

**Baker
McKenzie.**

State Taxation of Digital Goods and Services

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Agenda

1 UPDATES

2 TAXABILITY

3 SOURCING

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RECENT UPDATES

Recent Updates

- Maryland
 - Governor Hogan vetoed HB 732 (digital advertising services) and HB 932 (expansion of sales tax to digital products).
 - Legislature out of session until potentially January; status of override unknown.
- New York
 - Legislature in session; may consider digital advertising services tax.
- *Wayfair* – Kansas and Missouri have still not acted.

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TAXABILITY

Citrix Systems, Inc. v. Commissioner of Revenue (MA)

- Are sales of online products allowing remote access to a host computer and certain screen sharing capabilities sales of services or sales of underlying software?
- Taxable Sales of Software
 - Taxable as a sale of prewritten computer software transferred electronically – access or use is enough
 - “True Object” of sales was to obtain access and the ability to use online software products and not to obtain a nontaxable service

Digital Taxability Expanded to New Frontiers

- What does the *Citrix* decision signify for MA taxpayers and, even, nationwide?
 - Expanding taxability to items not traditionally regarded as taxable when provided in an “automated” fashion
 - Level of human interaction
 - Continued importance of true object analysis

New York – Security & Protective/Detective Services

- Tax Law § 1105(c)(8)
 - First enacted in 1975 and virtually unchanged since that time
 - “Protective and detective services, including, but not limited to, all services provided by or through alarm or protective systems of every nature, including, but not limited to, protection against burglary, theft, fire, water damage or any malfunction of industrial processes or any other malfunction of or damage to property or injury to persons, detective agencies, armored car services and guard, patrol and watchman services of every nature other than the performance of such services by a port watchman licensed by the waterfront commission of New York harbor, whether or not tangible personal property is transferred in conjunction therewith.”
- New York TSB-A-15(47)S
 - Sales tax applies to Internet monitoring and DNS software

States Taking Different Views

- Broad
 - Washington's Digital Automated Services tax
 - Texas's "Data Processing Services"
- More Nuanced
 - Pennsylvania's Sales Tax
 - Beware of telecommunication classifications and specialized taxes

Level 3 Communications v. Pennsylvania

- A service that provided infrastructure, including local dial network and modems to ISPs that outsourced the remote access to their networks or the Internet, was not taxable in Pennsylvania as a telecommunication services because it was access to the Internet
- The court employed the following definition of Internet access: “a service furnished via an arrangement of physical transmission, routing and switching facilities, that utilize the TCP/IP protocol suite and that provide connectivity between individual end-users and the Internet”
- Internet Tax Freedom Act

Taxability of Internet Access

- Internet Tax Freedom Act
 - Prohibits taxation that discriminates against electronic commerce.
 - Also prohibited the taxation of internet access, but some existing taxes were grandfathered.
- The grandfather clause expires June 30, 2020
 - Affects Hawaii, New Mexico, North Dakota, Ohio, South Dakota, Texas, and Wisconsin
 - States forced to make up lost revenue
 - Texas estimates a revenue hit of approximately \$350m per year

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SOURCING

Be Mindful of Sourcing

- Sourcing of Contracts
 - Location Important
- Be Precise in Contractual Language
 - Can open the door for taxability in unanticipated jurisdictions

Sourcing Update – Texas

- Texas Comptroller had adopted amended regulations under 34 Tex. Admin. Code § 3.334
 - Clarifies that local sales tax is tied to the place of business from which internet orders are fulfilled or the location to which items are shipped or delivered
 - Businesses previously interpreted statute to mean internet orders were “fulfilled” at certain locations in the state, many times receiving incentives from those local jurisdictions to create a presence in that jurisdiction for sales tax purposes
 - Other localities did not receive sales tax revenue for products delivered to addresses in those localities
 - Effective May 31, 2020



Questions

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