

State Tax Considerations in Light of the Constantly Evolving Use of Technology

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Today, many states are trying to close large budget deficits and are looking for new ways to raise revenue. This is particularly true with respect to the sale or use of technology. Accordingly, many states have enacted rules expanding (1) the definition of "doing business" in their state and/or (2) services that are subject to sales tax. Two areas with significant legislative changes, and we expect there are more to come, are "Amazon"/remote seller nexus and "cloud computing."

"Amazon"/Remote Seller Nexus

Determining whether an entity was "doing business" within a state was once a seemingly straightforward endeavor, but the significant increase in online sales has created a new and more complex world. So-called "Amazon tax"/remote seller laws have perhaps been the most significant sales/use tax development in recent years. As online/remote sales continue to grow, states are looking for ways to ensure that tax is paid on the sale of taxable products and services made to purchasers in its state.

One of the largest online retailers, Amazon.com, has been at the center of this controversy, as many states have attempted to require that Amazon collect and remit sales tax on the retailer's sales in a specific state. In order for a state to require that a



taxpayer collect and remit tax, however, the taxpayer must have a physical presence in the taxing state. These new "remote seller" provisions have often used the remote seller's relationships with local online advertising affiliates to create this taxable presence, also called "affiliate" or "click-through" nexus. This has led to the remote seller's decision to terminate these relationships in many of the states adopting "remote seller/affiliate nexus" rules which, according to the affiliates and their supporters, caused job loss and decreased business revenue.

Another version of "remote seller" nexus is described as "related entity"

nexus. A number of states have taken the position that the existence of common ownership between a corporation that has a physical presence in a taxing state (e.g., an in-state "brick-and-mortar" retailer) and an out-of-state corporation that has no physical presence in the state but makes substantial sales into the state (e.g., an out-of-state mail-order vendor) is sufficient to create constitutional nexus for the out-of-state affiliate. For example, a retailer that does not collect Colorado sales tax (the "remote retailer") and is a member of a controlled group of corporations, which also contains a retailer with a physical presence in

Colorado (the “in-state retailer”), is presumed to be doing business in-state at a level sufficient to require collection of Colorado sales tax. The remote retailer must register with the department and collect Colorado sales tax.

Currently, 19 states have officially adopted some form of remote seller nexus provision, each with their own effective date and many with state-specific nuances. In some instances, these remote seller laws have been challenged and in two cases have

been declared unconstitutional. Significantly, these rules can apply to all remote sellers (e.g., taxpayers simply shipping goods into a jurisdiction), not just those selling over the internet, a point of which many taxpayers are not aware. States with some form of “remote seller” rule include:

STATE	TYPE OF AFFILIATE NEXUS PROVISION	EFFECTIVE DATE	STATUS/COMMENTS
Arkansas	Related-entity	07/27/2011	
	Click-through	10/25/2011	
California	Both	01/01/2013	If Federal law is enacted by 7/31/12
	Both	09/15/2012	If Federal law is not enacted by 7/31/12
Colorado	Related-entity	03/01/2010	Reporting requirements declared unconstitutional by U.S. District Court on 03/31/12
Connecticut	Click-through	05/04/2011	
Georgia	Click-through	01/01/2013	
Hawaii	Both	07/01/2012	Passed by House. Will take effect if HI does not enact a law based on Federal law by 06/30/2013
Illinois	Click-through	N/A	Declared unconstitutional by Illinois Circuit Court
Kansas	Both	07/01/2012	Passed by Senate, yet to be signed and enacted
New York	Click-through	06/01/2008	
North Carolina	Click-through	07/01/2009	
Oklahoma	Related-entity	07/01/2010	
Pennsylvania	Both	Always	Pennsylvania has always believed that both affiliate nexus provisions have created nexus within the state
Rhode Island	Related-entity	10/01/2011	
	Click-through	07/01/2009	
South Dakota	Related-entity	07/01/2011	
	Click-through	07/01/2011	Retailers must notify customers that use tax is due from online purchases
Tennessee	Related-entity	03/26/2012	
Texas	Related-entity	01/01/2012	
Utah	Related-entity	07/01/2012	
Vermont	Click-through	Open	Effective when 15 or more states adopted same type of click-through nexus provision
Virginia	Related-entity	09/01/2013	

The potential tax at risk can be substantial and it is understandable why states are trying to create a sales tax collection obligation for remote sellers. For example, Amazon was issued a \$269 million tax bill for sales tax reportedly owed from 2005 to 2009 relating to sales to Texas customers. Also, it is clearly much easier for the states to collect tax from a single vendor as opposed to their millions of customers.

Some states (Nevada and Texas) have come to agreements with Amazon to allow the state to collect sales tax on revenue on Amazon's sales to the purchasers in the state. As part of the Texas agreement, Amazon will create jobs and make capital investments in the state beginning July 1, 2012. The Texas agreement will also void the tax assessment Texas billed to Amazon. In Nevada, where Amazon already has a warehouse and employs residents, Amazon will begin collecting sales tax on and after January 1, 2014. New Jersey is also trying to lure Amazon to its state by giving a sales tax break until June 30, 2013, so long as Amazon makes capital investments and creates full-time jobs in New Jersey.

If states are to have remote seller nexus rules, there must be understandable, equitable guidelines for determining when a taxpayer has a taxable presence in a jurisdiction. Many advocates of remote seller legislation argue that requiring all remote sellers to collect tax will "level the playing field" for all retailers. Their position has some merit, but it is not an accurate statement. For example, while large remote sellers may have the infrastructure to collect and remit tax in the thousands of tax jurisdictions in the United States, we have seen, for other smaller businesses, that the cost of setting up systems to determine taxability, compute the tax due, and remit the tax far outweigh the potential sales, let alone the potential tax. Forcing sellers to not compete in a business because the significant cost of

compliance is not "leveling the playing field" for all retailers.

Today, there is a growing push for the passage of Federal legislation, with at least three potential bills introduced in 2011, which would allow the states to require remote sellers to collect and remit sales and use taxes. The enactment of disparate remote seller rules across the

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United States has a dampening effect on the U.S. economy at a time when we need to encourage, not stifle, business growth. The states and the Federal government must be careful not to so encumber small business with additional regulation that they discourage economic growth. Amazon is now behind this push for a uniform Federal rule, provided the threshold for exempting taxpayers from the collection requirement are kept very low. Significantly, taxpayers with low taxable sales are the ones needing protection.

Cloud Computing

Another component of our new complex world encompasses a special type of "outsourcing." Today, many businesses are looking to outsource various functions: payroll processing, HR administration, technology, etc. and we are seeing many states looking to expand their tax to include the outsourcing of certain information technology tasks (commonly referred to as "cloud computing").

Cloud computing involves the delivery of software, infrastructure, and storage over the internet, either as separate components or a complete platform, based on user demand. It allows individuals and businesses access to various programs using a web-based model, thus granting users greater access, mobility, memory, and efficiency.

In essence, many taxpayers are reducing their hardware and software expenditures, and are hiring third parties to perform many technology functions.

Accordingly, many states are attempting to revise their tax laws to include some form of cloud computing as a taxable item. This change typically involves the question of whether cloud computing

is considered by the taxing jurisdiction to be a software or a service. Software, for example, has historically been taxed as tangible personal property (even though most would agree that software is intangible property), with taxability often depending on whether the software is delivered electronically or via a tangible medium and whether the software is considered to be "canned" or custom.

If a jurisdiction taxes cloud computing, taxpayers must then consider where to source the service (e.g., where is the tax due?). Some states that tax "cloud computing" services source the service to the place from which it is accessed. New York, for example, taxes the sale of a license to use a taxpayer's software to a subscriber in New York based on the location associated with the license. If the subscriber's employees using the software are located both in and out of New York State, the taxpayer should collect tax on the portion of the receipt attributable to the employee users in New York. (*New York Advisory Opinion No. TSB-A-09(33)s*, 8/13/2009.) Also, Vermont has recently suspended its sales tax on cloud computing until January 1, 2014. Vermont will allow refunds for those taxpayers that paid the tax from December 31, 2006. Vermont established a commission to study the issue of cloud computing and its taxability.

Taxpayers looking to use some type of “cloud computing” service must be sure they understand whether such services will be taxable in their state and, if so, how the tax is determined. Tax on these services can be significant and should be part of any “buy” or “build” analysis undertaken by a taxpayer looking to change its technology infrastructure. ■



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