Issue No. 2017-3
July 2017

Ernst & Young LLP Sales and Use Tax Quarterly Update

This edition of the *Ernst & Young LLP Sales and Use Tax Quarterly Update* provides a summary of the major legislative, administrative and judicial sales and use tax developments for the third quarter of 2017.

States taking aim at marketplace providers

On May 30, 2017, Minnesota Governor Mark Dayton signed an omnibus tax bill,[1] key provisions of which expand the reach of the state's sales and use tax to include marketplace providers and affiliates. Specifically, the new law expands the definition of "retailer maintaining a place of business in this state" to include any retailer that has an in-state marketplace provider or other third party operating under the authority of the retailer or its subsidiary, for any purpose, including the facilitation or processing of sales. The new law also specifically provides that a retailer will be deemed to be represented by a marketplace provider in the state if the retailer makes sales in the state "facilitated by a marketplace provider that maintains a place of business in this state."[2]

Under the new law, a "marketplace provider" is defined as any person who facilitates a retailer's retail sale by: (1) listing or advertising for sale by the retailer in any forum, tangible personal property, services, or digital goods that are subject to Minnesota's sales and use tax; and (2) either directly or indirectly through agreements or arrangements with third parties collecting payment from the customer and transmitting that payment to the retailer regardless of whether the marketplace provider receives compensation or other consideration in exchange for its services.[3]

Building a better working world

The new law represents a continuation of state efforts over the past decade that either expand the scope of what constitutes "establishing and maintaining a market" within a state; the standard espoused by the U.S. Supreme Court in *Tyler Pipe*[4] for determining whether the in-state activities of an affiliate or third-party may be attributed to a remote seller for sales and use tax nexus purposes. However, these latest efforts seek to impose a new requirement on third-party entities that are not directly involved in the taxable sales transaction. Whereas earlier efforts centered on asserting nexus on the remote seller, this new tactic takes aim at the in-state "facilitator."

It is uncertain whether this approach will succeed or withstand judicial scrutiny. However, through the first half of 2017, the Multistate Tax Commission (MTC) has begun studying the issue, and at least five additional states have formally considered or introduced marketplace provider legislation. Specifically:

- In Washington state, H.B. 2186 (signed July 7, 2017) will require online marketplaces to collect and remit sales and use tax or to comply with notice and reporting requirements.
- North Carolina, S.B. 81 would have required marketplace providers to collect and remit tax on sales to North Carolina customers by all third-party sellers.
- In New Mexico, Governor Susana Martinez vetoed provisions in HB 2 (first special legislative session) that would have expanded New Mexico's gross receipts nexus provisions by establishing economic nexus provisions as well as marketplace provider provisions, noting that the marketplace provider provisions "required a much closer and thorough vetting."[5]
- In New York, a marketplace provider provision was introduced in the 2018 Executive Budget, but ultimately was not adopted (a similar provision was considered in prior legislative sessions.
- In Texas, two bills (SB 1713 and HB 3875) would have authorized the state to study the feasibility of enacting a marketplace provider provision.

Our observation:

Online marketplaces currently account for more than one-third of retail e-commerce in the US, with the top marketplace providers hosting between 1.5 million and 25 million third-party sellers. Imposition of a collection and/or reporting requirement on these providers could have a profound and industry-altering effect, given the scope and logistics of the responsibility. Ultimately, whether the U.S. Supreme Court decides to revisit and overturn its 1992 *Quill* decision will determine the fate of these and similar measures at the state level. Should the Court refuse an appeal of one of the many challenges to recent state economic presence nexus statutes, or if it keeps the physical presence standard intact, marketplace providers and other "sales facilitators" will need to prepare for the potential of significant multistate compliance burdens.

Ultimately, whether additional states begin to enact or consider such measures will depend on what happens with the various *Quill* challenges currently working their way through the state courts and administrative review processes. And, it is expected that any affirmation or refusal by the U.S. Supreme Court to revisit that decision will serve as a catalyst for more states to attempt to expand their definition of "responsible person" for sales tax collection purposes to marketplace providers and other "sales facilitators" that have an in-state presence.

Other recent developments

Nexus

Federal: A proposed bill (H.R. 2193—the "Remote Transactions Parity Act of 2017") would allow eligible states to require all sellers (except those qualifying for a small seller exception) to collect and remit sales/use tax on remote sales into the state without regard to the location of the seller. A state would be eligible to require collection by remote retailers either by: (1) being a Streamlined Sales and Use Tax Agreement member state (associate states are not included in this category); or (2) adopting and implementing the minimum simplification requirements set forth under the Act. If enacted, a state would be allowed to require remote sellers to collect tax if a gross receipts threshold is met or the remote retailer uses an electronic marketplace for purpose of making products or services available for sale to the public. The annual gross receipts threshold would be phased down as follows: first calendar year following enactment—annual gross receipts not exceeding $10 million; second calendar year —annual gross receipts not exceeding $5 million, and third calendar year—annual gross receipts not exceeding $1 million. If enacted, the Act would prohibit a state from requiring remote retailers to collect tax until one year after its date of enactment and not during the period of October 1 through December 31 of the first calendar year after enactment. HR 2193 was introduced on April 27, 2017.

Federal: A proposed bill (S. 976 – the "Marketplace Fairness Act of 2017") would allow eligible states to require all sellers (except those qualifying for a small seller exception) to collect and remit sales/use tax on remote sales into the state without regard to the location of the seller. A state would be eligible to require collection by remote retailers either by: (1) being a Streamlined Sales and Use Tax Agreement member state (associate states are not included in this category); or (2) adopting and implementing the minimum simplification requirements set forth under the Act. A state would be able to require a remote retailer to collect and remit sales and use tax if its total remote sales in the US in the preceding calendar year exceeds 1 million. If the Act is approved, eligible states would not be able to collect tax from remote retailers in the first year after the enactment date of the Act or during the period from October 1 through December 31 of the first calendar year beginning after the date of enactment. The bill is similar to the remote seller legislation of the same name which was passed by the Senate in the 113th Congress in May 2013 but ultimately died when it was not taken up by the House of Representatives. S. 976 was introduced on April 27, 2017.

Federal: A proposed bill (H.R. 2887—the "No Regulation Without Representation Act of 2017") would limit a state's ability to tax or regulate a person's activity in interstate commerce "only when such person is physically present in the State during the period in which the tax or regulation is imposed." The bill, which also was introduced in the 114th Congress, would effectively codify the *Quill* physical presence standard for sales and use, and all other state tax purposes. H.R. 2887 was introduced on June 12, 2017.

Indiana: A new law establishes an economic nexus sales and use tax rule for remote retailers, effective July 1, 2017. Under the new provision, a retail merchant that does not have a physical presence in Indiana will collect and remit the gross retail tax on retail transactions made in Indiana, if the retail merchant meets either of the following conditions for the current or preceding calendar year: the retail merchant has gross revenue exceeding $100,000 from, or enters into 200 or more separate transactions from, any combination of the sale of tangible personal property delivered into Indiana, product transferred electronically into Indiana, or a service delivered in Indiana. The Indiana Department of Revenue may bring a declaratory judgment action in any Indiana circuit or superior court against a person in order to establish if the person has an obligation to collect and remit tax. During the pendency of the declaratory judgment action, the Department is prohibited from enforcing collection and remittance requirements against any person that does not affirmatively consent or otherwise remit the tax on a voluntary basis. A retail merchant that voluntarily or otherwise remits tax under these provisions is not liable to a purchaser who claims the tax was over collected. Ind. Laws 2017, P.L. 247 (HB 1129), signed by Governor Eric Holcomb on April 28, 2017.

Maine: On June 21, 2017, the Maine Legislature overrode Governor Ron LePage's veto of SP 483. As such, effective October 1, 2017, any person selling tangible personal property, products transferred electronically or services for delivery into the state must collect and remit the sales tax in the same manner as a retailer that has a physical presence in the state if:

- The person's gross revenue from delivery into this State of tangible personal property, products transferred electronically or services that are taxable by this State, in the previous calendar year or current calendar year exceeds $100,000; or
- The person sold tangible personal property, products transferred electronically or services that are taxable by this State for delivery into this State in at least 200 separate transactions in the previous calendar year or the current calendar year.

The stated intent of the new law is to apply the sales and use tax obligations imposed under the laws of the state to the limit of federal and state constitutional doctrines, and to "thereby clarify that the laws of this State permit the State to immediately argue in any litigation that such constitutional doctrine should be changed to permit the tax collection obligations of this section." As with the other states that have enacted economic nexus provisions over the past two years, a legal challenge is expected. LD 1405/SP 483, Governor's veto overridden (June 21, 2017).

Massachusetts: On June 28, 2017, the Massachusetts Department of Revenue issued Directive 17-2, which revokes the Department's economic nexus position three days before it was set to take effect. The revoked Directive, which would have become effective July 1, 2017, asserted a sales and use tax collection duty on internet vendors regardless of whether or not the vendor had physical presence in Massachusetts. Directive 17-2 states that a new economic nexus rule will be proposed in a forthcoming proposed regulation. In addition, Directive 17-2 indicates that the new rule will be similar to the one in Directive 17-1, but will be applied prospectively. Directive 17-2 (Mass. Dep't. of Rev. June 28, 2017). For more on Directive 17-1, see EY Tax Alert 2017-607.

Missouri: An out-of-state business's rental of shipping containers to Missouri customers establishes a physical presence for the business and, therefore, the business must collect and remit use tax on the rentals. The business also must collect and remit sales tax on its sale of containers when the customer already possesses the container in Missouri. Finally, the business must collect and remit use tax on the delivery and pick up charges for customers located in Missouri because the charges are part of the rental of tangible personal property, which are included in the sales price. Mo. Dept. of Rev., Private Letter Ruling No. 7798 (March 24, 2017).

New Mexico: Vetoed provisions in HB 2 (first special legislative session) would have expanded New Mexico's gross receipts nexus provisions by establishing economic nexus provisions as well as marketplace provider provisions. In vetoing these provisions, Governor Susana Martinez said the "internet sales tax provisions were poorly crafted and could cause more harm than good" and that the marketplace provider provisions "requires a much closer and thorough vetting." N.M. Gov., House Executive Message No. 3 (May 26, 2017).

North Dakota: A new law establishes economic nexus provisions for North Dakota sales and use tax purposes. Under the new provision, an out-of-state seller of tangible personal property or other taxable product for delivery in North Dakota (collectively "goods") that does not have a physical presence in the state, will be required to collect and remit sales or use tax to the state if the seller meets either of the following in the previous or current calendar year: (1) has gross sales of goods in North Dakota that exceed $100,000; or (2) sold goods in 200 or more separate transactions. These new economic nexus provisions have a contingent effective date and will only take effect on the date the U.S. Supreme Court issues an opinion overturning *Quill* (which requires a physical presence for sales and use tax nexus purposes) or otherwise confirms that a state may constitutionally impose its sales or use tax as outlined above. N.D. Laws 2017, SB 2298, signed by Governor Doug Burgum on April 10, 2017.

Ohio: Beginning January 1, 2018, out-of-state sellers with annual Ohio sales of at least $500,000, regardless of whether they have physical presence in Ohio, will be required to collect and remit tax on sales to Ohio customers, if they: (a) use in-state computer software to make Ohio sales; or (b) provide or enter into an agreement with a third party to provide content distribution networks in Ohio to accelerate or enhance delivery of the seller's website to Ohio consumers. This proposal is similar to economic nexus statutes being contested in other states, such as South Dakota and Alabama. As in other states with similar provisions, the constitutionality of Ohio's new expanded sales and use tax nexus provision is likely to be challenged. Am. Sub. H.B. 49 (Sub HB 49) signed June 30, 2017.

South Dakota: In its appeal to the South Dakota Supreme Court of a circuit court decision that found the state's "economic nexus" provision unconstitutional, the South Dakota Department of Revenue has restated its request for expedited review. The Department has acknowledged that the law, SB 106 (which was enacted in 2016), is unconstitutional under existing U.S. Supreme Court precedent in *Quill*. However, the Department's expressed goal is to get the matter before the Court as a vehicle for revisiting that decision. In its brief, the Department stated that it "respectfully suggests that the briefing is sufficient for this Court to fully consider this appeal and to craft an opinion identifying this case as an appropriate vehicle for the U.S. Supreme Court to reconsider its holdings in *Bellas Hess*[6] and *Quill*." The South Dakota Supreme Court is expected to hear arguments or decide the matter on the briefings at some point before the U.S. Supreme Court's October 2017 term begins. *South Dakota v. Wayfair, Inc*., S.D., No. 28160, *reply brief filed* June 22, 2017.

Tennessee: On April 10, 2017, a Tennessee chancery court stayed the enforcement of Rule 1320-05-01-.129 (Rule 129), by which the Tennessee Department of Revenue adopted an economic nexus standard for sales and use tax purposes, until a lawsuit challenging Rule 129 is decided (April 10th Order). Under Rule 129, an out-of-state dealer is deemed to have substantial nexus with Tennessee if the dealer engages in the regular or systematic solicitation of Tennessee consumers through any means, and makes sales exceeding $500,000 to Tennessee consumers during the previous 12-month period. On March 30, 2017, two retail groups filed suit against the Department, claiming Rule 129 is unconstitutional under *Quill Corp*. because it requires out-of-state companies with no physical presence in Tennessee to collect and remit sales tax. The April 10th Order prohibits the Department from enforcing Rule 129 until the suit is resolved, but does not preclude dealers from voluntarily complying with Rule 129 or the Department from collecting sales tax from dealers that voluntarily comply. For more on this development, see EY Tax Alert 2017-642.

Tax base

Colorado: Online travel companies (OTCs) are required to collect Denver lodger's tax on the full customer purchase price including both the amount the OTCs contract for with the hotel to charge (net rate) and the amount of the OTCs' markup. In reaching this conclusion, the Colorado Supreme Court found inclusion of the net rate and the OTCs' markup was a fair and reasonable reading of the statute and embodied legislative intent, as purchasers must pay the full purchase price in a hotel room sale and cannot decline to pay either the net rate or the markup. The court also determined that OTCs are properly characterized as "vendors" in merchant-model transactions and, therefore, are required to collect and remit taxes directly to the City of Denver, because OTCs deal directly in the transaction with the consumer-purchaser, set the price (consideration) for the room sale, collect the purchase price amounts directly from the consumers, and add to the purchase price amounts they determine to be sufficient for the lodger's tax. *Denver v. Expedia, Inc*., No. 14SC634 (Colo. S. Ct. April 24, 2017).

Illinois: The city of Chicago is not entitled to additional Chicago Hotel Occupancy Tax (CHAT) revenue on facilitation and service fees charged by online travel companies' (OTCs) because these fees are not paid for the use of a hotel room and, therefore, are not part of the gross rental or leasing charge that comprise the CHAT base. In reaching this conclusion, the Illinois Appellate Court determined that customers pay for the OTCs' service and facilitation fees in exchange for a convenient manner of making reservations and the benefits of the OTCs' pre-negotiations with hotels, rather than the right to occupy hotel rooms. The court restricted its decision to the specific OTCs before it. *City of Chicago, Ill. v. Expedia Inc*., No. 1-15-3402 (Ill. App. Ct., 1st Jud. Dist., April 26, 2017).

Illinois: An electronics company's sales of extended warranty contracts and conditional extended warranty contracts are sales of maintenance agreements not subject to the Illinois Retailer's Occupation Tax (ROT) or Service Occupation Tax (SOT). A customer's enrollment in a product upgrade program does not subject the sales to the ROT or the SOT, because the purchase of an extended warranty contract under the upgrade program does not change the fact that the purchase price of the product itself does not include the extended warranty contract, or that the extended warranty contract must be purchased separately from the product. Once the electronics company performs services under the warranty, it will be acting as a service provider and will be subject to the SOT on tangible personal property that is transferred. Ill. Dept. of Rev., Private Letter Ruling No. ST 17-0001-PLR (February 9, 2017) (released April 2017).

Illinois: A car company must exclude from the calculation of its trade-in credits the amount of cash back payments to car purchasers, and it cannot combine the trade-in credit with the advance trade-in credit when the trade-in credit belongs to a third party. In so holding, the Illinois Independent Tax Tribunal found the trade-in regulation, which provides that the overall trade-in credit is the value of the trade-in minus any cash back to the purchaser, does not impermissibly narrow the scope of the trade-in statutes; rather, it creates a chronological process for when trade-in credits can be recognized. The Tribunal noted cash back amounts are not part of any trade-in and any resulting trade-in calculation, and that there is no basis for demanding unrelated third-party trade-in credits be grouped with advance trade-in credits. *Motor Werks of Hoffman Estates, Inc. v. Ill. Dept. of Rev., Nos*. 14 TT 222 and 15 TT 37 (Ill. Indep. Tax Trib. March 27, 2017).

Missouri: A separately stated fee that an out-of-state corporation charges airline and aircraft customers when reselling jet fuel to them is subject to Missouri state and local sales tax. The corporation pays the separately stated fee to its supplier upon purchase of fuel, and then separately states the fee when it resells the jet fuel to airlines and other aircraft users. Because the fee is part of the corporation's sales price for the fuel, the amount charged should be included in its gross receipts despite the fee being a separately stated charge from the fuel charge. Mo. Dept. of Rev., Private Letter Ruling No. 7807 (April 13, 2017).

Rhode Island: A company's monthly or annually paid subscription product that gives customers access to several benefits, including free and discounted shipping, streaming or downloadable digital products and video games, and discount pricing, is subject to sales and use tax as a bundled transaction whose real object is ready access to both taxable and nontaxable benefits for no additional consideration. The Rhode Island Division of Taxation reasoned that even if some of the customers do not access or use the taxable benefits, the customers are paying for the unconditional right to access those items along with all of the other product benefits at no additional cost. Lastly, the one-month free trial subscription to the product is not subject to sales and use tax because there is no consideration paid in the transaction. R.I. Div. of Taxn., Ruling Request No. 2017-01 (March 31, 2017).

Exemptions and refunds

Alabama: A chemical manufacturer was entitled to a state and county use tax refund on materials used by its contractor on a project to remove an existing sulfuric acid converter and furnish, fabricate, and install a new converter at one of its facilities because the materials were taxable upon the contractor's purchase of them ("contractor provision"). The Alabama Tax Tribunal noted that although the converter is an integral part of and used in the chemical manufacturer's process, Alabama law requires that if the "contractor provision" applies, as it does in this case, it is irrelevant that the structure or machine involved is subsequently used in the manufacturing or production processes. The Tribunal also rejected the Alabama Department of Revenue's argument that the manufacturer was liable for sales/use tax on parts used to repair its machinery at the machine rate, finding instead that that the contractors engaged to repair machinery were liable for tax because the contractors (not the manufacturer) used the parts. In addition, the gas chromatographs and attachments and a dry max unit are both necessary parts of the manufacturer's manufacturing process and, therefore, they are taxable at the machine rate (1.5%, as opposed to the general 4% rate). *Akzo Nobel Functional Chemicals, LLC v. Ala. Dept. of Rev.*, Nos. S. 15-1278, County. 16-107 (Ala. Tax Trib. March 23, 2017).

Arizona: An Arizona electric power cooperative is not entitled to a refund of use tax paid on coal and natural gas purchased from out-of-state vendors because the purchases do not qualify for the resale exemption since the cooperative uses and consumes the coal and natural gas (tangible personal property) to generate electricity. In reaching this conclusion, the Arizona Court of Appeals found that the cooperative failed to rebut the statutory presumption that its purchases of coal and natural gas fall outside the scope of the use tax. Rather, the cooperative's expert's testimony reflected that the cooperative uses and consumes the coal and natural gas in the process of generating electricity. The coal and natural gas purchases also are not exempt from tax as an ingredient or component part of electricity generated by the cooperative. The court reasoned that just as fuel used or consumed in a manufacturing process is not considered to be incorporated into a manufactured product and, therefore, is taxable, fuel is consumed in the process of generating electricity and it does not directly enter into or become an ingredient or component part of the electricity as required by statute. *Ariz. Electric Power Coop., Inc. v. Ariz. Dept. of Rev*., No. CA-TX 16-0004 (Ariz. App. Ct., Div. 1, March 28, 2017).

Arkansas: A new law establishes sunset dates for the InvestArk retention tax credit and the increased sales and use tax refund for major maintenance and improvement projects, and clarifies existing provisions for, and increases the amount of, the refund available for sales and use tax paid on repair and replacement parts of manufacturing and machinery equipment. The InvestArk retention tax credit for manufacturers will sunset July 1, 2017; however, projects that qualify prior to the credit based on applications filed prior to July 1, 2017, will continue to earn credits, which may be claimed and carried forward as provided under current law. The increased sales and use tax refund for major maintenance and improvement projects will sunset June 30, 2022. SB 362 also increases the sales and use tax refund available for partial replacement and repair of certain machinery and equipment over four years until the sales are exempt beginning July 1, 2022. Until then, taxes in excess of these rates are subject to a refund as follows: (1) 3.875%, beginning July 1, 2018; (2) 2.875%, beginning July 1, 2019; (3) 1.875%, beginning July 1, 2020; and (4) 0.875%, beginning July 1, 2021. Finally, the new law clarifies the required method to claim a sales or use tax refund for partial replacement and repair of certain machinery and equipment. SB 362 took effect on March 13, 2017. Ark. Laws 2017, Act 465 (SB 362), signed by Governor Asa Hutchinson on March 13, 2017.

Florida: On May 25, 2017, Florida Governor Rick Scott signed HB 7109, a bill containing various tax reductions and modifications. Most notably, the tax rate on the total rent or license fee charged on the rental of commercial real estate is reduced to 5.8% (from 6.0%), effective January 1, 2018. The tax rate in effect when the tenant or person occupies, uses or is entitled to occupy or use the property, is the rate that applies to the transaction; "[t]he applicable rate may not be avoided by delaying or accelerating rent or license fee payments." Other sales and use tax law changes include the following:

- Exempts from sales and use tax a data center owner's or tenant's purchase, lease or rental of property used to construct, maintain and operate computer server equipment at the data center. To qualify for the exemption, the owner and tenant must make a cumulative capital investment of $150 million after July 1, 2017, and the data center must meet specified megawatt capacity thresholds. Clawback provisions are included if the Florida Department of Revenue (DOR) determines that the owner and tenants no longer meet the qualification requirements. The DOR may not issue temporary tax exemption certificates after June 30, 2022.
- Allows a purchaser of a taxable admission to seek a refund or credit of tax paid when the purchaser resells the admission to an entity that is exempt from sales and use tax for any reason other than sale for resale. The purchaser must provide proof of the exempt entity's qualification for the exemption. If the purchaser purchases the admission from a related dealer that is a member of the same controlled group of corporations for federal income tax purposes, the purchaser must seek a refund or credit from the related dealer. If the related dealer has already submitted the tax to the DOR, it could then seek a refund or credit of tax paid. If the DOR determines the entity was not entitled to the exemption, it would look solely to the entity that provided the exemption documentation for recovery of the tax. This provision is effective starting January 1, 2018.
- Establishes sales and use tax exemptions for various goods related to women (effective January 1, 2018), animal, and aquaculture health care, and for purchases of building material, pest control services and rental of tangible personal property used in new construction in Rural Areas of Opportunities. The exemptions related to animal and aquaculture are "remedial in nature and apply retroactively, but do not provide a basis for an assessment of any tax or create a right to a refund or credit of any tax paid before the effective date of this act."
- Establishes a back-to-school (August 4- 6, 2017) sales tax holidays.

Unless otherwise provided, these changes take effect July 1, 2017. Fla. Laws 2017, Ch. 2017-36 (HB 7109), signed by the governor on May 25, 2017.

Louisiana: A resolution (HCR 8) passed during the 2015 legislative session to suspend certain business utility exemptions for state sales tax laws from July 1, 2015, until 60 days after the 2016 Regular Session of the legislature, was not unconstitutional. In so holding, the Louisiana Court of Appeal found HCR 8 is a later expression of legislative will, and is not inconsistent with or superseded by a previous act of the legislature that made operable previously inoperable tax exemptions. In addition, HCR 8 was not required to pass with a vote of two-thirds of the legislature, because the suspension of tax (a temporary delay of it) is not the same as the repeal of an exemption (the abrogation of existing law by express legislative act). HCR 8 is a suspensive resolution rather than a bill, and it is not a revenue raising measure, as a tax levy raises revenues and the grant of an exemption does not change the underlying tax levy. Finally, the language of HRC 8's suspension of all of the exemptions from the tax levied pursuant to La. Rev. Stat. §47:331 for sales of steam, water, electric power or energy, and natural gas, is not vague or ambiguous. *La. Chemical Assn. v. La. Dept. of Rev*., No. 2016 CA 0501 (La. Ct. App., First Cir., April 7, 2017).

Nebraska: Two agricultural cooperatives were properly denied sales and use tax refunds for "depreciable repairs or parts" for agricultural machinery and equipment because neither provided the Nebraska Department of Revenue with the information needed to verify that the claimed repairs or parts were taxes as personal property. In reaching this conclusion, the Nebraska Supreme Court found the term "depreciable repair or parts" ambiguous because it is not defined in Neb. Stat. §77-2708.01 or elsewhere in the tax statute and the ordinary definitions of "depreciable" did not clarify the meaning. Legislative history, however, indicated the legislative intent was to prevent double taxation by providing a sales tax refund for purchases of depreciable repairs and parts subject to personal property tax. The court ultimately concluded that without providing the personal property tax return or depreciation schedules, the cooperatives failed to meet their burden of proof that the items for which they sought refunds were also taxed as personal property and qualified for a sales and use tax refund. *Farmers Cooperative v. Nebraska*, 296 Neb. 347 (Neb. S. Ct. April 7, 2017).

South Carolina: An energy company is entitled to a refund of use tax on its out-of-state purchases of canister systems it used to contain spent nuclear fuel rods following the manufacture of electricity because the canister systems qualify for the use tax exemption for pollution control machines. In reaching this conclusion, the South Carolina Administrative Law Judge found that the canister systems are machines that prevent or abate nuclear radiation originating from machines used to manufacture electricity and are necessary to comply with the regulations of a federal agency that has the responsibility to oversee control of this type of pollution. *Duke Energy Corp. v. SC Dept. of Rev*., No. 12-ALJ-17-0031-CC (SC Admin. Law Ct. April 28, 2017).

Utah: A new law adds additional sales and use tax exemptions for purchases or leases of certain machinery, equipment, and parts, and requires an annual study of these exemptions. One exemption includes amounts paid or charged for a purchase or lease of machinery, equipment, or normal operating repair or replacement parts by a manufacturing facility that: (1) is an establishment; (2) is described in the NAICS Code 336111 (Automobile Manufacturing); (3) is located in the state; and (4) uses the machinery, equipment, or normal operating repair or replacement parts in the manufacturing process to manufacture an item sold as tangible personal property. Another exemption includes amounts paid or charged for a purchase or lease of equipment or normal operating repair or replacement parts with an economic life of less than three years by a manufacturing facility that: (1) is an establishment, (2) is described in NAICS Code 325120 (Industrial Gas Manufacturing), (3) is located in the state, and (4) uses the equipment or normal operating repair or replacement parts to manufacture hydrogen. A purchaser that receives either exemption for the previous calendar year must report to the state, on or before October 1: (1) the total purchase or lease price for all machinery, equipment or normal operating repair or replacement parts for which the purchaser received the sales and use tax exemption, and (2) the total amount of sales and use tax that the purchaser would have owed on the purchase or lease price but for the exemption. These changes take effect on July 1, 2017. Utah Laws 2017, SB 132, signed by Governor Gary Herbert on March 22, 2017.

Transactions and services

Georgia: A new law amends the definition of the term "fair market value of the motor vehicle" for purposes of calculating the title ad valorem tax (TAVT) on leased motor vehicles (Ga. Code Ann. §48-5C-1(a)(1)). HB 340 adds a new provision that specifies "[f]or a new motor vehicle that is leased, the total of the base payments pursuant to the lease agreement" to the definition. In effect, the amendment changes Georgia from an "up-front" state, where the transaction tax for leased motor vehicles is based on the value of the vehicle, to an "accelerated lease stream" state, where the tax is based on the total of the lease payments with the tax due, in–full, on the first day of the lease. HB 340 does not include specific provisions addressing how the new definition is to be administered, thereby raising a number of issues and questions related to the TAVT for leases of new motor vehicles. This change takes effect January 1, 2018. Ga. Laws 2017, Act 197 (HB 340), signed by Governor Nathan Deal on May 8, 2017. For more on this development, see EY Tax Alert 2017-626.

Kansas: An assessment of retailers' sales tax against a big-box home improvement store was correctly abated because the store was acting as a contractor, not a retailer, when it installed built-in appliances (e.g., dishwashers, microwaves) into customers' homes. In reaching this conclusion, the Kansas Court of Appeals held the sales tax exemption statute (Kan. Stat. Ann. §79-3603(p)) specifically exempts all installation services connected with the "reconstruction, restoration, remodeling, renovation, repair or replacement of a residence," and does not include an exclusion distinguishing the installation of built-ins from other residential home improvements. Lastly, the court found the decision by the Kansas Board of Tax Appeals that the installation services related to built-ins were exempt from sales tax by statute was not unreasonable, arbitrary, or capricious. *In the Matter of the Appeal of Lowe's Home Centers, LLC*, No. 115,254 (Kan. App. Ct. April 14, 2017).

New Jersey: A fee charged for a subscription that allows a customer to both stream and download videos on demand is subject to the state's sales and use tax, because it is a bundled transaction containing taxable and non-taxable products. Under New Jersey law, specified digital products (e.g., electronically transferred digital audio-visual works, digital audio work, or digital book) are subject to the state's sales and use tax unless valid exemptions exist; an exemption applies if the specified digital product is accessed but not delivered electronically to the purchaser. The New Jersey Division of Taxation determined that streaming is not within the meaning of "specified digital products" and, therefore, is not taxable. Downloading, however, falls within the meaning of "specified digital products," and, as such, is taxable. Since the fee is for both taxable and nontaxable products, as part of a bundled transaction for one price, it is subject to the state's sales and use tax. N.J. Div. of Taxn., N.J. State Tax news: A quarterly newsletter (Vol. 46, No. 1, Spring 2017).

New York: A new law makes clear that sales and use tax applies to the sale of gas service or electric service of whatever nature if the charge is by the vendor for transportation, transmission or distribution regardless of whether such transportation is provided by the vendor or a third party. This change took immediate effect. N.Y. Laws 2017, Ch. 59 (AB 3009/SB 2009), signed by Governor Andrew Cuomo on April 10, 2017.

Utah: A company that develops and operates a website marketplace (company) that enables various unrelated businesses (vendors) to offer products for sale to consumers is not required to collect and remit Utah sales or use tax on consumer marketplace purchases since the company does not make the sales between vendors and consumers. The Utah Tax Commission found that the company does not make the transfer of title, the exchange, or a barter of the vendors' products. Further, the company is not a retailer of the products sold through the marketplace, as it is not a commission merchant, an auctioneer, or a "person regularly engaged in the business of selling to users or consumers." Finally, the company is not required to collect and remit sales or use taxes on its sales of services to the vendors that offer products for sale through the marketplace, because the company's services of processing orders, providing vendors with purchase order information, and processing consumers' payments are not services specifically enumerated as subject to tax. Utah Tax Comn., Private Letter Ruling No. 16-003 (March 31, 2017).

Technology

Indiana: Interface software which a diagnostic medical testing company purchases from third-party vendors so that its proprietary software can communicate with various medical facilities' software systems are a nontaxable service and do not constitute or include sales of taxable tangible personal property, prewritten computer software, or telecommunication services. The Indiana Department of Revenue determined that the charges for interface software are exempt because neither the company nor the medical facilities acquire the interface software for their own independent use and neither are granted any rights to use, control, or access the software. Rather, the software is used by the third party to provide translating services between various software platforms and, as such, the interface software is used incident to the service provided. The Department also found the company satisfied all of the requirements of the serviceperson test, which supports the conclusion that the interface software is nontaxable. Finally, the service is not a telecommunication service, as that does not encompass the third parties' interface services of "data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a purchaser whose primary purpose for the underlying transaction is the processed data or information." Ind. Dept. of Rev., Rev. Ruling No. 2015-07ST (March 7, 2017).

Indiana: The Indiana Department of Revenue found that although cloud-based software did not subject a company's mobile messaging service to Indiana's sales and use tax, the mobile messaging service nevertheless is subject to sales and use tax as a telecommunications service. The Department also found the company's separately listed printer usage fees are subject to sales or use tax as a charge for the rental of tangible personal property. Finally, the company is subject to Indiana utility receipts tax on the gross receipts from the mobile messaging service, as the definition of telecommunications services for purposes of the utility receipts tax includes transmission of such messages. Ind. Dept. of Rev., Rev. Ruling No. 2015-08ST (March 7, 2017).

Massachusetts: A manufacturer's lease of mobile point of sale devices that include pre-loaded prewritten software to a restaurant is subject to Massachusetts sales and use tax because both the device and the software are tangible personal property. The Massachusetts Department of Revenue determined that the pre-loaded software is pre-written software as it is neither designed nor developed by the manufacturer to the specifications of any specific restaurant, the manufacturer does not perform any modifications or enhancements to the software for any restaurant, and premium content on the device is available to each restaurant that elects to lease the device. In addition, charges for the premium license fee, which allows access and use of premium content software on the device, is subject to sales and use tax when the premium license fee includes the ability to access both taxable and nontaxable items (e.g., educational applications, puzzles, videos, and games) and is available only to customers who agreed to pay the fee. The Department noted that this is an additional taxable transfer of a license or right to use prewritten software and, as such, it must be separately stated on a restaurant customer's bill. Mass. Dept. of Rev., Letter Ruling No. 17-1 (March 23, 2017).

Pennsylvania: The Pennsylvania Department of Revenue issued a revised ruling on the extent "support" to canned computer software and other digital property is subject to the state's sales and use tax. In this context, the term "support" means "the providing of advice or guidance concerning otherwise taxable digital or electronic tangible personal property." "Support" includes identifying the source of a problem affecting the usability of property as well as placing/restoring the property in/to a useable state, such as help desk and call center support. Support can be delivered verbally, on-line, automatically or live discussion, and it may be delivered by the property vendor or by a third party support provider. The ruling includes examples of taxable support. The Department noted that support does not include training and generally does not include consulting unless the consulting falls within the aforementioned definition of support. Pa. Dept. of Rev., Legal Letter Ruling No. SUT-17-001 (revised April 4, 2017).

Rhode Island: A company's charges for various cloud computing services (e.g., remote storage service and computing service with an open source instance or a third-party instance) and data transfer fees are not subject to sales and use tax, as they are neither sales of tangible personal property nor taxable telecommunications services. The Rhode Island Division of Taxation determined the storage service, which provides digital storage space for data, applications and software, is not subject to sales and use tax because the customer does not purchase any tangible personal property, prewritten computer software, or specifically enumerated taxable services. The storage service is not subject to the telecommunications tax when the storage service is used to store data and not to route communications. Additionally, computing services with an open source instance or a third party instance are not a specifically enumerated taxable service, as neither the operating system nor the software is licensed to the customers, neither can be electronically downloaded for customers' own use, and customers do not receive a physical copy of the software. Further, these are not bundled transactions because customers pay for access to computing power rather than two or more distinct, identifiable products for a non-itemized price. Lastly, the data transfer fee is not subject to the sales tax; it is not an enumerated taxable service or a taxable telecommunications service. R.I. Div. of Taxn., Ruling Request No. 2017-02 (March 31, 2017).

Washington: The Washington Department of Revenue issued guidance on the tax treatment of computer software maintenance agreements. According to the Department, sales tax does not apply to separately itemized charges when these agreements do not include software upgrades or updates, but are taxable under the service and other activities Business and Occupation (B&O) tax classification. When a maintenance agreement sale is considered a mixed element (i.e., there are software updates and upgrades), then the taxpayer is subject to both retail sales tax and retailing B&O tax as a bundled transaction (assuming the updates or upgrades represent at least 10% of the total price). When professional service charges and the updates or upgrade changes are itemized separately, then each charge is taxed on the nature of the activity. For example, help desk support charges and diagnostic service charges are generally taxed under the services and other activities classification under the B&O tax, while update/upgrade charges are subject to retail sales tax and retailing B&O tax. Lastly, the B&O tax determined under the service and other activities classification may be owed on support service sales or maintenance sales if the sale relates to either custom software or to the customized elements of prewritten computer software. Wash. Dept. of Rev., Tax Topic: Tax treatment of computer software maintenance agreements (March 1, 2017).

Controversy and compliance

Alabama: On remand from the U.S. Supreme Court, the U.S. District Court for the Northern District of Alabama issued its decision in CSX Transportation and upheld Alabama's tax scheme of imposing a 4% sales and use tax on dyed diesel fuel and a 19-cents-per-gallon fuel-excise tax on clear diesel purchases, finding that it does not violate the Railroad Revitalization and Regulatory Reform Act (4-R). In so holding, the court determined that since Alabama does not force rail carriers to use dyed diesel (rail carriers can use either dyed diesel or clear diesel), any "discrimination" results from the rail carrier's business practices and not Alabama law. Alternatively, the court found the sales tax and the fuel-excise tax are roughly equivalent because the rail carriers pay, on average, less than half the amount of tax motor carriers pay. Thus, the evidence does not support a finding that the state's failure to exempt rail carriers from the sales tax for dyed diesel results in discrimination against the rail carriers. Lastly, the court found no discriminatory treatment from the state's exemption of water carriers from the sales tax, noting that the state's failure to provide this exemption could violate the Commerce Clause. Moreover, the rail carrier suffered no competitive injury from Alabama's exemption of water carriers from the sales tax. *CSX Transportation, Inc. v. Ala. Dept. of Rev*., No. 2:08-cv-00655-AKK (N.D. Ala. March 29, 2017).

Florida: In reversing the appeals court, the Florida Supreme Court upheld the state's communications services tax (CST), which imposes a higher tax rate on satellite services than cable services, finding the CST does not violate the dormant Commerce Clause because it is not discriminatory in either its purpose or effect. In reaching this conclusion, the court found cable and satellite providers are similarly situated in their provision of television service and direct competition for customers in the pay-television market, but neither industry is an in-state interest for dormant Commerce Clause purposes. Citing *Amerada Hess, Clover Leaf Creamery Co*., and *Exxon Corp*., the court reasoned that the cable and satellite business models have different impacts on local communities, but neither business produces anything in Florida, neither is headquartered in the state, both have employees and property inside and outside Florida, both employ Florida residents to sell, maintain, or repair their service to Florida customers, and each own and lease a significant amount of Florida property. Finally, the court found that there is no evidence from the statute's text that it was enacted with a discriminatory purpose. *Fla. Dept. of Rev. v. DirecTV, Inc*., No. SC15-1249 (Fla. S. Ct. April 13, 2017).

Oklahoma: A new law repeals the vendors compensation deduction under 68 O.S. §§1367.1 and 1410.1, effective July 1, 2017. Prior to the provision's repeal, vendors were allowed a 1% deduction from sales and use tax for keeping records, filing reports and remitting tax when due; capped at $2,500 per month, per sales tax permit. Okla. Laws 2017, HB 2367, signed by Governor Mary Fallin on May 24, 2017.

Puerto Rico: A new law establishes notification requirements for merchants that conduct sales by mail, including internet sales, and whose only contact with Puerto Rico is through the purchaser who is a person resident in Puerto Rico or a person dedicated to industry or business in Puerto Rico (i.e., a "non-withholding agent"). Beginning on July 1, 2017, merchants that are "non-withholding agents" are required to file the following notices: (1) each time a purchase is completed, the merchant must provide written notification to Puerto Rico purchasers about SUT reporting and payment obligations, including such notice in receipts and invoices; (2) the merchant must provide quarterly notice to the Puerto Rico Treasury Department (PRTD); and (3) the merchant must provide annual notice to Puerto Rico purchasers of their purchases. Merchants that import tangible property into Puerto Rico must submit an *Import Declaration* that provides detailed information on the 10.5% use tax related to the tangible property introduced in Puerto Rico. Act 25-2017 now requires that the *Import Declaration* include the 1% municipal SUT that will now be collected by the PRTD on imported tangible property. EY has learned that Puerto Rico Treasury will continue to pursue voluntary collection agreements with remote sellers, which would apply in lieu of the reporting requirements. For additional information on this development, see EY Tax Alert 2017-824.

Tennessee: A new law delays the effective date of certain Streamlined Sales Tax conformity changes to July 1, 2019 (from July 1, 2017). Provisions that will be delayed include sourcing sales to the delivery or shipping destination, modifications to the single article limitation on local option sales taxes, use of a single sales/use tax return covering multiple dealer locations and implementation of certain privilege taxes in lieu of sales taxes. Tenn. Laws 2017, Ch. 196 (HB 318), signed by Governor Bill Haslam on April 19, 2017. See also, Tenn. Dept. of Rev., Important Notice No. 17-06 (April 19, 2017).

West Virginia: The U.S. Supreme Court has been asked to review the West Virginia Supreme Court's (WVSC) ruling in *CSX Transportation*, which held that a transportation corporation required to pay West Virginia's motor fuel use tax was entitled to a credit for sales tax paid to both other states and to the subdivisions of other states on purchases of motor fuel in the respective jurisdictions. Citing the U.S. Supreme Court's 2015 ruling in *Wynne*,[7] the WVSC concluded that the disallowance of the sales tax credit for sales tax imposed by the subdivisions of other states would produce a total tax burden on interstate commerce higher than a purely intrastate transaction and, therefore, the disallowance of the sales tax credit violates the dormant Commerce Clause. In addition, allowing the sales tax credit only for sales tax paid to other states unfairly discriminates against interstate commerce. *Matkovich v. CSX Transportation, Inc.*, No. 15-0935 (W.Va. S. Ct. November 16, 2016), *petition for cert. filed*, Dkt. No. 16-1251 (U.S. S. Ct. April 17, 2017).

Endnotes

1. Minn. HF 1, 1st Spec. Sess. (signed May 30, 2017).
2. Note that the new law also includes in the definition of "retailer maintaining a place of business in this state" to include "the employment of a resident of this state who works from a home office in this state."
3. The effective date of the new law is the earlier of July 1, 2019, or the date of a decision by the U.S. Supreme Court modifying the *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), decision.
4. *Tyler Pipe Industries, Inc. v. Washington State Dept. of Rev.*, 483 U.S. 232 (1987).
5. N.M. Gov., House Executive Message No. 3 (May 26, 2017)6. Wehrenberg, Inc. v. Director of Revenue, 352 S.W.3d 366 (Mo. 2011).
6. 386 U.S. 753 (1967).
7. *Comptroller of the Treasury of Maryland v. Wynne*, 575 U.S. ___ (2015).

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