

Sales and Use Tax on Prewritten Computer Software

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Vermont Statute

Vermont sales tax applies to the retail sale of tangible personal property, unless an exemption applies. [32 V.S.A. § 9771\(1\)](#).

- Tangible personal property includes prewritten software:
 - “**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**. [32 V.S.A. § 9701\(7\)](#).
- Unlike tangible personal property, charges for a service are generally not taxable, unless specifically enumerated. [32 V.S.A. § 9771](#).

Vermont Sales and Use Tax Rule

“**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. [...]” [Vt. Reg. § 1.9701\(7\)-2.](#)

- Canned or commercial off-the-shelf (COTS) software
- Definition comes from Streamlined Sales and Use Tax Agreement, which Vermont joined in 2007. The Agreement allows states to exempt prewritten software “delivered electronically” or by “load and leave.”

Vermont Session Law

2015 Acts and Resolves, No. 51, Sec. G.8 created a sales tax exemption for prewritten computer software, but only when accessed remotely.

Sec. G.8. PREWRITTEN SOFTWARE ACCESSED REMOTELY

Charges for the right to access remotely prewritten software shall not be considered charges for tangible personal property under 32 V.S.A. § 9701(7).

- Remote access to software is also referred to as “software as a service” or “SaaS”.

Summary of Current Law

Prewritten computer 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 here?

Legislative Context

- 2010: Dept. of Taxes issued a technical bulletin interpreting the law as imposing sales tax on prewritten computer software regardless of how accessed.
- [2012, Act 143](#), Sec. 52 imposed a moratorium on sales tax on prewritten computer software accessed remotely until July 1, 2013, and allowed refunds of tax paid from Jan. 1, 2007-July 1, 2013.
- 2013-2014: Dept. issued guidance outlining taxation/exemption of remotely accessed prewritten computer software, then circulated draft regulations for comment.
- [2015, Act 51](#), Sec. G.8 created a session law exemption for prewritten computer software accessed remotely.

Legislative Context

- [2019, Act 71](#), Sec. 23, required Dept. to do outreach and education for tech sector on industry responsibilities under current law and under a possible repeal of the exemption.
- [2021, S.53](#)
 - March 9, 2021: passed out of the [Senate](#).
 - April 16, 2021: House passed a [proposal of amendment](#).
 - Secs. 9-11 impose sales and use tax on “vendor-hosted prewritten computer software” and associated services that are accessed remotely; and
 - Sec. 12 repeals the 2015 exemption for prewritten computer software accessed remotely.
 - Subsec. 16(2) makes cloud changes effective on June 1, 2022.

Legislative Context

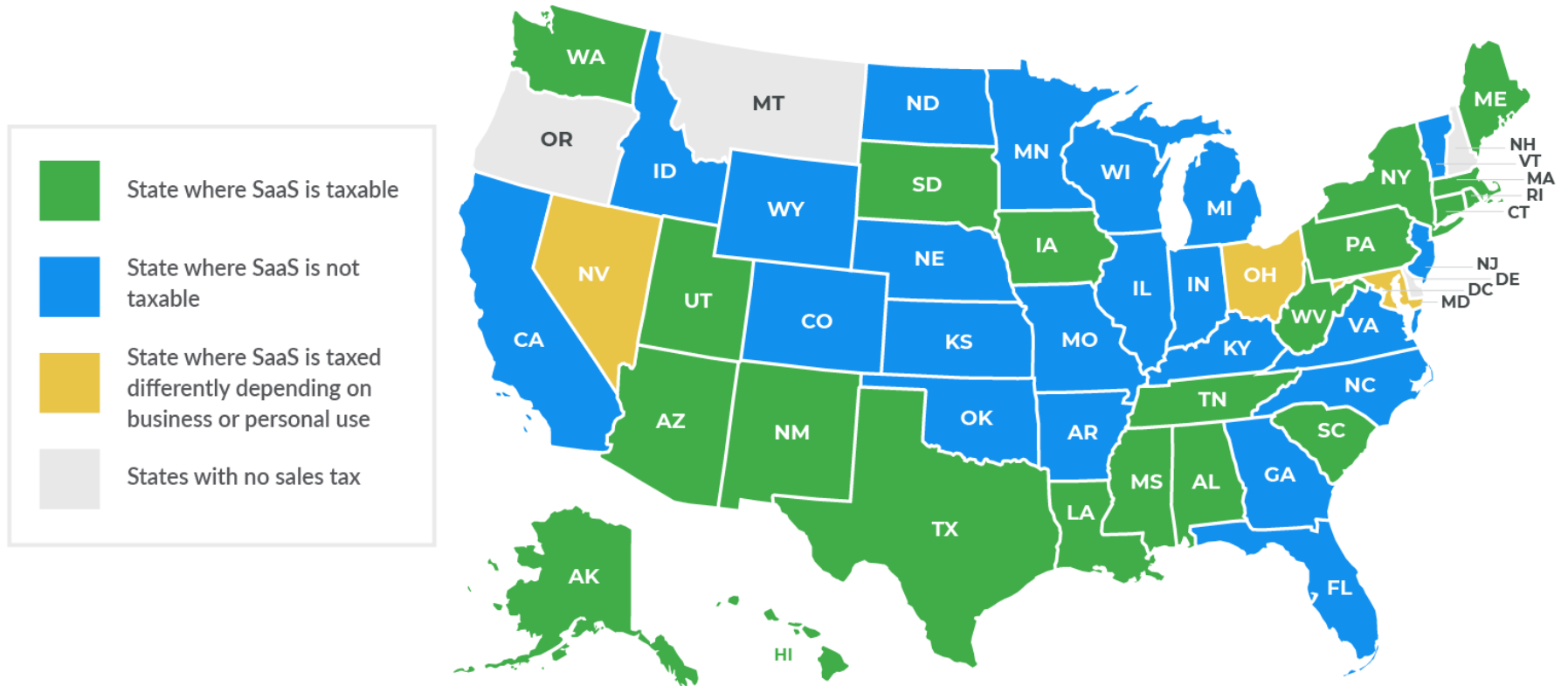
2021, S.53 House proposal of amendment

- “Vendor-hosted prewritten computer software” is defined as prewritten computer software accessed through the Internet or a vendor-hosted server or platform, including where possession of the software is maintained by the vendor or a third party. Sec. 9.
 - The definition applies regardless of:
 - the method of delivery or transfer of the software, including downloading;
 - whether the access is permanent or temporary; and
 - the type of charge for the right of access (per use, per user, per license, subscription, or on some other basis).
- Creates a new taxable category in addition to tangible personal property that applies to vendor-hosted prewritten computer software and the right to access that software to provide data processing services. Secs. 10-11.

Taxation of SaaS in Other States

- Most states tax or exempt prewritten computer software as a form of tangible personal property, like in Vermont.
- Treatment of remotely accessed software is determined differently in each state according to statute, case law, and administrative rulings.
- A handful of states, notably Iowa, Massachusetts, Rhode Island, and Washington, use broad language similar to S.53 to capture all different types of remotely accessed software, then carve out exemptions.
- States like Hawaii and New Mexico tax SaaS as a service.

Taxation of SaaS by State



Source: <https://blog.taxjar.com/saas-sales-tax/>

Note: Alaska does not have a state sales tax, but certain local jurisdictions do.

Taxation of SaaS by State

	22 States Tax	23 States Exempt	5 States ≠ Sales Tax
1	Alabama	Arkansas	Alaska*
2	Arizona	California	Delaware
3	Connecticut	Colorado	Montana
4	Hawaii	Florida	New Hampshire
5	Iowa	Georgia	Oregon
6	Louisiana	Idaho	
7	Mississippi	Illinois	
8	Maine	Indiana**	
9	Maryland**	Kansas	
10	Massachusetts	Kentucky	
11	New Mexico	Michigan	
12	New York	Minnesota	
13	Ohio	Missouri	
14	Pennsylvania	Nebraska	
15	Rhode Island**	Nevada	
16	South Carolina	New Jersey	
17	South Dakota	North Carolina	
18	Tennessee	North Dakota	
19	Texas	Oklahoma**	
20	Utah	Vermont	
21	Washington	Virginia	
22	West Virginia	Wisconsin	
23		Wyoming	

Bold = SSUTA full member states (23)

*State of Alaska does not impose a sales tax, but certain local jurisdictions do.

**Recent changes

Washington, D.C. and New York City tax SaaS

Other States: Recent Changes

- **Alabama:** eff. Jan. 2020, Alabama Supreme Court held that all software is tangible personal property and thus subject to sales tax. There is no distinction between canned or custom software. SaaS is taxable if bundled with purchase of software and downloaded.
- **Indiana:** eff. July 1, 2018, transactions involving the remote access of prewritten software over the internet, private or public networks, or through wireless media, are not considered to be delivered electronically, and so are not taxable.
- **Rhode Island:** eff. Oct. 1, 2018, vendor-hosted prewritten computer software is taxable.
- **Iowa:** eff. Jan. 1, 2019, vendor-hosted prewritten computer software (both custom and canned) is subject to sales tax whether delivered or accessed in physical form or electronically.
- **Maryland:** eff. March 14, 2021, canned or custom software, if obtained electronically, is a taxable digital product. SaaS is taxable, but exemptions exist for (1) custom computer software services and (2) a computer to be reproduced for sale or incorporated in whole or in part into another computer program intended for sale.
- **Connecticut:** eff. Oct. 1, 2019, electronically transferred software taxed at general rate of 6.35%, rather than reduced 1% rate.

Pre-Written Software Terms

“**Software as a Service**” (“SaaS”), “**Platform as a Service**” (“PaaS”), and “**Infrastructure as a Service**” (“IaaS”) are all currently exempt in Vermont.

- The terms are not uniformly defined in law, S.53 (or in the computing industry):
 - **SaaS** is when a service provider hosts software applications over the internet for a customer. It is also known as “cloud application services”.
 - **PaaS** is a service containing elements of both IaaS and SaaS. PaaS provides a framework for developers to build on and use to create customized applications.
 - **IaaS** is when a service provider owns, maintains, operates, and houses equipment (such as hardware, servers, network components, etc.) used to support a customer's operations. Customer accesses equipment over the internet and has complete control over the infrastructure.

Examples

Software as a Service (SaaS)

- TurboTax and Quickbooks
- Microsoft Office Online
- Dropbox
- Mail Chimp
- Google Apps (like Docs, Sheets, etc)
- Toast and Square

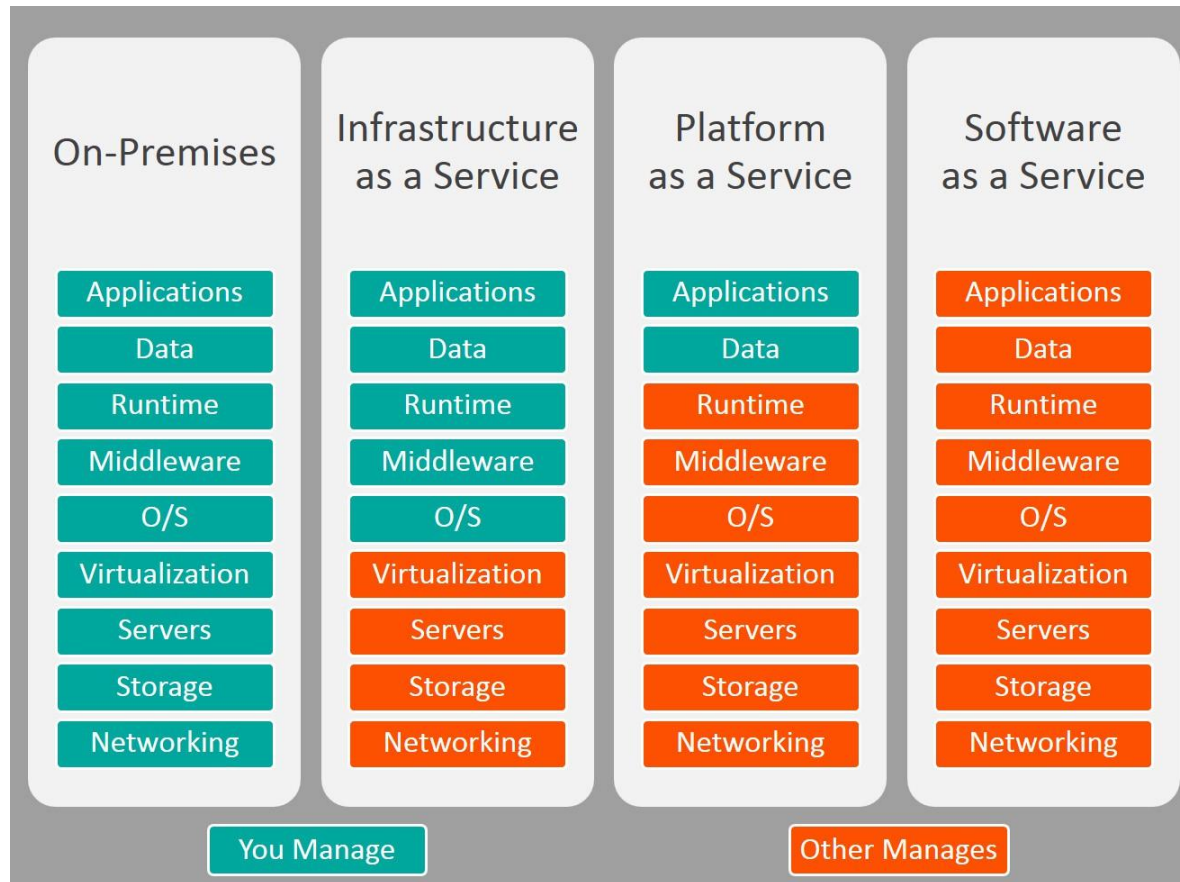
Platform as a Service (PaaS)

- Squarespace web design
- Force.com (as part of Salesforce)

Infrastructure as a Service (IaaS)

- Amazon Web Services
- Google Compute Engine

Differentiating Services



What happens in S.53?

- **All three types of vendor hosted computer software (SaaS, PaaS, and IaaS) become taxable under Vermont's 6% sales tax.**
 - Previous iterations of this have only targeted SaaS
 - Note: S.53 does not spell out specifically taxing each one of these types of software- rather, it has a broad definition of prewritten software accessed remotely (like Massachusetts, Washington, Rhode Island)
- Revenue impacts (as of May 2021)

S.53 Vendor Hosted Software Sales Tax Estimates						
Section	Provision	FY22	FY23	FY24	FY25	Effective Date
9-12	Sales Taxes On Cloud Software	-	\$10.9	\$12.3	\$13.9	Jun. 1, 2022
9-12	of which: SaaS	-	\$4.4	\$5.0	\$5.7	Jun. 1, 2022
9-12	of which: PaaS	-	\$3.8	\$4.3	\$4.9	Jun. 1, 2022
9-12	of which: IaaS	-	\$2.6	\$3.0	\$3.4	Jun. 1, 2022

- Data updates have historically increased estimates

Considerations for Legislators

Why apply the sales tax to this type of software:

- Tax currently applies if the software is purchased from a box
- State currently taxes other types of digital products similar to TPP (audio books, Netflix subscriptions, Zoom subscriptions).
- Ideally, sales tax bases should be broad and reflect the current economy
 - Modern economy uses significant vendor hosted computer software over the internet
 - Especially since beginning of COVID-19 pandemic, more and more software and services are moving online
- Post Wayfair decision, states have moved more into taxing this type of good
- Compliance costs not what they used to be with more and more states taxing this software, and companies like Avalara and TaxJar well versed in compliance.

Considerations for Legislators

Why not apply the sales tax to this type of software:

- The definitions of SaaS, IaaS, and PaaS not set in stone. Many products are a mix of two or all three.
 - How can a business know whether something it produces is taxable or not? Tax Department creates rules around taxability but complexity remains...
 - What about contracts where maintenance/service is bundled with software sale?
 - Typically, Tax Department requires itemization of taxable vs nontaxable sales.
- Compliance costs for small businesses that use or sell this type of software
- Taxation of intermediate goods for businesses
 - Software firms use this type of software a lot in the creation of their final product. Sales tax systems generally try to avoid taxation of intermediate goods.
 - In practice, sales taxes inadvertently tax intermediate purchases often.