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Wisconsin: Tax appeals commission finds software licenses should not be sourced to downstream customers

The Wisconsin Tax Appeals Commission determined that Wisconsin's specific sourcing rule for software licenses did not apply when the software was incorporated by the taxpayer's customer into another application that was subsequently sublicensed by the customer to its own downstream customers. The taxpayer licensed its database management software to a Wisconsin-based developer, which used the software in certain applications it produced and subsequently licensed to end-user medical providers throughout the United States. Under the terms of the agreement between the taxpayer and the intermediary developer, the taxpayer received a share of the proceeds from the licenses to end-users of applications that used the taxpayer's database management system. When the intermediary sold an application incorporating the taxpayer's software, the taxpayer would bill the intermediary an amount for each user of the application, and the intermediary would reimburse the taxpayer. The end-user customer did not make payments directly to the taxpayer.

The taxpayer took the position that, under Wisconsin's sourcing rules for use of computer software by purchasers or licensees, its receipts should be sourced based on the location of the end-users of those applications in which its database system was incorporated. The Department of Revenue argued that the taxpayer's only customer was the intermediary developer, and that all receipts from the transaction should be based on the intermediary developer's business location under the general rules for royalty income.

The taxpayer supported its position by citing a past decision of the Commission. However, the Commission determined here that a subsequent Court of Appeals decision was on point and controlling, and to the extent that the appellate ruling conflicted with the Commission's previous decision, the Commission decision was overruled. Next, it applied the logic of the Court of Appeals decision to the facts of this case, determining that the relationship between the taxpayer and the end-users was too attenuated to consider the end-users to be licensees of the taxpayer, noting that "[i]t is too much of a stretch to find that an addendum, which one 'party' cannot know has been provided to another 'party' constitutes proof of mutual assent to the end-user agreement" and that warranties contained in the contracts with the end-users were enforceable against the intermediary developer as well as the taxpayer. Finally, the Commission agreed with the Department that the taxpayer's receipts from the sublicenses were best characterized as royalties, which are sourced to the intermediary developer's Wisconsin location. Contact Bradley Wilhelmson with questions about Intersystems Corp. v. Wisconsin Department of Revenue.