State and Local Tax Technology Checklist

Guidance from the first quarter of 2024

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 first quarter of 2024. Topics covered include access to web-based content, data center exemptions, taxability of software, and telecommunications services. Highlights include:

California: The California Court of Appeals upheld the dismissal of the City of Lancaster's lawsuit to collect franchise fees from two streaming video service providers under the state's Digital Infrastructure and Video Competition Act. The court ruled that local governments were not authorized to sue non-franchise holders under the Act, and that such issues could only be enforced by the state Public Utilities Commission.

New York: The New York Supreme Court found that a taxpayer's service in measuring the effectiveness of clients' advertising campaigns was a taxable information service. The service involved surveying consumers, comparing the results to industry-specific benchmarking data, and providing reports to clients. The service was not a consulting service because the primary function of the service was the collection and analysis of information. Further, the service was not eligible for an exclusion from tax because the collected information was incorporated into the taxpayer's database and used for benchmarking purposes in other reports provided to clients.

South Carolina: The South Carolina Department of Revenue ruled that charges for digital textbooks are not subject to sales and use tax as communication services. The Department applied the "true object test" to determine that students were not purchasing the digital textbooks in order to access a communication system; instead, the true object was the purchase of a digital textbook. Additionally, the Department concluded that digital textbooks, as with printed textbooks, qualify for the sales and use tax exemption applicable to "textbooks."

Washington: The Washington Supreme Court recently ruled that the Universal Service Administrative Company (USAC), which administers the Lifeline program that provides subsidized wireless services for low-income consumers, is a tax-immune instrumentality of the federal government. The court noted that despite not being directly overseen by government officials, federal regulations narrowly define USAC's activities, and it was established to implement government telecommunications policy. The court also highlighted that the Federal Communications Commission controls USAC's funding and governance, and Congress has recognized its role. Despite some differences from other tax-exempt entities, the court concluded that USAC is tax-immune due to its function as a federal instrumentality.

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.

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State	Category	Development	Authority
California	Other	The California Court of Appeals affirmed a lower court's dismissal of a lawsuit initiated by the City of Lancaster against two streaming video service providers. The City sought to collect franchise fees from the service providers under the state's Digital Infrastructure and Video Competition Act. The Act authorizes the state Public Utilities Commission to contract with and issue state franchises to video service providers. In addition, the Act includes a requirement that franchise holders pay local governments a franchise fee for the use of public rights-of-way to construct and maintain their networks. Here, the two service providers did not hold state franchises, and they argued that the Act did not apply to them because they did not operate any networks or systems in public rights-of-way. In its decision, the appellate court agreed with the lower court's holding that the Act did not authorize the City to bring an action against a non-franchise holder to collect franchise fees. The court found that only franchise holders were obligated to pay the franchise fees required under the Act. Second, the Act did not create an express or an implied right of action for a local government to sue a non-franchise holder for payment of the franchise fees. Finally, the court also agreed with the lower court that the responsibility for enforcing issues related to the franchise requirements rested with the Public Utilities Commission, and not with local governments. Therefore, the appellate court affirmed the judgment in favor of the service providers.	City of Lancaster v. Netflix, Inc.
California	Telecommunications Services	The California Court of Appeals ruled in favor of the California Department of Tax and Fee Administration (CDTFA) in a lawsuit regarding the CDTFA's power to allocate a bundled transaction involving the sale of tangible personal property and a nontaxable service. Taxpayers purchased bundled cell phone and wireless service contracts from telecommunications service providers. The taxpayers later challenged a state regulation that determined how to measure the taxable gross receipts when a cell phone was sold at a reduced price along with a service contract that required subsequent monthly payments. The longstanding regulation provided that sales tax should be based on the cell phone's unbundled sales price. The lower court agreed with the taxpayers that the regulation was unlawful and prohibited the CDTFA from applying the regulation to bundled transactions. In reversing the lower court, the appellate court noted that the telecommunications service providers did not offer a true discount on the cell phones as the service providers recouped the phones' value through the subsequent monthly payments required under the service contracts. In the appellate court's view, the dispute was essentially an accounting problem of segregation, not a legal problem of taxability, and the regulation stepped in to fill the gap, requiring that only the portion of the contract price allocated to the cell phone was subject to sales tax. The appellate court also agreed with the trial court's finding that the rulemaking process used to enact the regulation complied with the state Administrative Procedure Act. Therefore, the appellate court reversed the portion of the trial court's ruling to the extent that it had invalidated the regulation.	Bekkerman v. California Department of Tax and Fee Administration

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State	Category	Development	Authority
Colorado	Access to Web-Based Content, Services or Software	The Colorado Department of Revenue recently issued a private letter ruling addressing the taxability of an online marketplace's subscription-based membership. This particular membership offers purchasers free delivery on certain future orders and other discounts, including reduced or no service fees on specific orders. In lieu of delivery, purchasers could also select a pick-up option for many purchases on the marketplace. The Department of Revenue explained that charges for transportation services, including delivery, are not subject to tax if they are separable from the sales transaction and stated separately on an invoice. Services are deemed "separable" if the service remains the same, whether contracted for at the time of purchase or at a later date, and if the service can be paid for either at the initial purchase or at a later time. With regard to transportation services, such charges are separable if they are performed after the taxable property is offered for sale and the seller allows the purchaser the option to use the seller's transportation services or other alternative transportation services. Here, the Department found that the taxpayer's delivery options were separable because they could be contracted for at the time of purchase or at a later date, and the services remained the same regardless of the option chosen. Further, the membership fees were invoiced separately to purchasers. Because the membership fees were both separable and separately stated, they were not subject to sales or use tax.	Colorado Public Letter Ruling-23-006
Indiana	Telecommunications Services	The Indiana Department of Revenue denied a refund claim filed by a telecommunications service provider for use tax paid on cell phones that the taxpayer purchased to provide to its customers, either as "free" phones at the beginning of a service contract, or as replacement phones under an optional warranty contract. The taxpayer protested the refund denial, arguing that its purchase of the phones qualified for an exemption for "radio or microwave transmitting or receiving equipment" that applied when the person acquiring the equipment furnishes or sells intrastate telecommunication service. The Department, narrowly construing the exemption, found that although cell phones were "radio or microwave transmitting or receiving equipment," the taxpayer's use of the cell phones did not qualify for the exemption. Therefore, the taxpayer's protest was denied.	Ind. Reg. ODR Doc. No. 04-20231163

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Michigan	Taxability of Software	The Michigan Department of Treasury released a technical advice letter concerning a taxpayer's sales of certain transactions involving software. The taxpayer, a foreign-based company, offered subscriptions to personalized services, primarily in the form of Software-as-a-Service (SaaS). These services were primarily accessed via a web portal or a free mobile application, with some services available for free. Most services require an internet connection, with limited offline functionality. The Department explained that Michigan generally imposes tax on the sale and use of tangible personal property, including prewritten computer software. In the *Auto-Owners Ins Co v Dep 't of Treasury case,* the Michigan Court of Appeals found that software accessed via a third-party server was not considered "delivered" to or "used" by customers, and therefore was not subject to tax. Conversely, downloaded software would be taxable unless incidental to the vendor's professional services. Here, because the taxpayer's services were sold with the option to download an application, the Department applied the "incidental to service" test, which evaluates factors such as the buyer's intent, the seller's business, the availability of goods without the service, and the value contributed by intangible services. The Department concluded that the taxpayer's transactions represented the sale of nontaxable services rather than the sale of software, as customers were seeking those services and the software application was provided free of charge.	Sales Tax Treatment of Certain Transactions Involving Software
New York	Other	The New York Supreme Court affirmed the Tax Appeals Tribunal's determination that a taxpayer's services in measuring the effectiveness of clients' advertising campaigns were taxable information services. The taxpayer's service involves surveying consumers, analyzing the data, and providing reports to clients. The reports compared a client's advertising campaign results to industry-specific benchmarking data collected in a database compiled by the taxpayer. On appeal, the taxpayer argued that its services constituted nontaxable consulting services. The appellate court rejected this argument, however, agreeing with the Tribunal that the primary function of the taxpayer's service was the collection and analysis of information. Any recommendations provided by the taxpayer were drawn directly from the data collected. The taxpayer also argued that even if its service is an information service, it should be excluded from tax because the information provided to its clients was not incorporated in reports furnished to other persons. However, the Tribunal found that the information collected from the service's surveys was anonymized and incorporated into the taxpayer's database and used for benchmarking purposes in other reports. Therefore, the Tribunal concluded, and the court agreed, that the information from the taxpayer's reports can be regarded as "substantially incorporated" into the reports furnished to others; as such, the taxpayer's services do not fall within the exclusion for information services.	Matter of Dynamic Logic, Inc. v. Tax Appeals Trib. of the State of New York

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South Carolina	Digital Equivalent	The South Carolina Department of Revenue (Department) issued a private letter ruling advising the taxpayer that charges for its digital textbooks were not subject to sales and use tax as communication services. The taxpayer offered digital textbooks, also known as eTextbooks, for college and university students to either buy or rent for their courses of study. The eTextbooks were digital downloadable versions of a printed textbook and could be accessed online or offline through any supported device. In making its determination, the Department applied the "true object test" to determine the nature of the transaction, i.e., whether the purchase of the eTextbook was for the textbook itself or access to a communication system. The Department concluded that students who purchased eTextbooks were not paying for access to a communication system; instead, the transaction's "true object" was a digital textbook. Therefore, the charges for eTextbooks were not charges for communications services subject to tax. Furthermore, the Department examined whether digital textbooks qualify as "textbooks" for purposes of a sales and use tax exemption available for such items used in a course of study in schools and institutions of higher learning. Because "textbooks" could be in any form—digital or print—the Department determined that the eTextbooks were digital versions of a printed textbook, containing the same educational information, and offered to and purchased by college and university students. Therefore, the eTextbooks were exempt from sales and use tax.	SC Private Letter Ruling #24-2
Washington	Access to Web-Based Content, Services or Software	The Washington Department of Revenue recently issued guidance on the taxability of online instructional classes. The Department explained that live webinars are not subject to the retail sales tax if they allow real-time participation and interaction between presenters and participants. Specifically, the interaction between presenters and participants must be a part of the live class (not merely the ability to separately submit questions that could be answered afterward). While these live online courses are not subject to the retail sales tax, gross income generated from these business activities remains subject to the business and occupation (B&O) tax under the "service and other activities" classification. For online classes that do not allow for real-time participation or interaction between the presenter and participants, these classes are subject to retail sales tax and the B&O tax under the retailing classification.	Wash. Dep't of Revenue Tax Topic: Online Instructional Classes

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State	Category	Development	Authority
Washington	Telecommunications Services	The Washington Supreme Court recently overruled a decision by the state Court of Appeals and determined that the Universal Service Administrative Company (USAC) is a tax-immune instrumentality of the federal government. This decision was in relation to a case where taxpayer, a telecommunications carrier, provided subsidized wireless Lifeline services to qualifying consumers. The Supreme Court's decision hinged on several key factors. First, the court observed that although federal government officials do not directly oversee USAC's daily operations, federal regulations nonetheless narrowly define the organization's activities. Second, the court emphasized that USAC was specifically established to implement the government's telecommunications policy objectives, with the Federal Communications Commission (FCC) playing a significant role in USAC's formation. Furthermore, the court noted that USAC's funding is sourced from the Universal Service Fund, which can only be accessed with the FCC's approval. In terms of governance, the FCC appoints or approves all of USAC's board members, and the nomination of USAC's CEO is subject to FCC review. Finally, the court pointed out that Congress had recently recognized USAC's role in statute. While the court acknowledged that certain factors differentiate USAC from other tax-immune instrumentalities, such as the absence of government ownership in USAC and the lack of government officials in its internal management structure, the court did not consider these distinctions decisive. The court concluded that USAC operates as an instrumentality of the federal government for the purposes of the intergovernmental tax immunity doctrine, and therefore, transactions with USAC are exempt from tax.	Assurance Wireless USA LP v. Department of Revenue
Wyoming	Taxability of Software	The Wyoming Department of Revenue released updated information on the taxability of various computer-related sales and services. The Department clarified that custom software sales and creation, whether delivered electronically or otherwise, are not subject to sales tax. In contrast, prewritten software is taxable as a sale of tangible personal property. Additionally, services such as repairing, altering, improving, or installing computer hardware or prewritten software are deemed taxable. The Department also explains that platforms that offer hosted software via an internet connection are not subject to sales tax, but only if the customer does not receive any tangible personal property or enumerated service embedded within the service. Common cloud computing models covered by this rule include Software-as-a-Service (SaaS), Platform-as-a-Service (PaaS), and Infrastructure-as-a-Service (IaaS). Finally, the Department clarified that fees for accessing web-hosted sites are not subject to tax since the consumer never takes possession or control of tangible personal property.	Wyo. Dep't of Revenue, Computer Sales & Services

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