

# **Exhibit O**

MDOR Position Statement

## Taxation on the sale of computer software in Mississippi

The Department of Revenue recommends that sales of computer software in Mississippi should be subject to the regular retail rate of sales tax in Mississippi in order to maintain the historical tax base and taxation of software as provided under current Mississippi sales and use tax law. Sales of computer software in Mississippi should be eligible for the special reduced rates of tax provided for manufacturers, farmers, and any other special reduced rates provided for by statute.

### **What is Software?**

The Department recommends that a definition of computer software be put into statute. Software is generally separated into two distinct categories, custom and pre-written. A recommended definition is as follows:

Computer software is defined as set of coded instructions designed to cause a computer to perform a task. Computer software includes programming, code writing, and modification of existing programs. Computer software does not include internalized instruction code that is considered a part of the hardware and taxable as such.

Custom computer software means a computer program prepared to the special order of a single customer.

Pre-written computer software means all software, other than custom software, that is held or exists for general or repeated sale, license, or lease, including software initially developed as customer software for in-house use and subsequently sold, licensed, or leased to third parties.

Computer software does not include access to data or databases but does include the computer programs and code which are used to generate databases. A database is text, data, or other information that may be accessed or managed with the aid of computer software but that does not itself have the capacity to direct the operation of a computer system. Databases are a form of information retrieval services where the customer accesses information but does not have the ability to manipulate the underlying data. Some common examples of data or databases include, but are not limited to, the following:

- Database files
- Research databases
- Genealogical information
- Mailing lists
- Subscription files
- Credit reports
- Surveys
- Real estate listings
- Stock market or bond rating reports
- Abstracts of titles

- Back check lists
- Broadcasting rating services
- Wire services
- Price lists or guides
- Consumer banking
- Newsletters
- Scouting reports
- News clipping services
- Legal reference material

Computer software does not include offerings that include a sufficiently large direct human service component such as accounting services, payroll services and tax return preparation services. The purchase of software by a service provider to use in the performance of these services is taxable; but the charge to the customer for the performance of the services is non-taxable.

### **Method of Delivery to the Purchaser**

The Department recommends that computer software be taxable regardless of the method of delivery. A sale of computer software should include any transfer of title or possession or both, including a license or subscription to use. Software can be delivered in a physical form, such as on a disc or USB, delivered through an electronic or local download to a physical device, computer, or server, or remotely accessed over the Internet. The first two methods of delivery result in the purchaser having physical access to the software. However, in the instance where the software is accessed remotely over the Internet, the seller has given constructive possession to the purchaser and the purchaser has the right to use or control the software.

Software accessed remotely over the Internet is commonly referred to as Software as a Service (SaaS). Software as a service simply means the sale, storage, use or other consumption of vendor-hosted computer software, such as software accessible on the cloud. This includes all vendor hosted software whether the access is permanent or temporary, whether any downloading occurs, or whether the software is hosted by the retailer of the software or by a third party.

While the focus of this study committee is to “examine and develop recommendations regarding the taxation of remote and internet-based computer software products and services”, the DOR also recognizes the need to develop a taxing scheme for Infrastructure as a Services (IaaS) and Platform as a Service (PaaS).

### **Issues to Consider**

Due to the unique issues presented while discussing the taxation of software, the Department believes that there are several issues that should be addressed within the broad context of taxation of software. These issues include:

- Sourcing,
- Bundled transactions; and
- Credit for tax paid to another state

### Sourcing

1. Software that is delivered to the customer at the seller's place of business shall be sourced to the seller's place of business.
2. Software that is not received at the seller's business location is sourced to the location where the purchaser receives the product. If the receipt occurs in multiple locations, the transaction is sourced to those locations if the seller receives delivery information from the purchaser by the time of the invoice.
3. If the locations of the sale cannot be determined as provided above, the sale should first be sourced to the purchaser's address as indicated by the seller's business records, or the purchaser's address as obtained during the sale, including the address indicated on the purchaser's payment instrument, if no other address is available.
4. If the software is delivered electronically, the sale is sourced to the location where the electronic delivery of the software is loaded on the purchaser's computer or server. If the receipt occurs in multiple locations, the transaction is sourced to those locations if the seller receives delivery information from the purchaser by the time of the invoice.
5. Software accessed remotely through the Internet shall be sourced to the location from which the purchaser uses or directs the use of the software, not the location of the code embodying the software. If the purchaser uses the software from locations both within and without the state, then the tax due to Mississippi is based on the portion of the receipt attributable to the users located in Mississippi.

### Alternate Sourcing Options

#### Software received on physical media:

1. Software delivered to the customer on physical media at the seller's place of business shall be sourced to the seller's place of business.
2. Software delivered on physical media that is not received at the seller's business location is sourced to the customer's shipping address if the seller is required to ship the software as a condition of the sale.

#### Software downloaded via the internet and Software as a Service:

1. Software downloaded or accessed via the internet should be sourced to the customer's billing address; or
2. Sourced to any other address of the customer that is known to the seller as the location where the software is downloaded or accessed.

Businesses using software in multiple states may apportion the use tax on the purchase of software according to the use in Mississippi compared to the total use in all states. Businesses using software in multiple states may apply for a direct pay permit to purchase software exempt from Mississippi sales or use tax and then self-accrue the proper tax.

### Bundled Transactions

“Bundled transaction” means a transaction that consists of distinct and identifiable properties or services which are sold for a single nonitemized price, but which are treated differently for tax purposes.

Bundled transactions including a taxable sale of software and other taxable or non-taxable properties or services in which the price of the bundled transaction is attributable to properties or services that are taxable and nontaxable, the portion of the price that is attributable to any nontaxable property or service shall be subject to the tax unless the provider can reasonably identify that portion from its books and records kept in the regular course of business. The software provider shall allocate the price among the properties or services:

- a. By reasonably identifying the portion of the price attributable to each of the properties and services from its books and records kept in the regular course of business; or
- b. Based on a reasonable allocation methodology approved by the department.

This shall not create a right of action for a customer to require that the provider or the department, for purposes of determining the amount of tax applicable to a bundled transaction, allocate the price to the different portions of the transaction in order to minimize the amount of tax charged to the customer. A customer shall not be entitled to rely on the fact that a portion of the price is attributable to properties or services not subject to tax unless the provider elects, after receiving a written request from the customer in the form required by the provider, to provide verifiable data based upon the provider's books and records that are kept in the regular course of business that reasonably identifies the portion of the price attributable to the properties or services not subject to the tax.

Note: Businesses who believe that they are paying for software along with non-taxable products or services may try to use a direct pay permit to pay use tax on a portion of their bill.

### Credit For Tax Paid to Another State

Traditionally, credit for tax paid to another state is not given against sales tax, but it given against use tax paid by the purchaser on property brought into this state that is used in another state. The Department agrees that any solution must include a provision to allow credit in the instance where software that resides out of state may be taxed in whole by another jurisdiction.