephone or other means are not subject to sales or use tax when (1) the person or persons’ employees who have access to the software are not located on the premises where the equipment/software is located and do not operate the equipment or control its operation, and (2) software that is downloaded or physically transferred to the customer or its computers is incidental to the data processing services . The support fees are also not subject to tax if the technical support provided via the Internet or telephone consists of informing the customer how to solve a problem and allowing the customer to perform the tasks necessary to correct the problem rather than correcting the problem for the customer. Set-up fees that consist of data configuration and data processing, data migration, or forms programming are not services listed as taxable under Wis. Stat. Sec. 77.52(2)(a) and thus not subject to sales or use tax. Training fees are specifically not taxable under Wis. Admin. Code Sec. Tax 11.71(2)(c) and other fees charged to the customer related to the installation of software maintained on servers located in Nevada are not subject to Wisconsin sales or use taxes. (Wisconsin Private Letter Ruling No. W1025002, 3/24/10)

IV. DIGITAL GOODS

A. <u>WASHINGTON</u>

Sales tax imposed on digital products clarified

Effective July 1, 2010, data processing services, live interactive presentation, advertising services, and web-hosting, storage, and back-up are excluded from the definition of “digital automated services” and thus not classified as “digital products” subject to sales and use tax. If a business purchases a digital good solely for business purposes, then the purchase is exempt. The same is true if the digital products are given away for free to the general public (which specifically includes library patrons). In both cases, the purchaser must provide an exemption certificate. In addition, sales of photographs by a photographer who takes the photo and sends the photo electronically are sales subject to sales tax as long as the customer is the end user. (L. 2010, SHB 2620)

B. WYOMING

Permanent use of digital products

Effective July 1, 2010, a sale of digital products is only subject to sales tax if the purchaser has permanent use of the specified digital product. Vendors that purchase the product for further commercial broadcast, transmission, licensing, and distribution to another person are considered wholesalers and are not subject to tax. (L. 2010, c. 64, § 1)

V. BAD DEBTS

A. MICHIGAN

The Michigan bad debt deduction statute does not permit a deduction for sales tax paid on property that is repossessed. The court found that the statute clearly and unambiguously states that bad debt does not include repossessed property and the Michigan Department of Treasury has consistently treated it in that manner. (*Daimler Chrysler Services of North America v. Department of Treasury*, Michigan Court of Appeals, No. 288347, 1/21/10)

B. NEW YORK

A home improvement products retailer entered into agreements with third-party finance companies whereby the finance companies would issue credit cards bearing the retailer's name, while the finance companies owned the underlying credit accounts and were entitled to all payments made on those accounts. The retailer claimed refunds for sales tax paid on amounts paid for by credit card, which were ultimately uncollectible by the finance companies. Under the regulations in effect during the relevant time period, taxpayers could apply for a refund of sales tax paid on uncollectible receipts where they were the actual vendor of the tangible personal property or taxable services, but not where the transaction was financed by a third party. The court upheld the decision of the Administrative Law Judge which denied the refunds, finding that the Commissioner's regulation was not arbitrary, capricious, or irrational, even though the regulation was subsequently changed to allow for refund requests on uncollectible receipts from transactions financed by third parties. (*In the Matter of Home Depot USA, Inc. v. Tax Appeals Tribunal of the State of New York*, 68 AD3d 1571, New York Supreme Court, Appellate Division 3rd Jud. Dept., 10/20/09)

Effective July 1, 2010, a private label credit card lender or vendor may no longer apply for a credit or refund of the sales tax portion of a bad debt account charged off by the lender as worthless regardless of the date of the underlying transaction or the date the bad debt is written off. (L. 2010, c. 57, §1132)

C. WASHINGTON

Amendment of "bad debt" definition for sales tax

Effective for refunds or credits filed with the Department after June 30, 2010, reversing the effects of the 16-year old *Puget Sound National Bank v. Department of Revenue* case, the definition of "bad debt" for sales tax purposes in Washington no longer includes "debts sold or assigned by the seller to third parties, where the third-party is without recourse against the seller." The *Puget Sound* case had allowed an assignee of a debt instrument the right to recover sales tax paid to the state when the debtor defaults. The new law does allow the original seller the opportunity to submit a refund claim for the tax after a debt has been reassigned to it by the third-party lender. (L. 2010, SB 6143)

VI. SERVICES/SOURCING/BUNDLED TRANSACTIONS

A. MAINE

Maine voters veto tax reform legislation

Maine voters overturned tax reform legislation scheduled to go in to effect in 2011 that would have expanded sales and use tax to more than 100 goods and services, including personal property services, amusement and entertainment services, leases and rentals, transportation and courier services, and repair, maintenance, or installation services, in return for reducing the personal income tax rate by 2%. Although estimates claimed 90% of Maine residents would see a net tax reduction, Mainers were wary that the expansion in the sales tax base would only lead to more taxes and were worried that nonresidents would bear an unfair proportion of the increases through the increased meals and lodging tax rate, which would negatively impact the state's thriving tourist industry. (Maine Tax Reform Repeal Referendum, 6/8/10)

B. MISSOURI

Interstate call forwarding not taxable

The Missouri Department of Revenue ruled that the interstate telecommunication services exception applied to an out-of-state company's contracts with in-state retailers whereby potential customers would dial a toll-free number that connected to out-of-state computer servers that then dialed the retailers' respective local numbers. Applicant was an out-of-state company that provided advertising and call tracking services to Missouri retailers through an out-of-state third-party service provider. The retailers would reserve toll-free "vanity" numbers with the service provider in connection with their call tracking service contracts. These toll-free numbers connected to the service provider's computer servers located out-of-state, which then dialed the retailers' respective local number. The Director ruled that these services were interstate telephone calls not subject to sales tax. (Missouri Private Letter Ruling No. LR 6211, Missouri Department of Revenue, 4/26/10)

C. NEW YORK

Sales taxability on litigation support services

Company provides a variety of litigation support services, including some using its online proprietary software. Service entails processing voluminous documentation obtained from the customer through hard drives. The data is organized and stored based on the customer's specifications, enabling the customer to only retrieve and print data that was originally submitted. The customer has no ability to enter data, manipulate data, or run reports using the software. Any modifications or change can only be done by the service provider. The organized data is returned to the customer only and is not available for outside third-party use. The data is delivered to the customer by either DVDs, CDs, hard drives, or can be hosted on the service provider's servers and accessible through its website. The fee of deliverables can vary from $20 to $250. According to the company, this charge is nominal in relation to the overall service charge.

The above-mentioned litigation support services are not subject to sales tax because they are characterized as personal or individual in nature. The NY Tax Law Section 1105(c)(1) taxes "services of collecting, compiling or analyzing information of any kind or nature and furnishing reports therefore to other persons, but excluding the furnishing of information which is personal or individual in nature and which is or may not be substantially incorporated into reports furnished to other persons… " As such, an exclusion from tax exists for services that furnish information that is personal or individual in nature and are not provided to third parties. In addition, the deliverables are not subject to tax regardless of the form they are delivered because the integral part of the service is nontaxable. Therefore, litigation support services are nontaxable, regardless of the media on which the reports are delivered. (New York Advisory Opinion TSB-A-10(20)S, 5/6/10)

Taxation of information services

Sales of financial data, software, reports, and technical support, research support and training services are subject to sales tax because, according to Tax Law Section 1105(c), services, like furnishing information, are taxable. Sales of application software are subject to sales tax as they are considered tangible personal property; however, separately billed charges for technical support, research support and training are not subject to sales tax. The exclusion pertaining to information that is personal or individual in nature that is not substantially incorporated into reports is inapplicable to data feed services. Since all customers access the same data source, the information obtained by them by definition can be incorporated into reports and furnished to others. Note however that customization wouldn't necessarily mean the sale was tax-free. (New York Advisory Opinion TSB- A-10(32)S, 7/23/10)

D. PENNSYLVANIA

Taxation of delivery of electricity unaffected even if unbundled

The owner of a sports and entertainment facility that purchased electricity from one provider that was delivered by another was charged sales tax on "unbundled charges" such as competitive transition charges, intangible transition charges, transmission services, etc. It argued that non-generation costs did not constitute a taxable sale and made a claim for a refund. The Pennsylvania Supreme Court disagreed, upholding a lower court decision denying a refund. The situation at hand arose when Pennsylvania adopted the Competition Act to deregulate electricity and modified the definition of sale of electricity and the Tax Code along with it. However, the modifications did not remove electricity delivery charges from the definition of "sale." The aim was to collect the same amount of revenue under deregulation as before.

The taxpayer argued the unbundling of generation and delivery of electricity under the Competition Act was sufficient to render the Unbundled Charges separate from any generation costs such that the charges are not taxable. The court agreed with the state, finding that the Competition Act was clear and unambiguous in defining "retail sale" as "the total value of anything paid or delivered, or promised to be paid or delivered…in complete performance of a sale at retail." The total value here is all costs, not just generation costs, because the electricity must be both generated and delivered to be used. In addition, there was no legislative intent to exempt the Unbundled Charges from taxation. The taxpayer also argued that the Pennsylvania Administrative Code exempts charges for delivery when made or billed by a party other than the producer. The court found that this exemption is inapplicable to the Unbundled Charges because the deliverer of the electricity has some involvement in the production of electricity and is not merely delivering the electricity, which is required for the exemption. Finally, the taxpayer argued that it is not permissible to use a different taxation scheme for gas and electricity and thus create a disparity between the two. The court rejected the argument, finding that Pennsylvania's Policy Statement which states that delivery charges for electricity are subject to sales tax shows that the legislature intended this disparate treatment. (*Spectrum Arena Limited Partnership v. Commonwealth of Pennsylvania,* Pa. S. Ct., 42 MAP 2008, 11/5/09)

E. <u>SOUTH CAROLINA</u>

Taxability of web-based services

Subscription service charges and other fees charged by a web-based (hosted) on-demand collaboration platform are charges for communication services and thus are subject to South Carolina sales and use tax. The company provides service solutions to businesses that require secure communications of data between their suppliers, employees, and vendors. The subscription service applications are accessed via an online portal hosted by the company and central data-messaging hubs that provide a single connection for the subscriber's systems to exchange business transactions in various electronic formats with its trading partners. One of the hubs uses internal software to compose and transmit messages, while the other uses a web browser to exchange data. Under SC Code Ann. Sec. 12-36-60, "communications" are included in tangible personal property subject to sales and use tax, and under SC Regs. 117-329.4, "database access services or online information services…and charges to access an individual website (including Application Service Providers)" are among the examples of taxable communication services. As such, charges for monthly subscription and maintenance fees, fees in connection with building of the site for the client, and fees for services related to sending messages and maintaining mailboxes, which are all considered communications services, are subject to tax and should be sourced to the primary business address of the end user. (South Carolina Private Letter Ruling No. 10-2, 7/29/10)

F. <u>TEXAS</u>

Telecommunications products are a taxable service, not tangible personal property

A telecommunications company is not entitled to a manufacturing sales tax exemption because the company sells a telecommunications service, not tangible personal property. The company filed a claim for refund on switch equipment used in the course of its operations, claiming that the switches constituted tangible personal property used in manufacturing telecommunication signals. The court held that the company was not entitled to the manufacturing exemption because sales tax was imposed on the equipment as a service, not as tangible personal property. In Texas, telecommunications services are considered a taxable service and because they are taxed as a service, the company does not manufacture, process or fabricate tangible personal property for sale within the meaning of the manufacturing exemption. (*GTE Southwest Inc. v. Combs*, Court of Appeals of Texas, 3rd Cir., Dkt. No. 03-0800561-CV, 6/3/10)

VII. ALTERNATIVE ENERGY

A. ARIZONA

Extension of solar device installation exclusion

Effective July 29, 2010, Arizona extended the exclusion from the transaction privilege and use tax of contracts to provide and install a solar energy device, including those that provide heating, cooling, electrical power, mechanical power, or solar daylighting, which was set to expire on January 1, 2011. The exclusion will now expire January 1, 2017. (L. 2010, HB 2700)

B. CALIFORNIA

Expansion of alternative energy exemption

Effective March 24, 2010, California extended the sales and use tax exemption on tangible personal property used for alternative energy projects until January 1, 2021. The legislature also expanded the definition of "alternative sources" to cover any source of energy that will "reduce the use of fossil and nuclear fuels," and the definition of "projects" to cover any tangible personal property used "for the design, manufacture, production, or assembly of advanced transportation technologies or alternative products, components, or systems." (L. 2010, SB 71)

C. MASSACHUSETTS

Applicability of sales and use tax on machinery used to construct wind turbine

Taxpayer's purchases of wind turbine and related items are exempt from sales tax because they qualify as machinery that is used directly and exclusively in furnishing electricity that is delivered to consumers through mains, lines, or pipes. The tower and its components (except the tower name plate) and the supporting foundation also qualify because they are adjuncts or attachments necessary to secure the turbine and its electrical works in order for the turbine to accomplish its intended function or are used to control, regulate, or operate the wind turbine. To be eligible for exemption, machinery and replacement parts must also satisfy the test of being used directly and exclusively in the furnishing of electricity. The result of finding an exemption does not change even though 5% of the electricity will be sold directly to a particular consumer, while the rest will be sold to a local utility for use by other consumers. Sales of other machinery used in the construction of the wind turbine, tower, or foundation, such as erection cranes, support cranes, and bulldozers, are subject to tax unless such machinery becomes a part of the integrated and synchronized system that furnishes the electricity to consumers. (Massachusetts Letter Ruling 10-3, 7/7/10)

D. MISSOURI

Application of sales and use tax on equipment used on wind farm

The Missouri Department of Revenue ruled that the Supervisory Control and Data Acquisition System (SCADA), the underground cable collector system, and the centralized main power transformer used in a wind farm to manufacture, transmit, and distribute electricity are subject to sales tax. Machinery and equipment used in the transmission or distribution of electricity do not qualify for the manufacturing machinery and equipment exemption under Mo. Rev. Stat. §144.030(2)(5) and Mo. Rev. Stat. §144.054(2). Only machinery and equipment used or consumed in the manufacturing of electricity are exempt. (Missouri Private Letter Ruling No. LR 6097, 3/5/10)

E. NEW YORK

Wind farms eligible for electricity production exemption

Wind farms are eligible for the electricity production exemption from sales tax as they are engaged in the generation of electricity for sale. However, only those parts that are directly and predominantly (more than 50% of the time) used in the generation of electricity for sale are eligible for the sales tax exemption. This includes: (1) the rotor blades, nacelle, hub, and tower of the turbine itself, and (2) the Supervisory Control and Data Acquisition (SCADA) equipment and meteorological equipment when integrally connected to the operation of the wind turbines (i.e., not used 50% or more of the time to assess a site's potential as a wind farm). This does not include tangible personal property not considered machinery or equipment, such as concrete foundations, or tangible personal property directly and predominantly used for transmission purposes rather than in the production process, such as transformers, power lines, and collection system equipment. Installation services and construction costs are considered part of the sales price for exempt machinery and equipment and are likewise exempted. Installation charges for other tangible personal property not qualifying for the production exemption are exempt to the extent they qualify as capital improvements. (New York Advisory Opinion No. TSB-A-09(59)S, Petition No. S090220A, 12/9/09)

Wind farm components not capital improvements to leased premises

As detailed above, the components of a wind farm directly and predominantly (more than 50% of the time) used in the generation of electricity for sale are eligible for the sales tax exemption for machinery and equipment used in electricity production. However, where the construction and installation of a commercial wind farm was on leased premises under a contract that specified that all wind facilities would be removed at the end of the lease term, none of the remaining components would qualify for sales tax exemption as capital improvements. (New York Advisory Opinion No. TSB-A-09(62)S, Petition No. S080416A, 12/29/09)

F. PENNSYLVANIA

Solar energy facility qualifies as a manufacturer and for related exemption

A company is preparing to construct a solar energy facility in Pennsylvania that will transfer its electrical output to a public utility through a high voltage transmission system for nonresidential use. Pennsylvania excludes from the definition of taxable sale at retail the transfer of tangible personal property, including but not limited to machinery, equipment, parts, and supplies used or consumed directly in the operations of the manufacture of tangible personal property. Because tangible personal property includes "electricity for non-residential use," the company may claim the manufacturing exemption on the machinery, equipment, and supplies it predominantly and directly uses in its generating of electricity starting with those used in the initial stage of the photovoltaic process and ending at the final production stage where the electricity is acceptable to the public utility purchaser. (Pennsylvania Sales and Use Tax Ruling No. SUT-10-001, 4/7/10)

G. <u>WYOMING</u>

Renewable energy exemption

The Department issued a policy statement on renewable energy exemption reporting requirements and sunset dates relating to the legislation passed last year. Project developers have three deadlines to meet to qualify for the exemption.
First Deadline- January 1, 2010: Project developers must have a written agreement in place with the landowner, including a description of the equipment to be placed on the land, such as turbines, power transformer stations, power lines, and any access roads.
Second Deadline- December 31, 2011: Exemption is repealed. All equipment must be in Wyoming by this date.
Third Deadline- Date of sale or taxable transaction: Project developer must have received all required permits and approvals for the development and construction of the project.
The transaction will not qualify for the exemption if the equipment arrives in the state prior to the developer meeting the eligibility requirements. (WY Department of Revenue, Policy Statement, 9/24/09)

VIII. RESALE EXEMPTION

A. <u>ALABAMA</u>

Complimentary peanuts given to customers at restaurant not subject to use tax

Reversing the administrative law judge's decision, the circuit court in *Logan's Roadhouse, Inc. v. State of Alabama Department of Revenue* held that peanuts given to a restaurant's customer for free are eligible for the sale-for-resale exemption when purchased by the restaurant. The operator of the restaurant purchased the peanuts tax-free at wholesale and then provided the peanuts to its customers for free, regardless of whether the customer ordered food at the restaurant. On audit, the Alabama Department of Revenue assessed use tax on the purchase price of the peanuts. The taxpayer argued that it accounted for the cost of the peanuts in its charges for food and drink and that the peanuts were akin to condiments given away at fast food restaurants which are not subject to tax. The judge in that case found that the key to whether an item like the peanuts is taxable is whether the item is being sold as an integral part of the food. Because the peanuts were merely a marketing or advertising tool and not related to the sale of its menu items, use tax was due. The circuit court disagreed, finding that Logan's sold the peanuts at retail and therefore was not liable to remit use tax. The court agreed with Logan's, reasoning that the customers paid for the peanuts as part of the cost of their foods and drinks. The Department has appealed. (*Logan's Roadhouse, Inc. v. State of Alabama Department of Revenue*, No. CV-09-1930, Alabama 10th Jud. Cir. Ct., 4/2/10)

B. <u>FLORIDA</u>

Sales tax on printed material purchased for resale from third-party printer

A taxpayer that purchases printed materials for resale from a third-party printer is responsible for collecting and remitting sales tax on direct mailing sales when the printed materials are delivered into Florida. Although Florida allows an exemption from sales tax for printers, the exemption does not apply to the taxpayer. The taxpayer should present a resale certificate to the printer in lieu of paying sales tax because it is purchasing the printed materials to be resold to its clients. However, it needs to collect the sales tax from the clients. The taxpayer would not be required to collect sales tax from the client, if at the time of the sale, it agrees to deliver the printed materials to a location outside Florida and the printed materials are delivered to a location outside Florida. Sufficient documentation must be maintained to support that the exportation process of the printed materials is continuous and unbroken. (Florida Technical Assistant Advisement 10A-023, 5/13/10)

C. MASSACHUSETTS

Sale for resale exemption requires purchase for purpose of resale

The Supreme Judicial Court of Massachusetts held that a defense contractor's purchases of certain goods that were indirect costs items in connection with performing its contracts with the federal government did not qualify for the exemption for sales made for the purpose of resale in the regular course of its business despite the fact the title to the items eventually transferred to the federal government. The court found that the taxpayer purchased the indirect cost items with the intent of facilitating the completion of its contracts and not for the purpose of reselling them in the regular course of its business.

Indirect cost or overhead items are costs "not directly identified with a single final cost objective, but identified with two or more final cost objectives or with an intermediate cost objective." These items are necessary for the completion of the defense contractor's contract's with the federal government even if they are not delivered to the federal government as final products. Under the terms of the Federal Acquisition Regulations (FARs), which control the government contracts, title to the indirect cost items passes to the federal government, though possession remains with the contractor.

The court determined that it is not enough to ask merely whether title to the items passed in the regular course of the contractor's business with the government, but rather must ask whether the contractor purchased the items for the purpose of resale in the regular course of its business. In this case, the court found that the items were not purchased for the purpose of resale in the regular course of its business. In its decision, the court specifically rejected the model of other state courts that have held that similar sale for resale exemptions covered government contractors' purchase of indirect cost items (see Arizona, California, Missouri, Texas). (*Raytheon Co. v. Commissioner of Revenue*, 916 N.E.2d 372, Supreme Judicial Court of Massachusetts, 11/10/09)

D. MISSOURI

Resale exemption

The Missouri Supreme Court refused to apply the resale exemption to sales of items that were later resold to tax-exempt municipalities. In this case, a private operator of a jail facility providing jail services to certain municipalities was not entitled to the resale exemption for its purchases of consumables provided to inmates. Since the government entities are exempt from sales tax, the taxpayer cannot charge them sales tax for the consumables even if it factors the cost of these consumables into the per-inmate fee it charges the government entities. As a result, it cannot claim a resale exemption on its purchases of these consumables because the "resales" to the government entities are not taxable sales at retail. (*ICC Management, Inc. v. Director of Revenue*, 290 SW3d 699, Supreme Court of Missouri, 6/16/09)

The Missouri Supreme Court held that a live entertainment producer was liable for sales tax on its sales of tickets to local businesses if the tickets were subsequently given to customers who took time-share tours. However, the producer was exempt from sales tax for sales of tickets to local businesses that resold the tickets to customers for cash or bundled them with other products sold. In that situation, the businesses are liable for sales tax. There must be a retail sale in order for the resale exemption to apply. (*Music City Centre Management, LLC v. Director of Revenue*, 295 SW3d 465, Supreme Court of Missouri, 8/4/09)

In response to the *ICC Management* and *Music City Centre Management* decisions, the Missouri legislature enacted legislation effective May 12, 2010 that provides that a sale for resale will not be subject to sales tax provided that the subsequent sale is (1) subject to tax in Missouri or any other state, (2) for resale, (3) excluded from Missouri sales tax, (4) subject to but exempt from Missouri sales tax, or (5) exempt from the sales tax laws of another state if the subsequent sale is in that state. The statute also addresses the *Music City Centre Management* decision by treating charges for admission or seating accommodations at places of amusement, entertainment, or recreation and charges for rooms, meals, and drinks at places that regularly serve such items to the public differently from all other transactions. Operators of such places must remit tax on the gross receipts received for admissions or seating accommodations and for rooms, meals or drinks, and subsequent sales will not be subject to tax if they are an arms-length transaction for fair market value with an unaffiliated entity. (L. 2010, SB 928)

Machinery and equipment exception and sale for resale exception for reusable items

The taxpayer owns numerous restaurants in Missouri and claimed a refund for use tax paid on (1) machinery, equipment, and replacement parts (including kitchen equipment such as refrigerators, fryers, soda machines, etc.), and (2) reusable service items (such as non-disposable tableware, cutlery, chairs, tables, etc.). The Missouri Supreme Court upheld the decision of the Administrative Hearing Commission, rejecting the refund for machinery, equipment, and replacement parts, as well as for the reusable service items. The Court found that the manufacturing machinery and equipment exemption did not apply because the provision requires the machinery and equipment to be used in "plants" and a restaurant does not qualify as a "plant." The refund for the reusable service items was rejected because the use of the items failed to meet the definition of sale or resale. According to the Court, three elements must be satisfied to meet the definition: 1) transfer, barter or exchange; 2) of the title or ownership of the tangible personal property, or the right to use, store, or consume the same; 3) for consideration paid or to be paid. Although the customers acquire temporary use in the sense that the reusable items are used as a mechanism to facilitate the delivery of their food and drink, the degree of control is de minimis and does not rise to the level of an actual transfer of a right to use. The Court distinguished this case from others in which a sale took place absent a permanent transfer of possession and title by noting that here the taxpayer merely incorporated the cost of the items into overhead and charged the same amounts to customers whether they ate in the restaurant or ordered to go. If they had charged only the eat-in customers for the use of these items, then they might have met the definition. (*Brinker Missouri Inc. v. Director of Revenue*, Supreme Court of Missouri, Dkt. No. SC90463, 8/31/10)

E. TENNESSEE

Security equipment leased to customers not sale for resale

The Tennessee Court of Appeals determined that the taxpayer that provides security and monitoring services and equipment to both residential and commercial customers was liable for sales and use tax on equipment it installed as part of its security monitoring service contracts for which a monthly fee was charged because proof did not exist that the taxpayer had leased its equipment to its customers. The taxpayer's contracts did not indicate an equipment fee or lease fee, only an installation charge where installation taxes were collected. As a result, the taxpayer failed to demonstrate that its purchases of monitoring system components were exempt from sales and use taxes as a sale for resale. The court further determined, under the doctrine of equitable recoupment, the taxpayer was not entitled to offset its liability for sales and use taxes on its monitoring equipment by taxes that it had charged and remitted on the installation of the equipment. This was true because the taxpayer did not assert the doctrine until after the matter was tried. (*ADT Security Services, Inc. v. Johnson*, M2008-02008-COA-R3-CV, Court of Appeals of Tennessee Nashville, 11/19/09)

F. TEXAS

Resale exemption

The Texas Court of Appeals held that a distributor's provision of soda fountain equipment to a retailer free of charge in exchange for a minimum-purchase commitment does not qualify as a resale of the equipment for purposes of the sale for resale exemption nor does it qualify for manufacturing exemption. The sale for resale exemption did not exempt the distributor's purchases of the fountain equipment because the transactions were not sales as contemplated by the exemption. None of the contract provisions which covered exclusivity of sales, risk of loss or damage to the equipment, or minimum purchases of the company's products constituted relevant consideration needed to meet the requirement that the provision of equipment to the retailers be done or performed for consideration. The manufacturing exemption did not exempt the distributor's purchases of the equipment because the equipment was not used by the distributor in manufacturing, processing, fabricating, or repairing tangible personal property. The exemption only applies to the entity that uses the equipment for manufacturing. (*Laredo Coca-Cola Bottling Co. and Coca-Cola Enterprises, Inc. v. Combs*, Court of Appeals of Texas, Dkt. No. 03-09-00157-CV, 4/15/10)

IX. MISCELLANEOUS

A. ALABAMA

Transfer of title does not constitute retail sale

An automaker that acquired title to custom-made tooling equipment from its near-bankrupt suppliers who had used the tooling to manufacture parts on behalf of the automaker was not liable for sales tax on the transfer because it did not constitute a taxable sale. The Taxpayer asserted that its acquisition of legal title to the tooling equipment should not be considered a purchase of the tooling at retail because the suppliers had purchased the equipment at retail from the tooling vendors, and through their use of the tooling in Alabama, were liable for Alabama use tax on the equipment. The Department countered that the transfer of title did in fact constitute a taxable sale. The court concluded that the transfer of title did not constitute a taxable sale because the suppliers were the manufacturers who used the tooling to manufacture parts. Thus, based on the substance of the transaction, the suppliers were liable for use tax on its retail purchases of the equipment in question and the automaker did not owe sales tax on their acquisition of title to the equipment. (*Mercedes-Benz US Int'l, Inc. v. State of Alabama Dep't of Rev.*, Admin. Law Div., Dkt. No. S. 09-519, 2/24/10)

B. ARKANSAS

Manufacturer's natural gas purchases subject to use tax

The Arkansas Supreme Court held that a manufacturer's natural gas purchases were subject to use tax because the gas came to rest at the manufacturer's local plant after its purchase from out-of-state sellers. The gas was transported through interstate pipelines directly to the company's internal gas lines for consumption at the Arkansas plant. The company argued that its gas purchases were not subject to use tax because the gas did not "come to rest" in Arkansas as required by section of the statute covering use tax. The court rejected this argument, determining that "come to rest" means a point in which tangible personal property put into interstate commerce and sent to Arkansas can satisfy its purpose, such storage, use, distribution, or consumption. Here, once the gas had left the interstate pipeline, it had effectively been delivered to the company and having gained control of it, could use it for consumption within the plant. (*Alcoa World Alumina LLC v. Weiss*, 2010 Ark. 94, 2/25/10)

C. CALIFORNIA

Registration and tax reporting for sellers of medical marijuana

Sales of medical marijuana are subject to tax. In addition, sellers are required to have a permit. A seller may be subject to penalty and interest if they do not obtain a permit before their first tax return is due. Installment payment agreements and offer in compromise programs are available to satisfy tax liabilities to those qualifying. (California SBE Special Tax Notice No. L-245, Important Information for Sellers of Medical Marijuana, 1/1/10)

D. COLORADO

Separately stated transportation charges

A manufacturing company is involved in purchasing tangible personal property from a supplier with agreements that the supplier will ship the goods in the most economical manner possible, whether via common carrier or the supplier's own transportation services. Transportation of tangible personal property between a supplier and purchaser is a service that is presumed to be a nontaxable service. In order for transportation charges to be considered exempt in transactions that involve both a taxable good and nontaxable service, the transportation service must be (1) separable from the sales transaction and (2) stated separately on a written invoice or contract. Even if a transportation service is separately stated it will be included in the tax calculation if it is inseparable from the sale of the goods. For example, the transportation service is inseparable from the sale of ready-mix concrete or extreme low temperature liquids which require special transportation equipment only the supplier can provide. (Colorado Private Letter Ruling No. PLR-10-2, 3/23/10)

Natural gas equipment is not construction and building materials

The Colorado Supreme Court issued a judgment without an opinion affirming a lower court decision, finding that certain equipment used by an oil company in connection with its natural gas operations did not constitute construction and building materials. As a result, the equipment was not subject to county or local use tax. (*Board of County Commissioners of the County of Rio Blanco v. ExxonMobil Oil Corporation*, Colorado Supreme Court, No. 08SC698, 11/9/09)

E. <u>CONNECTICUT</u>

Aircraft manufacturing exemption

A helicopter manufacturer could avail itself of the exemption from sales and use tax on the purchase of materials, tools, fuel, machinery, and equipment used in the manufacture of helicopters, parts, and components even when the items were for research and development as part of the manufacturing process for the helicopters. While the Tax Commissioner argued that the exemption did not apply because the items were purchased solely for use in research and development and not manufacturing, the Connecticut Supreme Court found that the items qualified for the exemption. Its determination was based on finding that "aircraft manufacturing facility" includes those portions where research and development take place. In addition, the "predominant use" requirement of the exemption was satisfied if the items are used in research and development with respect to or in furtherance of manufacturing tangible personal property. The court found that the legislative history indicated the legislature's intention to include items used in the processes that have at least an indirect connection with manufacturing, including processes like research and development, in addition to processes that have a direct connection with manufacturing. (*Sikorsky Aircraft Corporation v. Commissioner of Revenue Services*, Dkt. No. SC 18302, Supreme Court of Connecticut, 7/27/10)

F. <u>FLORIDA</u>

Applicability of use tax on aircraft purchased in California to be used in Florida

A Florida-based corporation purchased an aircraft in California for use in Florida but kept it in California for at least six months after the purchase date in order to repair and restore the aircraft to flying condition. After that point, it will be flown to Florida and based there. Although the corporation argued that the aircraft was purchased outside of Florida and used outside of the state for six months or more prior to the time it was brought into Florida, the corporation is not entitled to the presumption that the aircraft is exempt. The presumption is denied because at the time of purchase, the corporation intended to use the aircraft in Florida. It has also failed to provide any evidence that the aircraft was purchased for use in California. As such, the aircraft will be subject to Florida use tax as soon as it is imported into Florida. (Florida Technical Assistance Advisement 10A-006, 2/10/10)

Use tax exemption for aircraft owned by nonresidents

Effective July 1, 2010, Florida exempts from use tax aircraft owned by a nonresident when the aircraft enters and remains in Florida for no more than 20 days during the six months after the date of purchase. Temporary use and subsequent removal of the aircraft from Florida can be demonstrated by invoices for fuel, tie-down, hangar charges issued by out-of-state vendors or suppliers, or similar documentation that clearly and specifically identifies the aircraft. A use tax exemption also applies for aircraft owned by a nonresident when the aircraft enters or remains in Florida exclusively for purposes of flight training, repairs, alterations, refitting, or modification, which must be supported by written documentation issued by in-state vendors or suppliers that clearly and specifically identify the aircraft. (Florida L. 2010, H173)

G. ILLINOIS

Applicability of use tax on citizens of foreign countries

Foreign citizen seeking tax refunds on purchases made on a vacation visit to Illinois does not qualify for an exemption from use tax. Purchases are not exempt even though the purchaser immediately transported the items outside the state for use because the purchaser received physical possession of the property within the state. As a result, both foreigners and domestic travelers are not exempt from taxes on purchases made if the property was delivered and used in Illinois. (General Information Letter, Illinois Department of Revenue, No. ST 09-0153-GIL, 12/8/09)

Delivery charges not subject to sales tax if separately agreed to by customer

Charges designated as delivery or transportation charges are not taxable if it can be shown that they are both agreed to separately from the selling price of the tangible personal property which is sold and that such charges are actually reflective of the shipping costs. A separate line item for shipping charges on an invoice is not sufficient to show that it was agreed to separately from the selling price. The best evidence that the delivery or transportation charges were agreed to separately is a separate and distinct contract covering delivery or transportation. However, documentation which demonstrates that the purchaser had the option of taking delivery at the seller's location for the agreed purchase price or having delivery made by the seller for the agreed purchase price plus the delivery charge is also sufficient. The Department noted that it was considering amending section 130.415 of the Illinois Administrative Code concerning the taxation of delivery charges in light of the 2009 decision by the Supreme

Court of Illinois in *Nancy Kean v. Wal-Mart Stores, Inc*. (Illinois Dept. of Rev. General Information Letter No. ST 09-0165-GIL, 12/23/09)

H. KANSAS

Sales tax or use tax on rock shipped out of state via private carrier

A construction company in Kansas purchases a rock from an in-state quarry and contracts a private carrier to ship the rock to a job site in Oklahoma. According to K.A.R 92-19-29, "where tangible personal property pursuant to a sale is delivered in this state to the buyer or his agent other than a common carrier, the sales tax applies, notwithstanding that the buyer may subsequently transport the property out of this state." Therefore, the construction company is liable for Kansas sales tax on the purchase at the time of pick-up from the quarry, even though the company is transporting the purchase out of state. The result holds because the company used a private carrier, who acted as an agent on behalf of the company, as opposed to a common carrier. If the company contracted the quarry to have them deliver the rock to the Oklahoma jobsite, then neither Kansas sales tax nor Oklahoma use tax would be owed. Under K.S.A 2009 Supp. 79-3602, if the quarry had hired a private carrier, then shipping charges may be subject to sales or use tax. (Kansas Opinion Letter No. O-2010-001, 3/26/10)

I. KENTUCKY

Enterprise zone incentives

A steel company was entitled to enterprise zone incentives for the amount of sales and use tax paid for parts used in repair, replacement, and modification of existing equipment and machinery, which was within the enterprise zone and subject to exemptions. According to the enterprise zone statute, "New and used equipment purchased and used by a qualified business within an enterprise zone shall be exempt from sales and use taxes." The Department of Revenue promulgated a regulation that effectively modified this statute out of existence in order to deny the exemption. The Board held that the regulations cannot define away the clear meaning of the statute and thus the statute controls, allowing the exemption. (*AK Steel Corporation v. Finance and Administrative Cabinet Department of Revenue*, K08-R-36, Kentucky Board of Tax Appeals, 4/23/10)

J. LOUISIANA

Use tax on catalogs mailed directly from out-of-state printer

A corporation that operates retail department stores in several states including Louisiana was not liable for use tax on catalogs that it contracted an out-of-state printer to print and mail to its credit card customers and stores in Louisiana. Because the catalogs were mailed free of charge to the company's customers and to the company's stores for distribution to its customers and browsers, the company did not take physical possession of the catalogs which is required to be subject to the tax. The Court distinguished the case from *J&B Publishing Co. v. Dept. of Revenue*, La. Ct. App., 2nd Cir., 775 So 2d 1148 (2000), in which the telephone directories printed were delivered directly to the taxpayer but had an inherent utility aside from mere advertisement. Instead, the case was similar to *Louisiana Health Services and Indemnity v. Dept. of Revenue*, La. Ct. App., 1st Cir. 746 So 2d 285 (2000), in which the mailing of free brochures by an out-of-state advertising firm to an insurance company's potential customers in Louisiana did not constitute a transfer of brochures to the insurance company because it was part of a marketing plan. (*Dillard's Inc. v. Kennedy*, La. Ct. App., 1st Cir., Dkt. No. 2009 CA 1423, 5/7/10)

Use tax on advertising materials supplied by out-of-state printer

A corporation that operates retail department stores in several states including Louisiana was not liable for use tax on costs incurred for catalogs, circulars, and other promotional materials provided by an out-of-state printer and direct mailed by a third party to the retailer's credit card customers and stores in Louisiana. Because the catalogs were mailed free of charge to the company's customers and to the company's stores for distribution to its customers and browsers and the advertising materials were not transferred to the retailer for its own use, the retailer did not have possession of the materials which is necessary to be subject to use tax. The case was remanded to the trial court for further proceedings solely on the issue of whether or not tax was due on the flat fees (or "handling charges") charged to the retailer's customers when merchandise was shipped to them. (*Bridges v. Higbee Co. t/a Dillards's*, La. Ct. App., 1st Cir., Dkt. No. 2009 CA 1634, 6/28/10)

Storage Alone Not Subject To Use Tax

The Taxpayer purchased tangible personal property out-of-state and tax-free before importing the goods into Lafayette Parish where it held them in storage for use elsewhere. The Court of Appeals agreed with the Taxpayer's interpretation of the relevant Lafayette ordinance, finding that use tax was due only if the property was both stored and used or consumed in the Parish. The court rejected the School Board's argument that tangible personal property imported into Lafayette Parish was taxable "the moment it comes to rest in the Parish." (*Sci. Drilling Int'l, Inc. v. Meche*, 29 So. 3d 1283, La. App. 3 Cir., 2/3/10)

K. MASSACHUSETTS

R&D purchases by a chip-set manufacturer exempt

The Massachusetts Supreme Judicial Court affirmed a Court of Appeals decision, holding that purchases related to the research and development of a ground-breaking micro-chip device that optimized telecommunications system functionality were exempt from Massachusetts sales and use tax because the company was "engaged in manufacturing." The company's engineers created and designed the chip's numerous software and hardware components, using blueprints to direct the physical construction of the chip from raw silicon and the embedding of the software into the hardware. The court agreed that the entirety of taking the chip from abstract concept to production constituted manufacturing. The company's activities during the blueprint phase were "essential and integral" to the total manufacturing process, which entitles them to classification as a manufacturing corporation.

The court also rejected the "finished product test" proposed by the Commissioner, finding there was nothing in the statute that limits the period of eligibility for the manufacturing exemption to the stage during which a finished product emerges. To interpret the statute in that manner would disadvantage new or specialized corporations in comparison to established corporations by exempting purchases of established corporations during the R&D phase, while denying an exemption for the exact same purchases by a new corporation. (*Onex Communications Corporation v. Commissioner of Revenue*, Mass. Sup. Jud. Ct., Dkt. No. SJC-10623, 7/30/10, aff'g Mass. App. Ct., 909 NE2d 53(2009))

L. <u>NEW MEXICO</u>

Taxability of floor coverings and maintenance contracts

A corporation with its principal place of business located outside of New Mexico acquired several small companies also located outside of New Mexico that are in the business of selling and installing carpet and other floor covering products to general contractors, decorators, and end-users. The company also offers optional regularly scheduled maintenance services to the end-users. These services are invoiced separately from the materials. The sale of floor coverings, other than carpeting, on an installed basis is the sale of construction services and is eligible for exemptions and deductions from the gross receipts tax. Carpeting is not considered a construction material even when sold for use in a construction project and thus is treated as a sale subject to the gross receipts tax. The receipts from the maintenance contracts with end-users in New Mexico are receipts for performing services and are subject to the gross receipts tax unless an exemption or deduction applies. (New Mexico Taxation and Revenue Dept. Ruling No.430-10-1, 6/17/10)

M. <u>NEW YORK</u>

Definition of common carrier for promotional materials exemption

A company publishes and distributes telephone directories containing both advertisements and telephone and address information to state residents and businesses free of charge through various distributors, including the USPS and private delivery companies. Under NY Tax Law Sec. 1115 (n)(4), printed promotional material shipped via common carrier, USPS, or a like delivery service is exempt from sales tax. The private delivery companies were found not to be common carriers or a "like delivery service" because the companies were not required to provide delivery services and instead were retained pursuant to a contract with negotiated terms, including rates, delivery schedules, and verification and reporting requirements. In contrast, the USPS did not operate under a contract, was paid standard rates, and made deliveries pursuant to standard delivery schedules. As such, only the deliveries made by the USPS meet the statutory requirements for the sales tax exemption and the refund on sales tax for the directories delivered via private delivery companies was properly denied. (*In the Matter of Yellow Book of New York, Inc. v. Commissioner of Taxation and Finance, et al.*, N.Y. S.Ct., App. Div., 3rd Dept., Dkt. No. 506697, 7/22/10)

Taxability of certain food items in supermarkets

A supermarket chain without areas for consuming food on premises questioned whether fudge, halva, maple sugar candy, sushi, and gift baskets containing food products would be subject to sales tax. Under Tax Law section 1105(a) fudge, halva, and maple sugar candy are taxable when sold since they are considered candy or confectionary products, while all other food products are exempt. Sales tax exempt items include sushi products that are sold for off-premises consumption because they are prepackaged food sold in an unheated state. Sushi is taxable when sold as meals ready to be eaten when arranged on plates or platters. Gift baskets that contain fruits, nuts, cheese, and other non-taxable products are also exempt from sales tax when sold, including the wrapper, bows, and gift cards since they are ancillary, and minimal in relation to the total cost of the food items. However, if a basket contains sugar-coated food items, then the whole basket would be deemed taxable unless the sugar-coated food items are separately stated and tax is applied to those food items (New York Advisory Opinion, No. TSB-A-09(54)S, 10/9/09)

N. PENNSYLVANIA

Taxation of professional employer organization's services

A Professional Employer Organization (PEO) which provides human resource services by placing client's employees on its payroll, allowing for competitive pricing and economies of scale, does not owe sales tax on the fees received for these services because the services don't fall within the definition of taxable "help supply services." To be considered "help supply services," two factors are required: (1) Be on the payroll of the supplying entity and (2) Be under the supervision of the business to which the help is furnished. The PEO has no supply of employees of its own and does not provide any new or additional employees to its clients. Instead, the client transfers its personnel to the payroll of the PEO, which then uses the client's employees to perform human resource functions for the client. It is the PEO that supervises the client's employees, not the client supervising the employees. In other words, the services provided by the PEO meet none of the statutory requirements of the definition of "help supply services." As such, the fees received for the services provided by the PEO are not taxable. (*All Staffing Inc. v. Commonwealth of Pennsylvania*, Pa. Commw. Ct., Dkt. No. 325 F.R. 2006, 1/5/10)

O. TEXAS

Taxation of temporary scaffolding

An oil company paid contractors to install temporary scaffolding at one of its refineries. While the Comptroller treated the installation as a taxable rental of tangible personal property, the company argued that the installation should have been treated as nontaxable services. The court deemed the transaction as a rental for tax code purposes and not attendant services because the possession of the scaffolding was transferred to the company. The key element of possession is operational control over the tangible personal property. Operational control over the scaffolding is exercised by whoever uses the scaffolding. In this case, the only people who used the scaffolding were the refinery's employees and maintenance contractors, which indicated that possession was transferred to the oil company's refinery. In addition, the essence of the company's scaffolding contracts was the rental to facilitate maintenance work, not the attendant services so the entire transaction is subject to tax. (*Combs v. Chevron USA, Inc.*, Court of Appeals of Texas, 3rd Cir., Dkt. No. 03-07-00127-CV, 4/9/10)

P. VIRGINIA

Taxability of printed materials delivered from out-of-state

A Virginia advertiser that provides direct mail marketing services for businesses in Virginia was found not liable for tax on the purchase of printed materials from an out-of-state printer. The company provides assistance in designing advertising postcards, identifying the target demographics, and in arranging for the production and mailing of the postcards. Out-of-state printers are contracted to print and mail by common carrier postcards to homeowners in Virginia. Under Virginia law, an advertiser is deemed the taxable user and consumer of tangible personal property used in providing its advertising services when the advertiser makes use of the property in Virginia. However, an advertiser is not subject to tax on the property simply by virtue of the fact that it is an advertiser – it must make use of the property in Virginia, which the advertiser here did not. Virginia overturned Virginia Public Document Rulings 05-10 (2/3/05) and 07-110 (7/19/07) to the extent they are inconsistent with the law and policy regarding the mailing of printed materials into Virginia from out-of-state. (Virginia Public Document Ruling No. 10-72, 5/18/10)

Storage of goods prior to transport to customer out of state

The taxpayer produces large format printing and displays which are delivered to the taxpayer's customers' distribution centers and remain in box kits until distributed outside of Virginia. Although the taxpayer contends that the goods were destined for foreign export and should be deemed to be delivery for use or consumption outside of Virginia, the Tax Commissioner found that the customers' possession and storage of the goods in Virginia prior to their transport outside of Virginia constitutes "use" for sales and use tax purposes. Further, the customers are not factors or export agents delivery to whom is necessary for the exemption to apply. Thus, the tangible personal property at issue is subject to Virginia sales and use tax prior to being used by the customers in other states. (Virginia Public Document Ruling No. 09-141, 9/29/09)

Q. WASHINGTON

Destination-based sourcing for the printing industry

The taxpayer appealed a ruling request on how the state treats purchased print jobs, paper and supplies within the printing industry. Under that ruling, sales of printed materials were held to be sourced to the location where the materials were delivered and that the distribution of printed material does not meet the definition of "direct mail." As such, taxpayers must source the sale of the paper and supplies to the location where the customer takes receipt of those items. In its appeal, the taxpayer argued there should not be a distinction between printing delivered by US mail or by its own delivery vehicles. The Department rejected that argument, pointing out that since the taxpayer does not deliver its printed material "by United States mail or other delivery service to a mass audience" the taxpayer must source the sales to the location where the property or services are received by the purchaser as addressed in the Streamlined Sales and Use Tax Agreement. (Washington Tax Determination No. 09-0203, 7/31/09)

Sales and use tax exemption for data center equipment and infrastructure

Effective April 1, 2010, Washington enacted a fifteen-month sales tax exemption for taxpayers building data centers within the state. The exemption covers sales tax charges for eligible businesses server equipment installation in an eligible computer data center and to charges made for services and labor rendered in respect to installing this equipment. A qualifying business must prove within six years of receiving the exemption that it has increased employment by 35 family wage jobs and must complete an annual report. Construction, renovation or expansion of a structure, as well as machinery and equipment purchased by the taxpayer or an affiliated person do not qualify for the exemption. In order for businesses to take advantage of the credit, an application must be submitted to the Department for a certificate. (L. 2010, SB 6789)

Manufacturer's natural gas purchases subject to use tax

The Washington Supreme Court held that a manufacturer's natural gas purchases from out-of-state brokers were subject to use tax because the manufacturer consumed the gas within the taxing authority's jurisdiction. The gas was delivered to the company's pipeline hubs in two Washington counties. The company then transferred the gas to its Tacoma plant to use for production and sales to third parties. The company argued that it initially took dominion and control of the gas outside of Tacoma city limits and that the term "use" is restricted to the first act of exercising dominion and control over the gas within the state. The court disagreed, finding instead that "use" includes consumption and the company consumed the gas at its Tacoma plant. Examining the legislative purpose of the statute, the court determined the use tax was intended to replace lost public utility tax revenue in light of federal natural gas deregulation, so the legislature gave cities the power to tax the use of natural gas rather than its sale, allowing them to tax revenues even when a user purchases from an entity other than a local distributor or utility. (*G-P Gypsum Corp. v. Dept. of Revenue,* Supreme Court of Wash., Dkt. No. 81995-5, 7/29/10)

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[i] Kim Buresh, Brenda Esquivel, Kristin Kramer, Aaron White, and Musab Zaidi of the Los Angeles office of WTAS LLC contributed to the preparation of these materials.