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April 10, 2015

The Honorable William Botzow, Chair
The Honorable Michael Marcotte, Vice Chair
Committee on Commerce and Economic Development
Vermont House of Representatives
115 State Street
Montpelier, VT 05633-5301

In Support of Cloud Tax Exemption Proposals in H. 124

Dear Chairman Botzow, Vice Chairman Marcotte and Members of the Committee:

Thank you for the opportunity to provide testimony in support of the proposal your Committee is considering regarding the exemption of remote access software from sales and use tax. My name is Mark Yopp and I am an attorney at the New York City office of the law firm of McDermott, Will & Emery. I have advised businesses with a multistate presence on emerging state and local tax issues in e-commerce for over seven years. I appear before you today as an expert on the state taxation of software and cloud services to express the technical and policy reasons to support the adoption of the proposed exemption.

Background

Since its inception in 1969, Vermont's sales and use tax has been broadly imposed on the retail sale or use of "tangible personal property." Historically the definition of tangible personal property was limited to physical goods, consistent with the economic landscape that existed at the time of the enactment of the tax. Until 2003, Vermont defined tangible personal property as "personal property which may be seen, weighed, measured, felt, touched, or in any other manner perceived by the senses."[1] In 2003, the Vermont General Assembly passed legislation to expand the definition of tangible personal property to include "electricity, water, gas, steam, and prewritten computer software."[2]

In September 2010, the Department of Taxes ("Department") issued a technical bulletin interpreting the imposition on prewritten computer software to encompass remotely-accessed

[1] *See* Vt. Stat. Ann. tit. 32, § 9701(7) (formerly stating that tangible personal property "shall not include rights and credits, insurance policies, bills of exchange, stocks and bonds and similar evidences of indebtedness or ownership").
[2] H. 480, 67th Biennial Sess., 2003 Vermont Laws Pub. Act 68.

software (frequently referred to cloud computing).[3] After nearly two years of attempted enforcement by the Department of Taxes, including assessments for liability extending as far back as 2006, in part in response to an outcry from the business community the General Assembly passed a moratorium in 2012 on the collection of sales and use tax on remote access software. That moratorium ultimately expired June 30, 2013. The Department issued a publication shortly after the expiration that expressed a continued desire to impose tax on remotely accessed software.[4] This publication expired after a year, prompting the Department to issue draft regulations governing cloud-based transactions in July 2014. The draft regulations maintained the sales and use tax imposition on remote access software and contained a list of criteria used to determine when a product was taxable. The criteria showed that there may be issues in determining when a product is taxable.

In response to feedback from the tax and business community during the proposed regulations comment period, Commissioner Mary Peterson publicly indicated at a Senate Finance Committee hearing in February that the Department concluded that remote access to software is a service, and not tangible personal property. As someone who has closely monitored the imposition of this tax, I applaud the Commissioner's position and encourage your Committee to codify and preserve it.

Discussion

It is important for the Vermont Legislature to codify the Commissioner's position. An opportunity to do so is before your Committee in H. 124. Language can be added to this bill that would provide clarity and certainty to the business community regarding the taxation of remote access to software.

I. A Cloud Tax Exemption Promotes Economic Development in Vermont

A recent survey suggests that over 75 percent of businesses have integrated cloud computing into their operations, making it an increasingly important consideration for most businesses.[5] Passing a cloud computing exemption will distinguish Vermont from nearby states like Massachusetts and New York that currently tax these cloud services.

Vermont can gain an advantage over states in attracting cloud computing businesses by enacting an exemption for remotely accessed software. Because the Commissioner has already

[3] Vt. Technical Bulletin 54, Treatment of Computer Software and Services (issued Sept. 13, 2010), withdrawn June 30, 2013.
[4] Vt. Pub. FS-1001 (issued June 30, 2013), expiring on June 30, 2014.
[5] North Bridge Business Wire, "2013 Future of Cloud Computing Survey Reveals Business Driving Cloud Adoption in Everything as a Service Era; IT Investing Heavily to Catch up and Support Consumers Graduating from BYOD to BYOC" (Feb. 18, 2014).

stated that she will take this position, Vermont can gain more visibility for the exemption by codifying it in legislation.

An exemption benefits Vermont businesses. Because the United States Supreme Court has not abandoned the physical presence nexus standard in the context of sales and use taxes, Vermont can only impose the cloud tax on providers with *some* physical presence in the state.[6] Given that many technology-based companies are located entirely outside Vermont, customers are only taxed when they buy from companies that have presence in Vermont. An exemption will ensure that in-state companies do not have a higher tax burden than out-of-state companies.

Furthermore, an exemption would benefit businesses that purchase cloud computing. Businesses are increasingly relying on these services to run their businesses. If there is no exemption, then Vermont companies would be required to pay tax, while their competitors in other states where cloud computing is not taxable would not have to pay tax. This would create a disadvantage for Vermont businesses.

II. The Options for Exemption Language.

A. S. 97

On February 27, the Senate passed S. 97. A companion bill is currently within the House Ways and Means Committee. As passed by the Senate, this bill states that for purposes of the definition of tangible personal property, "[c]harges for the right to access and use prewritten software run on underlying infrastructure that is not managed or controlled by the purchaser or any related company shall not be considered tangible personal property." This language is a good first step to establish the exemption, but it can be improved. Specifically, the "managed or controlled" language is not commonly used in sales and use tax provisions, and as such, could be misinterpreted. The "managed and controlled" language is not necessary for the exemption, and its inclusion could lead to unintended consequences. For instance, some could argue that a user of cloud computing services has some level of control or ability to manipulate (and therefore manage) the software.

B. H. 146

A separate bill, H. 146, was recently introduced and would provide a direct exemption from sales tax for "prewritten computer software accessed remotely." This language is also a good step towards an exemption, but can be improved. Providing a direct exemption, rather than a definitional provision, does not support the reasoning advanced by the Commissioner and leaves open the possibility that remote access to software is tangible personal property, just an exempt form of tangible personal property. The statute would be less ambiguous if the exemption arises by means of the definition rather than an exemption.

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[6] *See Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904 (1992).

C. Alternative Language

I would recommend alternative language, which would state: "Charges for the right to remotely access prewritten software shall not be considered charges for tangible personal property under 32 V.S.A. § 9701(7)." This language provides the clear exemption that the business community is seeking while also providing language that is consistent with the Commissioner's reasoning. This language is clear and unambiguous, and will ensure that remote access to software remains exempt, even if a future commissioner does not agree with the current Commissioner's position on whether remote access to software is tangible personal property.

Conclusion

I urge your Committee to exempt remote access to software from sales and use tax as part of H. 124. The General Assembly should ensure the Commissioner's position to not tax cloud computing is codified and preserved for future taxpayers. Clarifying that remotely accessed software is not tangible personal property will ensure that in-state businesses are not disadvantaged compared to their out-of-state counterparts and will make Vermont a more attractive location for high-tech companies to locate than if it taxed such transactions. Thank you for your time.

Respectfully,

Mark W. Yopp

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