KPMG

# State and Local Tax Technology Checklist

Guidance from the third quarter of 2022

## Announcing the Latest "Techlist": Guidance from the Third Quarter of 2022

To make recent state and local tax developments related to technology more accessible to our clients, Washington National Tax–SALT has compiled a technology checklist (Techlist) that summarizes state guidance issued during the third quarter of 2022. Topics covered include access to Web-based services, telecommunication services, and data processing. Highlights include:

**Maryland:** The Maryland legislature enacted two identical bills intended to serve as technical corrections to a previously enacted law extending sales and use tax to a wide range of digital products. The new legislation clarifies that certain enterprise software and digital marketing products are exempt from sales tax.

**Maine:** A telecommunications provider was not subject to the state's prepaid wireless fee but was properly subject to the state's service provider fee. Despite the taxpayer's Lifeline program having some hallmarks of a prepaid plan – such as no monthly billing relationship with customers – there was no indication that the taxpayer received federal subsidies as payment in advance of its provision of services. Therefore, the taxpayer was not subject to the prepaid wireless fees. The court did find that the taxpayer was subject to the service provider tax because the tax was applicable to the value of telecommunications sold in Maine even if the taxpayer received consideration from a third party.

**Massachusetts:** The Department of Revenue issued a Technical Information Release (TIR) addressing the Massachusetts Supreme Judicial Court's decision in *Oracle USA, Inc. v. Commissioner*, concerning the apportionment of sales tax for software purchased by a taxpayer for use in multiple states. The TIR states that in addition to the apportionment process set forth in the Department's regulations, a taxpayer may also apply for an abatement of sales and use tax.

**Virginia:** The Virginia Supreme Court approved a taxpayer's refund claim contending that Fairfax County's Business and Professional Occupational License (BPOL) tax was preempted by the Internet Tax Freedom Act (ITFA). The court ruled that ITFA applied to the tax and that the tax was not rescued by ITFA's grandfather clause.

We will continue to publish the Techlist on a quarterly basis to help keep clients apprised of important developments. If you have any questions about the Techlist, please contact Audra Mitchell or Reid Okimoto.

| State | Category | Development | Authority |
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| Illinois | Access to Web-Based Content, Services or Software | In an update to the *Apple Inc. v. City of Chicago* case, the city of Chicago and the taxpayer agreed the taxpayer will dismiss its lawsuit against the city and collect the city's amusement tax on streaming entertainment services provided to Chicago-based customers. In turn, Chicago agreed to hold the taxpayer harmless for not collecting amusement taxes on certain streaming services provided to Chicago-based customers for prior periods. | Agreed Dismissal Order (entered July 20, 2022) |
| Virginia | Access to Web-Based Content, Services or Software | The Virginia Supreme Court reversed a lower court ruling and approved a taxpayer's refund claim contending that Fairfax County's Business and Professional Occupational License (BPOL) tax was preempted by the Internet Tax Freedom Act (ITFA). The taxpayer, a communications provider, had been denied a BPOL tax refund claim by the lower court on the basis that the tax was not preempted by ITFA, and even if ITFA applied, the County was entitled to protection under ITFA's grandfather clause, as the taxes related to periods where the clause was still in effect. On appeal, the supreme court held that because the BPOL tax is imposed on every business in the county, and the tax was used to raise revenue for general purposes, the BPOL tax is a "tax" as defined under ITFA. On the issue of whether the BPOL tax was a tax on internet access, the court held that as a tax on gross receipts, including receipts from providing internet access, ITFA applied to the BPOL tax. Under ITFA's grandfather clause, a provider of Internet access must have had a reasonable opportunity to know, by rule or public proclamation made by the appropriate administrative agency of a state or political subdivision, that such agency will apply their tax to Internet access services. The court found that the County and the Board of Supervisors of Fairfax County were not administrative agencies of Fairfax County and that their publication of the ordinance of the BPOL tax did not satisfy the requirement that the "County agency responsible for the interpretation and collection of taxes has interpreted and will apply the BPOL tax to internet access services." Here, although the county ordinance was published, no public proclamation was made clarifying the meaning of the ordinance and that it applied to Internet access service. The court further held that Fairfax County failed to show that it "generally imposed and actually enforced" the BPOL tax on internet access services. | *Coxcom, LLC v. Fairfax County* (opinion dated July 14, 2022) |

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| Massachusetts | Apportionment | The Massachusetts Department of Revenue issued a Technical Information Release (TIR) addressing the Massachusetts Supreme Judicial Court's (SJC) decision in *Oracle USA, Inc. v. Commissioner*. The key issue in *Oracle* was whether a purchaser of software that was to be used in more than one state was required to issue a certificate indicating it would assume responsibility for apportioning and paying the tax to Massachusetts and the other states in which the software was used at the time of purchase as required under the Commissioner's regulation, or whether the purchaser could subsequently apportion the tax based on use and seek a refund through the general abatement process. The SJC held that a purchaser was not limited to the apportionment process set forth in the regulation and a taxpayer's noncompliance with the regulations did not preclude apportionment through the abatement process. The TIR states that *Oracle* addresses the general procedure for claiming a tax abatement with respect to software transferred for multi-state use but does not address specific methods of apportioning the sales or use tax on such transfers. As such, taxpayers are advised to continue to follow the apportionment process set forth in the regulations but may also apply for an abatement of sales and use tax. The Commissioner will generally accept an apportionment method based on the number of licensed users in a particular state; however, based on the specific facts, other methods may also be considered reasonable. The method used must accurately reflect actual use, or a reasonable approximation of use, of the software in the Commonwealth. The chosen method must be consistent and uniform and supported by the taxpayer's books and records. The TIR cautions that the burden of proving that the apportionment method meets the reasonableness requirements will fall on the taxpayer. | Massachusetts DOR TIR 22-8 |
| Washington | Data Center Exemption | The Washington Department of Revenue issued a special notice on June 9, 2022, informing qualified businesses and tenants that they can apply for a sales and use tax exemption certificate for purchases of eligible server equipment and eligible power infrastructure for a data center located in a nonrural county. The exemption also applies to labor and services required to construct or install the equipment or infrastructure. Applicants must submit an "Application for Sales Tax Exemption for Purchases by Data Center" to the Department. The Department can only approve six applications in the first calendar year and an additional six each year in years three through six of the exemption. The exemption is available on a first-in-time basis. | Special Notice (June 9, 2022) |

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| Texas | Data Processing | The Texas Comptroller provided guidance on the taxability of an online learning platform's products, including subscriptions to a "teacher plan" and an online lead generation service. The taxpayer operated an online learning platform that offered thousands of on-demand digital courses through different learning plans, and the taxpayer requested a letter ruling from the Comptroller on the taxability of the learning plans. The taxpayer's "teacher plan" allowed its users to store, retrieve, and compile data and information relating to lessons for students; specifically, the plan included customizing lessons, scheduling instruction, assigning homework and assessments, and maintaining and tracking student grades. The Comptroller ruled that these functions were elements of a taxable data processing service and therefore subject to tax with a twenty percent exemption from the sales price. Similarly, the taxpayer's online lead generation service, referred to as "insertion orders," involved the gathering and forwarding of prospective students' information to universities who paid for marketing leads. For these services, the Comptroller held that they qualified as taxable information services, also eligible for a twenty percent exemption from the sales price. | STAR: State Automated Tax Research for the State of Texas |

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| New York | Other | The New York State Department of Economic Development adopted an emergency rule for administration of the Digital Gaming Media Production Tax Credit Program, which was enacted with the 2022 budget and will run from January 1, 2023 through December 31, 2027. Digital gaming media production entities engaged in qualified digital gaming media production shall be allowed a 25 percent tax credit on qualified expenses. In addition, qualified entities shall be allowed an additional 10 percent tax credit for qualified digital gaming media production costs incurred and paid outside the metropolitan commuter transportation district in New York. Entities engaged in qualified digital media production must have a minimum of $100,000 in total production costs with 75% of those costs incurred and paid by the applicant for work performed and/or services rendered in New York. Eligible expenditures include: (1) wages or salaries paid to individuals, excluding actors or writers, directly employed in the creation of digital gaming media production or productions and (2) payment for services performed in digital game media productions predominantly in the development, design, production, editing and composing of digital gaming media. Certain expenditures such as distribution, marketing, promotion, or advertising content are excluded expenditures as well as executive staff salaries when the eligible company has more than ten (10) employees. Finally, a maximum of $4,000,000 in qualified costs per project may be used in the calculation of the tax credit and costs may not include those used by the taxpayer or another taxpayer as the basis of any other tax credit allowed under New York tax law. | Emergency Rule for the Empire State Digital Gaming Media Production Tax Credit Program |

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| North Carolina | Other | The North Carolina Department of Revenue ruled that the sale of optional Helpdesk technical support was a taxable service contract. The taxpayer at issue provided Information Technology as a Service (ITaaS) to businesses. Customers could opt to purchase "Helpdesk services" to assist users in resolving service interruptions to the taxpayer's ITaaS platform. The ruling noted that the Helpdesk feature was not intended to monitor, repair, or maintain customer's routers or customer-owned devices. Nevertheless, the Department determined that the taxpayer was performing a service contract. Notably, the taxpayer may at times be obligated to troubleshoot its customer's network infrastructure by power cycling a customer's router to reestablish a connection with the taxpayer's ITaaS services. The diagnostic procedure of power cycling in certain instances will reload a router's operating system and other software, clear the router's memory, reinitialize the router's configuration, and may resolve issues with dynamic IP address conflicts. Based on these and other facts, the Department ruled that the Helpdesk services met the definition of a taxable service contract. | NC SUPLR 2022-0004 |
| Maryland | Taxability of Software | The Maryland legislature enacted two identical bills concerning software and digital products that the governor allowed to become law without his signature. The legislation served as a technical correction to the previously enacted HB 932 (2020), the 21st Century Economy Fairness Act, which extended the sales and use tax to a wide range of digital products. The new legislation clarifies that certain enterprise software and digital marketing products are exempt from sales tax. A taxable "digital product" does not include computer software or software as a service purchased or licensed solely for commercial purposes in an enterprise computer system, including operating programs or application software for the exclusive use of the enterprise software system, that is housed or maintained by the purchaser or on a cloud server, whether hosted by the purchaser, the software vendor, or a third party. A taxable "digital product" also does not include a product where the purchaser holds a copyright or other intellectual property interest in the product, in whole or in part, if the purchaser uses the product solely for commercial purposes, including advertising or other marketing activities. | Maryland HB 791 (2022) |

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| California | Telecommunications Services | The California Office of Tax Appeals (COTA) denied a taxpayer's sales tax protective refund claim and petition for redetermination contending that certain receipts represented nontaxable commissions rather than the sale of cellphones. The taxpayer was a retailer that sold cellphones and activated the cellular service provider's telephone service on the cellphones it sold. Prior to January 2010, the taxpayer derived its money exclusively from the sale of cellphones. In January 2010, the cellular service provider created a new marketing plan that lowered the price of their cellphones and eliminated the practice of giving subscribers the first month of service free of charge. To incentivize the taxpayer to continue selling its phones at a discounted price, the cellular service provider paid the taxpayer a commission consisting of the discounted price of the cellphone and an amount equal to the customer's first monthly reoccurring charge. In an audit of the taxpayer, the CDTFA found that the cellphone commissions should be included in the taxpayer's taxable receipts. On appeal from the taxpayer, the COTA agreed with the CDTFA's findings that the commissions were compensation for the taxpayer's sale of cellphones and were thus subject to sales tax. | *In re Appeal of 1 Stop Communications, LLC* (opinion dated July 15, 2022) |

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| Georgia | Telecommunication Services | The Georgia Court of Appeals reversed a denial of a taxpayer's sales tax refund claim that certain equipment qualified for the state's high-technology ("high-tech") exemption. The high-tech exemption provides that the sales and use tax shall not apply to the sale or lease of computer equipment to be incorporated into a facility in Georgia to any high-technology company where such sale of computer equipment for any calendar year exceeds $15 million. Georgia defines "computer equipment" to exclude "telephone central office equipment or other voice data transport technology." The taxpayer invested in a new broadband LTE network which provided customers with high-speed capacity and bandwidth for all data sessions such as internet, smartphones, texting, streaming and social media. The taxpayer's LTE network was initially only an internet protocol-based data network with no voice switching capabilities. Over time, configurations to the LTE network enabled a small amount of voice transmission over the network but 98.8 percent of the traffic over the network was still data. The Georgia Tax Tribunal found that the LTE network was designed from the beginning as a data network not intended for voice transmission. The trial court, reviewing the Tax Tribunal, held that all equipment at issue was excluded voice data transport technology, finding that the LTE network was intended to permit voice calls. The appellate court reversed the trial court, holding that the trial court had erroneously disregarded the Tax Tribunal's factual findings and substituted its own. The appellate court remanded the case to the trial court for consideration under the proper standard of review. | *T-Mobile South, LLC v. Crittenden* (opinion filed June 28, 2022) |

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| Maine | Telecommunication Services | The Maine Supreme Judicial Court determined that a taxpayer's telecommunication service was not subject to the state's prepaid wireless fee but was properly subject to the state's service provider tax. The taxpayer was a provider for the federal Lifeline program which authorizes access to telecommunications services specifically to qualifying low-income consumers. The taxpayer received a federal subsidy from the Universal Service Administrative Company (USAC) to provide this service, and did not pay any taxes or fees to Maine for the receipt of the subsidy. In an audit, the State Tax Assessor assessed the taxpayer for the prepaid wireless fee and service provider tax based on the subsidy, and the taxpayer appealed. The prepaid wireless fee statute required that for a telecommunications service to be subject to the fee the service must be "paid for in advance" and "sold in predetermined units or dollars that decline with use in known amounts." The court reasoned that despite the taxpayer's Lifeline program having some hallmarks of a prepaid plan – such as no monthly billing relationship – there was no indication that the taxpayer received payment from USAC in advance of its provision of services; therefore, the court concluded the service was not subject to a prepaid wireless fee. The court then discussed the service provider tax and determined the taxpayer was properly subject to such tax. The taxpayer received consideration from USAC for the telecommunications services provided to the Lifeline customers. The service provider tax is applicable to the value of telecommunications sold in Maine, and the court explained there is no requirement that the consideration for the telecommunications service must come directly from the customers. Therefore, the taxpayer's service was deemed a taxable sale and was subject to the service provider tax. This holding was not affected by the fact that the Maine legislature subsequently passed a bill exempting the taxpayer's subsidized service from the service provider tax. | *State Tax Assessor v. Tracfone Wireless, Inc.* (opinion dated June 23, 2022) |

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| Missouri | Telecommunications Services | The Missouri Court of Appeals held that a taxpayer's Voice Over Internet Protocol (VoIP) technology was subject to local license taxes in Missouri. The taxpayer employed VoIP technology to provide telephone services to its customers in Missouri. Customers using VoIP technology could make real time two-way calls between two VoIP customers or between VoIP and traditional telephone customers over the taxpayer's broadband cable network. In a class action lawsuit, over 123 municipalities alleged that the taxpayer had failed to pay business license taxes due from telephone service providers doing business in their jurisdictions. The taxpayer argued that the relevant tax-enabling statutes and ordinances failed to define "telephone company," "telephone," or "telephone service" to include VoIP-enabled telephone services, and therefore the taxpayer's services were not subject to the local taxes. The trial court found in favor of the municipalities, and the taxpayer appealed. On appeal, the appellate court relied on the taxpayer's representations to the court and its advertisements that, "just like traditional wireline services," taxpayer's service worked through regular telephone jacks and phones, and provided access to 911 emergency services and directory listings. Additionally, the taxpayer "offered its customers regular telephone services that happened to be provided using a different technology" which the taxpayer considered to be functionally equivalent to traditional wireline telephone services. The court therefore held that the taxpayer was a "telephone company" that provided "telephone service," noting that it was unnecessary for a statute to anticipate all technologies, such as VoIP, that may arise in the future because requirements of such exactitude and foresight would defeat the purpose of generally phrased law. | *Collector of Winchester v. Charter Communications, Inc.* (opinion filed July 26, 2022) |

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| Virginia | Telecommunications Services | A Virginia circuit court reversed the Tax Commissioner's denial of a telecommunications provider's refund claim involving software and equipment used to provide internet access to customers. As part of its operations, the taxpayer sold software, equipment, and services to a regional provider of wireless telecommunications for its network operations in Virginia. The taxpayer filed a sales tax refund claim for equipment used for data transmissions in its wireless network, as well as software that enabled features and capacity on its wireless network. With regard to the software at issue, the Tax Commissioner denied the refund claim on the basis that the software was not exempt because there was no sales invoice, contract or other sales agreement that certified the software was transferred electronically and not through a tangible medium. With regard to the equipment at issue, the Tax Commissioner denied the refund claim because it found that the taxpayer was not an exempt retail internet service provider. On appeal to the circuit court, the taxpayer established that the software was exempt as electronically delivered software used to provide access to the internet. Further, the court found no requirement that exempt software sales must certify that the software was delivered electronically. With regard to the equipment, the court found that the taxpayer had produced evidence showing the equipment qualified as exempt broadcasting equipment, parts, and accessories. In addition, the court rejected the Tax Commissioner's contention that broadcasting exemption was limited to "retail" internet service providers. | Virginia Tax Commissioner Ruling 21-171 |

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