

## **Overcast Ahead: Cloud Computing Meets the Sales and Use Tax.**

The internet has changed a lot of things about how business is conducted: one of the newer innovations, cloud computing, offers a different approach to software licensing. In the past, I would pay a one-time license fee to acquire software rights to a program such as Word and would load a copy onto my computer. Now, many vendors license software with a focus on monthly service charges for access to their servers. Meanwhile, state revenue departments remain dependent upon sales taxes that are imposed under statutes that are very much of the brick and mortar world. Pennsylvania, for example, imposes a tax on “the sale at retail of tangible personal property.” 72 Pa. C.S.A. § 7202(a).

In May, the Pennsylvania Department of Revenue issued a letter ruling addressing the sales and use tax consequences of cloud computing. Cloud Computing, No. SUT-12-001 (May 31, 2012), available at [http://www.revenue.state.pa.us/portal/server.pt/community/letter\\_rulings/14831](http://www.revenue.state.pa.us/portal/server.pt/community/letter_rulings/14831).

Those who don't follow sales and use tax closely may wonder how a statute aimed at sales of “tangible personal property” could reach the clouds, so a bit of history is in order. Historically, Pennsylvania treated “canned software” as tangible personal property where it was transferred on a disk or other media. See *Graham Packaging Co. L.P. v. Commonwealth*, 882 A.2d 1076, (Pa. Commw. 2005) (discussing Rev. Ruling SUT-99-024).

Of course, as high speed internet became more prevalent, many software transactions no longer included physical media, a problem that Pennsylvania's Commonwealth Court faced in *Graham Packaging*, where the focus was on license renewals that did not involve physical media. In 2010, the Pennsylvania Supreme Court decided *Dechert LLP v. Commonwealth*, 998 A.2d 575 (Pa. 2010), ruling that software transactions were subject to the sales and use tax as “tangible personal property.” That ruling rested on the Court's conclusion that the term “tangible personal property” was ambiguous, given the fact that the legislature had included some decidedly non-tangible things that look very much like services in the definition, including cable television and electricity. *Dechert LLP*, 998 A.2d at 584; see also 72 Pa. C.S.A. § 7201(m) (defining tangible personal property to include “electricity for non-residential use,” “premium cable or premium video programming service,” and “interstate telecommunications originating or terminating in the Commonwealth and charged to a service address in the Commonwealth.”).

With its recently published guidance, the Department of Revenue takes the logic a step further, indicating that remote use of “canned” software is taxable to the extent that the end-user accessing the software is in Pennsylvania. Cloud Computing, No. SUT-12-001 (May 31, 2012). The ruling makes two other key points:

- If the server is located in Pennsylvania, that will not make a transaction with an end user outside the Commonwealth subject to sales and use tax.
- If the billing address for an end user is in Pennsylvania, the Department of Revenue will presume that all users are located in Pennsylvania. To rebut this presumption, the purchaser would file an exemption certificate that indicates the percentage of end users in Pennsylvania.

The ruling is presented as a logical extension of the Supreme Court's holding in *Dechert*; whether courts will view it that way remains to be seen. The Court in *Dechert* appeared to assign at least some weight to the fact that a copy of the licensed software was received by the

purchaser, noting that the analysis of the process of loading software made by the Commonwealth Court in Graham Packaging was helpful. 998 A.2d at 583. In the cloud computing model, the licensee simply gains access to the use of the software without downloading a copy. Time will tell whether that is a distinction without a difference.

Note- I would like to thank Annette Nellen, whose blog post brought this issue to my attention. <http://www.salestaxsupport.com/blogs/sales-use-tax/sales-tax-policy/cloud-computing-and-sales-tax-variations-and-issues/>

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