Sales tax on prewritten software

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Current Vermont law

- The sales tax applies to the retail sale of tangible personal property

- Tangible personal property includes prewritten software

  - 32 VSA 9701(7)"Tangible personal property" means personal property which may be seen, weighed, measured, felt, touched, or in any other manner perceived by the senses. "Tangible personal property" includes electricity, water, gas, steam, and prewritten computer software.

What are we talking about

Prewritten software

- Purchased on storage media in Vermont = taxable

- Downloaded to a computer in Vermont = taxable

- Accessed remotely via the internet = not taxable

How did Vermont get there?

Streamlined Agreement

- Has definitions for "tangible personal property", "prewritten software", "delivered electronically", "load and leave"

- Permits states to exempt prewritten software "delivered electronically" or by "load and leave"

- Vermont regulations currently include these definitions and a number of other related definitions

VT Regulations 1.9701(7)-2

- **"Prewritten computer software"** means computer software, including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more prewritten computer software programs or prewritten portions thereof does not cause the combination to be other than prewritten computer software. Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the specific purchaser. Where a person modifies or enhances computer software of which the person is not the author or creator, the person shall be deemed to be the author or creator only of such person's modifications or enhancements. Prewritten computer software or a prewritten portion thereof that is modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software; provided, however, that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute prewritten computer software.

Current Vermont law

- In 2010, the Tax Department issued a technical bulletin to collect the sales tax on prewritten software accessed remotely.

- In Act 51 of 2015, a session law exemption was created so the sales tax on prewritten software accessed remotely is not currently collected.

Other terms

"Software as a Service" ("SaaS"), "Infrastructure as a Service"("IaaS"), and "Platform as a Service"("PaaS")

- These terms are not uniformly defined in law (or in the computing industry:
  - SaaS is defined as a service provider hosting software application over the internet for a customer.
  - IaaS is defined as a service provider owning, maintaining, operating, and housing equipment (such as hardware, servers, network components, etc.) used to support a customer's operations, which the customer accesses via the internet in order to use the equipment.
  - PaaS is defined as a service containing elements of both IaaS and SaaS.

Big picture

- At least 33 states tax prewritten software accessed remotely

- 18 tax software as a service

- If Vermont's current exemption were removed, it is likely the language currently in regulation could be enforced with minor changes.

Example

- TurboTax
  - Someone wanting to do their taxes can purchase TurboTax in three ways:
    - 1) Buy the TurboTax disc and install it on their computer
    - 2) Download the TurboTax software on their computer
    - 3) Use TurboTax through the internet, without downloading or installing

- Right now, sales tax is applied to options 1 and 2, but not 3.
- Ending the exemption would mean option 3 is subject to sales tax.

Another example

- A small clothing store uses a website design template from Squarespace to design their website and to facilitate online orders.
- The "software" is the template and the payment processing functions
  - It is accessed and used remotely
- The store pays Squarespace to use this software remotely
- Ending this exemption would mean the store would pay sales tax on the subscription to Squarespace.
  - Squarespace would be required to remit to VT

Another example-cross-state

- A Vermont-based business operates a reservation software system

- A restaurant in New York purchases this software and uses it remotely.

- Does the Vermont business need to pay Vermont sales tax?
  - No, but the Vermont business would be required to collect New York sales tax and remit it to New York, so long as it matches their thresholds and they tax cloud services
  - Wayfair decision removes the physical nexus requirement.

Another example-cross state

- A New York company offers accounting software that businesses can access remotely

- A Vermont business purchases an annual subscription of this software and accesses it over the cloud

- Would sales tax be due?
  - Yes, and the New York company would be required to remit

How much money will this raise?

- $5-6 million in FY20
  - Based upon national data on software sales to consumers and businesses from the Bureau of Economic Analysis
    - Total sales of U.S. prepackaged software: $232 billion
  - Assumes that 30% of all software purchased by businesses and consumers is accessed remotely
    - US cloud service revenue: at least $50 billion and growing fast (Gartner Consulting)
    - 2015 estimate assumed 20%
  - Assumes a modest downward adjustment for compliance ramp up in first year.