KBF
CERTIFIED PUBLIC ACCOUNTANTS

SALES AND USE TAX NEWSLETTER

1st Quarter 2023 Edition

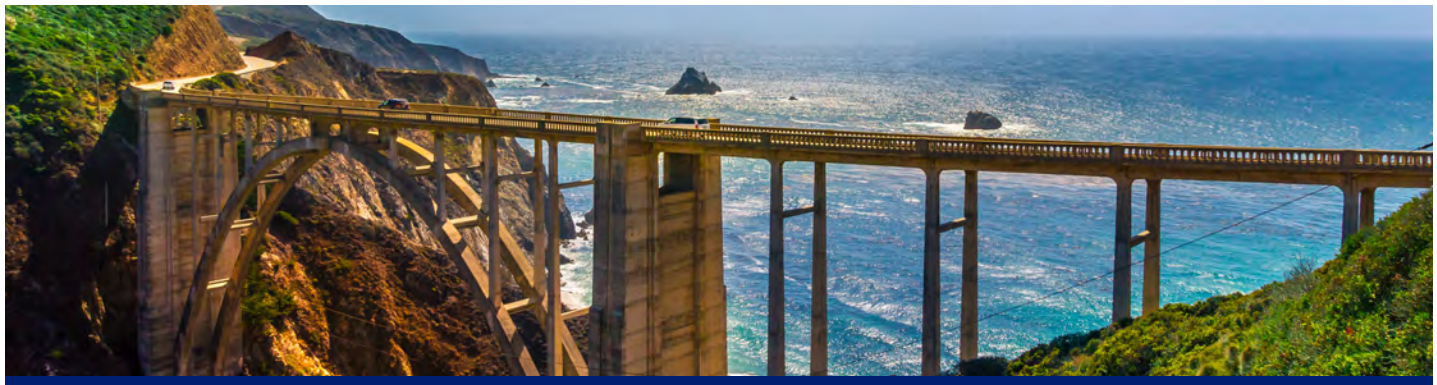
KBF's quarterly newsletter updates clients on sales and use tax news, developments, and trends from around the country.

ARIZONA

Arizona Appeals Court Re-Affirms State Position on Remote Software Licensing

The Arizona Court of Appeals ruled in favor of the Department of Revenue, rejecting a refund request from an HR software company that challenged the taxation of their sales of software licenses. In line with prior decisions published by the state, the court rejected the taxpayer's view that their software did not qualify as tangible personal property and reaffirmed the state's position that licenses to access cloud-based software are taxable as rentals of tangible personal property under Arizona's transaction privilege tax. The court rejected the taxpayer's attempt to define the software as an intangible good, clarifying that the court decision Honeywell Information Systems Inc v. Maricopa County only applied that definition for property tax purposes, and as the provision of a service, defining the taxpayer's customer's use of the software as exclusive use and control over their login to the software.

(ADP LLC v. Arizona Department of Revenue and City Of Phoenix, 1 CA-TX 21-0009, Arizona Court of Appeals, Division One)



CALIFORNIA

CA Appeals Court Sides with CDTFA And Amazon in Sales Tax Issue

The California Court of Appeal, Second Appellate District released a decision on January 9, 2023, confirming the CDTFA had the legal discretion to hold third-party sellers responsible for the sales tax due on sales made through Amazon. California has been seeking payment from out-of-state third-party sellers on transactions before mid-2019 in relation to goods sold through the Fulfillment by Amazon (FBA). Since the state is looking at sales that occurred before the ruling South Dakota v. Wayfair Inc., they need to establish a physical presence, which California claims is established by the storage of goods in Amazon's California fulfillment centers. The unpaid taxes on these sellers, California argued, can be staggering, and several of these third-party sellers have filed suits claiming that Amazon was the true retailer and should be held liable instead of them due to Amazon's control of the final sale and fulfillment of the goods. In this case, the plaintiff, Grosz, argued that FBA Amazon sales met the three requirements to be considered a consignment seller.

However, the CDTFA argued this regulation does not require any entity to be considered "the" retailer, merely that they consider entities as "a" retailer. The court decided that because of the CDTFA's power over sales and use tax, the case could not go any further, a decision plaintiff Grosz contended would make the legal merit of the CDTFA's decision unreviewable. The court ruled this was not true and pointed out Grosz could pursue his claims via a tax refund action or by filing suit against a collection action. In fact, in at least one similar case, Online Merchants Guild v. Maduros, filed in and dismissed from federal court, the parties have said they may appeal to the US Supreme Court after being rejected by the Ninth Circuit Court of Appeals in November 2022 due to the Tax Injunction Act.

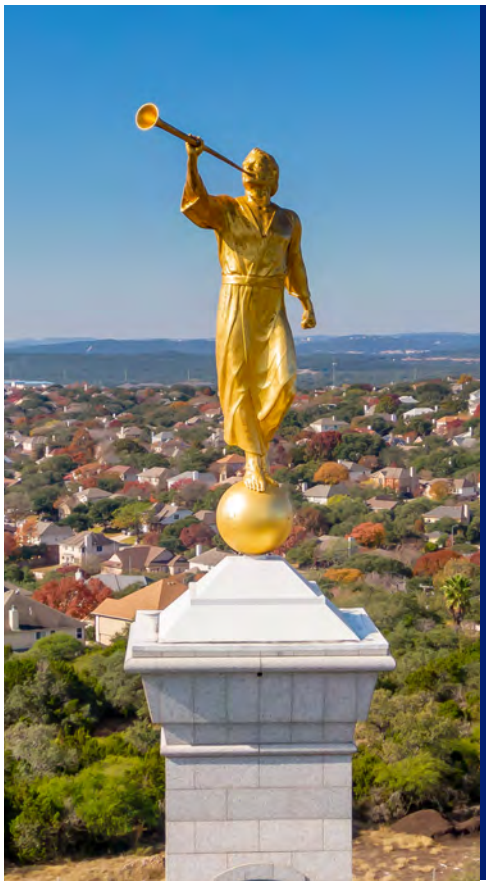
(Court of Appeal of the State of California, Second Appellate District. Stanley E. Grosz v. California Department of Tax and Fee Administration, Et Al. 9 Jan. 2023)

ILLINOIS

Illinois Issued a Letter Discussing Taxability of Various Digital Goods

The Illinois Department of Revenue issued a general information letter encompassing the applicability of sales and use tax to the sales of various digital goods by a digital goods distributor (taxpayer). The applicable statute considers a provider of software-as-a-service a serviceman. If a provider is transferring an API, applet, desktop agent, or remote access agent to enable the customer to access the provider's network and services, the customer is receiving computer software that is subject to tax.
On the other hand, if a provider does not transfer any tangible personal property to the customer, then the transaction generally would not be subject to retailers' occupation tax, use tax, service occupation tax, or service use tax. For example, computer software that is provided through a cloud-based delivery system, where the software is never downloaded onto a client's computer and is only accessed remotely, is not subject to tax.

(General Information Letter ST 22-0027-GIL, Illinois Department of Revenue, December 2, 2022, released February 2023)



MASSACHUSETTS

Massachusetts Supreme Court Rejects Retroactive Wayfair Application

The Massachusetts Supreme Judicial Court has rejected the Mass Department of Revenue's attempt to apply its 'cookie nexus' regulation to pre-Wayfair periods and upheld the Appellate Tax Board's (ATB) ruling that activities outlined in the regulation do not constitute physical presence under the Quill nexus rule. Because of the Court's limited discussion of the technical functioning of website 'cookies' and 'apps,' the decision may not be helpful in considering whether such a 'virtual presence' might constitute in-state business activity for income tax purposes under P.L. 86-272.

(U.S. Auto Parts Network, Inc. v. Commissioner of Revenue, Mass., SJC-13283, 12/22/22)

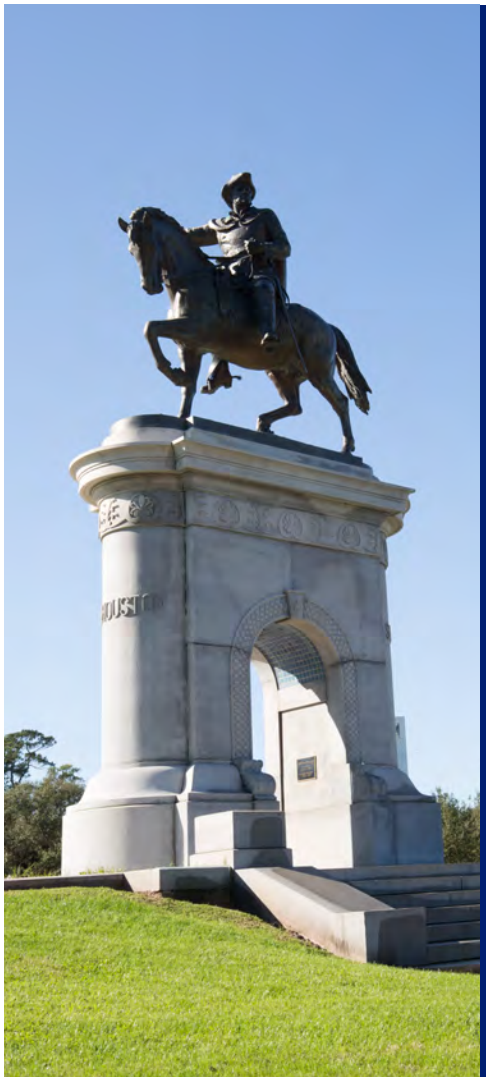
NEW YORK

SaaS Provider's Vendor Management System Fees are Deemed Taxable Software Licensing

In a case involving a taxpayer assisting large companies with gathering, organizing, assembling, and managing their contingent labor force, an administrative law judge (ALJ) with the New York Division of Tax Appeals held that the taxpayer's charged vendor

management system (VMS) fees constituted taxable licensing of prewritten software via a bundled transaction rather than nontaxable consulting services. In doing so, the ALJ noted that the taxpayer's VMS software is "anything but incidental to the entire bundled package being sold," and that even its website highlights how important and intertwined the VMS software is to its final product because the software streamlines, automates and integrates the entire bundle of services as a "web-based application delivered through a software-as-a-service model." Despite the taxpayer's assertions to the contrary, the ALJ reasoned that the taxpayer's ultimate goal is to provide customers a seamless, automated, and efficient system of fulfilling and monitoring their temporary employment needs, which requires utilization of the software technology license, and that separating the software component from the remaining services it offers "would appear to greatly diminish the value of the ultimate product customers purchased."

(https://www.dta.ny.gov/pdf/determinations/829516.det.pdf Determination DTA No. 829516, N.Y. Div. of Tax App., ALJ Div. 2/9/23)



TEXAS

Taxability of Credit Ratings

The Texas Comptroller of Public Accounts Feb. 17 issued guidance on the taxability of credit rating services for legal entities and debt obligations, for sales and use tax purposes. The guidance includes that: 1) credit reporting services are listed as a taxable service; 2) credit ratings of legal entities are taxable as a credit reporting service; 3) charges to assign a credit rating for a debt obligation are for the evaluation of a financial instrument and don't constitute the assembling or furnishing of credit information of a person; 4) credit ratings of debt obligations aren't taxable; and 5) sellers of credit rating services are required to collect sales and use tax.

(Tex. Comptroller of Pub. Accts., Comptroller's Memo, Accession No. 202302004L, 02/17/23)

WISCONSIN

StubHub Liable for $8.5 Million in Wisconsin Back Sales Taxes

The ticket reseller StubHub Inc. is liable for nearly $8.5 million in unpaid Wisconsin sales taxes the state Tax Appeals Commission ruled. In an opinion examining StubHub's tickets sales between 2008 and 2013, the commission said the essential question is "whether StubHub sold tickets for admission to entertainment or athletic events at retail in Wisconsin on its online marketplace, and whether StubHub is thereby liable for the sales tax." The commission rejected StubHub's assertion that it should be viewed essentially as an "open-air market" for ticketholders and buyers. The commission ruled that StubHub is a seller providing the service of selling taxable admissions at retail. StubHub is entitled to either a rehearing before the commission or judicial review.

(StubHub Inc. v. Wisconsin Dept. of Revenue, Wis. Ct. App., No. 16-S-268, ruling and order 2/28/23)

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