

Cloud Computing Transactions Are The New “Wild West” Sales Tax Frontier As Jurisdictions Push Aggressively To Increase Online Revenue

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To support a marketing initiative, you buy a list of prospective customers from a vendor in California. The list consists of raw data – names, addresses, e-mail addresses and phone numbers. The names are qualified but the vendor has not otherwise added value – there is no analysis provided, and no rankings or recommendations are included.

The list is software-as-a-service (“SaaS”) and, as such, is not subject to New York State sales tax, correct?

Wrong. New York imposes a sales tax on basic data access known as a taxable information service. In addition, the state has begun subjecting SaaS and cloud computing to sales/use tax if the buyer is located in New York. It is one of a limited number of jurisdictions at the leading edge of aggressiveness in defining the taxability of online and cloud-computing transactions.

But such aggressiveness is a growing trend. Many jurisdictions are expanding their definitions of the taxability of online sales.

For businesses, this tax posture creates a new set of obligations. Both vendors and customers must determine if they are responsible for collecting or paying local sales or use tax. Arriving at the correct answer generally requires a professional assessment.

Jurisdictions are aggressive in taxing Internet and cloud computing transactions

There are several issues in play. The first and broadest is the question of what consti-

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tutes a taxable presence or nexus. In the brick-and-mortar world, nexus generally requires a physical presence within the jurisdiction’s boundaries – a warehouse, a factory or a sales office, for example – that, if it existed, would make the out-of-jurisdiction entity subject to local sales tax collection for goods sold to in-state customers.

Obviously, the Internet wreaks havoc with the question of physical presence. Amazon, for example, sells billions of dollars worth of goods via online transactions. In the early days of the Internet, those transactions were generally exempt from local sales taxation (or tax codes were simply unenforced). But in an era of huge online sales and local tax revenue shortfalls, few jurisdictions are willing to forgo that income and hence the rush to define “click-through nexus” – the level of presence that would make an online interstate transaction subject to state and local sales tax.

Of the 46 states that collect sales tax, 26 have not enacted click-through nexus standards, at least not yet. New York is at the forefront, however. The state’s so-called Amazon Tax (NYS Tax Law Sec. 1101(b)(8)(vi), passed April 2008) imposes sales tax collection responsibility when a non-resident seller (like Amazon) does business in excess of \$10,000 in the previous four quarterly periods in New York. The law applies if there is a written agreement with a local individual or corporation who gets paid a fee or a commission for sales it helps generate. Amazon responded by challenging the law in court. The NYS Court of Appeals recently upheld the law, but an appeal to the U.S. Supreme Court is likely.

Meanwhile, the federal government hopes to impose something like New York’s



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Amazon Tax nationally. The Marketplace Fairness Act of 2013, which is based on a similar definition of a “remote seller,” has passed the Senate. If a remote seller has national remote sales of greater than \$1 million, such seller would have to collect sales tax from customers located in any state in which it makes a remote sale of taxable property or services. The Act goes now to the House, where it is likely to receive broad support.

It is not easy to determine when a transaction is taxable and who must pay

In such complex circumstances, when is sales tax due? And who – customer or vendor – is responsible for paying it?

New York holds that when you purchase data and other forms of software-as-a-service (SaaS), you are in constructive possession of tangible personal property, which is subject to sales tax. If the cloud-based vendor has a physical presence in New York State, it must collect sales tax even if its server is located elsewhere. If not, you, as the customer, are responsible for paying the reciprocal use tax.

A systematic questionnaire can flag hidden sales tax exposure

How do you know if you are responsible for sales tax on an Internet or cloud transaction, or if your vendor is? The best practice is to have your tax professional provide a nexus questionnaire for both corporate income and sales tax. A comprehensive questionnaire, listing activities by jurisdiction, can determine where income tax and sales tax filing requirements exist.

But it is even more important to engage a state and local tax consulting expert in the wild, rapidly evolving world of Internet and cloud taxation, where there are only a few certainties. The tax picture is confusing, jurisdictions are hungry and aggressive, and the result can be akin to a Mack-truck collision, especially for small and mid-sized businesses that aren’t sufficiently focused on fast-moving state and local tax laws.

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