SIXTEENTH ANNUAL PAUL J. HARTMAN
STATE & LOCAL TAX FORUM

SALES & USE TAX SOURCING OF SERVICES

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Agenda

- What is a Service
- Situsing of Services
- Allocating the Tax Base
- Questions

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What is a Service?

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Taxation of Services

- While some questions exist on what constitutes tangible personal property for sales/use tax purposes (e.g. computer software, electricity, etc.) even more questions exist with respect to what constitutes a taxable service.
  - Whereas most states have a general imposition clause imposing a tax on the transfer of tangible personal property for consideration, few states have imposed a similar tax on the provision of "services" for consideration. Instead, states have been limited to identifying specific types of services (e.g. consulting, financial, lawn care, etc.) that are subject to tax.

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TPP v. Service

Historical View

Consider the following examples:

- Books
- Magazines
- Newspapers
- Software
- Music
- Mailing Lists
- Databases

*With new technologies emerging and wide spread use of the internet, the above items are not only offered in **tangible** form, but also in **electronic** form.*

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TPP v. Service

Taxable as a Service?

The majority of states that impose a sales and use tax still only tax those services specifically enumerated as taxable. Determining if the sale is taxable can be a daunting task.

- Laws and interpretive guidelines are often outdated.
- There is often a lack of clear guidance.
- Categorization can have significant impact:
  - Reduced rates.
  - Temporary imposition.
  - Reduced tax bases.

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Characterization of Digital Items: TPP or Service?

- **Case Study**
  - Purchase of Software
    - Buy in store on a CD.
      - Prewritten computer software delivered in tangible form.
    - Download to computer via Internet.
      - Prewritten computer software delivered in electronic form.
    - Remotely access on Internet (download nothing).
      - Prewritten computer software, data processing, information service, telecommunications service.

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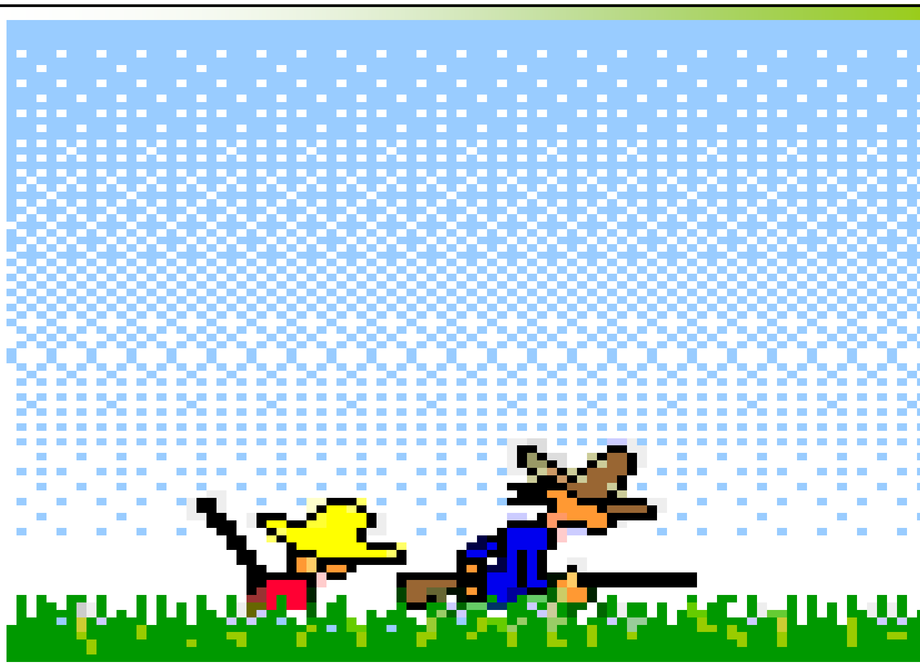

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Situsing of Services

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Taxation of Services

- The Destination Principle
  - The destination principle holds that the sales or use tax will apply at the destination of the taxable property or service irrespective of where title transfers.
  - Destination generally means where the property is delivered to the ultimate consumer. Delivery to the ultimate consumer may include delivery to a purchaser's agent.
  - This principle is generally followed throughout the country even though virtually every state's statute imposes tax on the transfer of title or possession.
  - Although there are some issues with respect to where delivery occurs and who is responsible to collect the tax (e.g. drop shipments), it is generally easier to pinpoint the state in which tangible personal property is delivered. The same cannot be said of services.

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Taxation of Services

- Where are services delivered?
  - As stated above, services are generally taxed where they are delivered to the ultimate consumer or the consumer's agent. However, unlike sales of tangible personal property, the location of the delivery of a service is a little harder to pinpoint.
  - Obviously, when the service provider is in the same state as the ultimate consumer and the service is not provided outside of that state, the service is delivered in that state. However, what happens when more the service provider and the customer are in different states or the service is provided in more than one state.
    - For example: An architect/engineer based in New York visits Illinois to oversee a project and to make modifications to the blueprints.
    - A consulting firm has staff in five states working on a project at multiple locations.

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Sourcing of Services

Sourcing under SST – Section 310:

(A)(1) When the product is **received** by the purchaser at a business location of the seller, the sale is sourced to that business location.

(A)(2) When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.

(A)(3) When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.

(A)(4) When subsections (A)(1), (A)(2), and (A)(3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.

(A)(5) When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A)(4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

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Sourcing of Services

Sourcing under SST – Section 311:

For the purposes of Section 310(A), the terms “receive” and “receipt” mean:

(A) Taking possession of tangible personal property,
(B) Making first use of services, or
(C) Taking possession or making first use of digital goods, whichever comes first.

The terms “receive” and “receipt” do not include possession by a shipping company on behalf of the purchaser.

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SST: Sourcing Rules

- **SST – New Sourcing Rule**
  - December 2007, Governing Board SSUTA amendment to permit an option to destination sourcing for purposes of intrastate sales:
    - A member state may allow origin sourcing for intra-state sales as follows:
      - Applies only to sales of tangible personal property and digital goods.
      - Sourcing to the location of order receipt.
      - Purchaser held harmless for any potential additional use tax due (also not permitted to obtain refunds).
      - Requires state to enhance their direct pay authority.
      - State my elect destination or origin for intra-state sale of tangible personal property and service when invoiced on the same invoice and pursuant to the same contract.

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SST: Sourcing Rules

- **Interpretive Rules for Sourcing of Services**
  - SLAC is currently working on drafting rules related to the sourcing of services.
    - The effort is focusing on services **commonly** taxed by the member states.
    - The effort has begun with sourcing of "services to tangible personal property."
      - What is a service to tangible personal property?

Allocating the Tax Base

Allocating the Tax Base

- Services Delivered to More than One State
  - If a service is provided in more than one location, where should the service be subject to tax?
  - Consider Complete Auto Transit, Inc. v. Brady, 430 U.S. 2174 (1977):
    - the tax must be applied to an activity with a substantial nexus with the taxing state;
    - the tax must be fairly apportioned to activities carried on by the taxpayer in the taxing state;
    - the tax must not discriminate against interstate commerce; and
    - the tax must be fairly related to the services provided by the state.

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Allocating the Tax Base

- The United States Supreme Court has looked specifically at this issue with respect to the telecommunications industry in Goldberg v. Sweet, 148 U.S. 252 (1989) and the transportation industry in Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175 (1995).
- Goldberg v. Sweet
  - Illinois imposed tax upon the “act or privilege” of “originating” or “receiving” interstate communications in Illinois so long as the call was charged to an in-state service address (i.e. to equipment in Illinois). The tax was imposed at a rate of five percent of the gross charge for the telecommunications.
  - The Appellants contended that the Illinois tax violated the apportionment prong of Complete Auto because the tax was levied upon the gross charge for each telephone call instead of the portion of the gross charge that reflected the ratio of in-state activity to total activity associated with the telecommunication.
  - The Supreme Court, however, viewed the issue as to whether the tax was internally and externally consistent; meaning whether the tax was rationally related to the activity in the state and whether if all states imposed the same method of taxation there would be double taxation.
  - The Court recognized only a limited opportunity for multiple taxation since only two types of states had a sufficient nexus to impose a tax on telecommunications: (a) those like Illinois that keyed the imposition of the tax to the service address and (b) those like Arkansas that taxed calls either billed or paid within their boundaries.

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Allocating the Tax Base

- The Court doubted that a state could tax a call merely because electronic signals passed through it, or that the termination of an interstate call, by itself, provided a substantial enough nexus for taxation.
- Illinois avoided "actual multistate taxation" pitfalls by providing a credit for the amount of tax any taxpayer paid in another state on the same call that triggered the Illinois tax.
- In determining that the tax was fairly apportioned among the states, even though based on the gross charge for the call and not just the portion attributable to mileage traveled within Illinois, the Court likened the tax to a sales tax: it was assessed on individual consumers, collected by the retailer providing the service, and accompanied the retail purchase of an interstate telephone call.
- The Court noted that if all states passed the same statute, only one state would tax each interstate telephone call. Even with different statutes, the credit provision in the Illinois statute avoided multiple taxation.
- The Court further found that the tax was fairly related to benefits provided by the state to its taxpayers and, since it fell only on in-state consumers, did not discriminate unfairly against interstate commerce.

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Allocating the Tax Base

– <u>Oklahoma Tax Commission v. Jefferson Lines, Inc.</u>
  - Jefferson Lines, Inc. provided bus services as a common carrier in Oklahoma.
  - Jefferson Lines, Inc. did not collect sales tax on tickets it had sold in Oklahoma for bus travel from Oklahoma to other states.
  - Oklahoma imposes a tax on transportation for hire.
  - Jefferson Lines, Inc. objected
    – The tax imposes an undue burden on interstate commerce.
    – The danger of double taxation.

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Allocating the Tax Base

- Central Greyhound Lines, Inc. v. Mealy et al., 334 U.S. 653 (1948)
  - New York sought to tax the total receipts of Greyhound Lines for transportation services of which 43 percent of the mileage lay in New Jersey and Pennsylvania.
  - The Court held that transactions that substantially took place in New Jersey and Pennsylvania could not be deemed legally to have taken place in New York.
  - Unfair burden of being taxed in multiple states on same revenue
  - Even if neither Pennsylvania nor New Jersey taxed the income, New York could not.
  - The court, however upheld the tax as being constitutional and distinguished Greyhound Lines.
  - The identity of the taxpayers and the opportunities that existed for multiple taxation of the same taxpayer.
  - The Court reserved the question as to whether the Commerce Clause would sanction taxation of tickets sold in Oklahoma for travel wholly outside of the state or for travel on routes originating in other states and terminating in Oklahoma.

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Impact of SSTP

Sourcing Rules for Software, Software Maintenance Agreements & Computer Services

- The Multiple Points of Use ("MPU") Exemption was repealed at the December, 2006 Governing Board Meeting.
- Sourcing rules related to the sourcing of sales of prewritten computer software, software maintenance agreements and computer services were adopted at this same meeting. The sourcing rules essentially follow the hierarchy of Section 310:
  - The sourcing rules generally provides as follows:
    1. Over the counter sales are sourced to the business location of the seller where the sale occurs.
    2. If not over the counter sale, sale is sourced to location where receipt occurs (which can be multiple locations).
    3. When (1) and (2) do not apply, the sale is sourced to the location indicated by an address for the Purchaser that is available from the business records of the Seller that are maintained in the ordinary course of business when use of this address does not constitute bad faith.
    4. When (1), (2), and (3) do not apply, the sale is sourced to the location indicated by an address for the Purchaser obtained during the consummation of the sale, including the address of a Purchaser's payment instrument, if no other address is available, when this address does not constitute bad faith.
    5. When none of the previous rules apply, then the location is determined by the address from which the prewritten software was shipped or, if delivered electronically, was first available for transmission by the Seller.

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Impact of SSTP

SSTP Sourcing "Computer-Related Services"

- "Computer-Related Services" are undefined, and are sourced to where purchaser makes "first use."
- Contains a "delivery" concept:
  - "Over-the-counter" sales are sourced to seller's business location.
  - Services performed at purchaser's location are sourced to that location.
  - Presumption in favor of purchaser's location, not the seller's:
    - Purchaser, with a single location in State A, accesses, but does not license, software located on Seller's server located in State B, which is characterized in both States A and B as a computer-related service. The Seller knows that the Purchaser makes first use of this service at its location in State A. Seller sources the transaction to State A.
- Allocation is allowed when purchaser and seller agree on the allocation method.

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Sourcing Issues

- **Multi-State Sourcing: Develop a Sensible and Uniform Approach**
  - State statutory and regulatory guidance often does not provide an answer/approach. Rather, a "range" of acceptable answers is the norm.
    - Tex. Tax Code 151.330(f)
      - Services performed for use both within and outside this state are exempt to the extent the services are for use outside this state and made taxable on or after September 1, 1987.
  - Most auditors will look for a sensible approach that reflects a system of assigning sales to locations where the service is being "received."
  - Yes, it's true: allocate, allocate, allocate!!
    - Services are often delivered simultaneously to several jurisdictions, which requires allocation.

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Sourcing Issues

- **BUT, how does one source between A, B, C & D?**
  - Based on expected usage?
  - Based on actual usage?
  - Based on an pro-rata split?
  - Based on "value" of the usage (management versus line employees)?
  - Others?
- **No single answer, allocation must be "a reasonable and consistent method" (see SSTP Rule 309.3(2)(b)).**

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Sourcing Issues

- **And, local tax sourcing???**
  - Forgetaboutit!!
  - SSTP does not clearly address (Interpretative rules apply to destination sourcing only).
  - Watch for origin sourcing in several states (e.g., Texas, Ohio).
  - Mix of "destination" and "origination" rules could result in tax credit issues.

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Sourcing Example

- **Sourcing Sales of E-mail and Similar Services**
  - A consumer’s computer may not be located in one jurisdiction.
  - Multiple servers supplying the same information.
- **500 Different “User” Locations in ten different states**
  - Where does “Use” occur?
  - Where does the transaction take place?
    - Server
    - Corporate headquarters
    - Customer’s location
    - Customers billing address
    - Other

Questions?

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SALES & USE TAX SOURCING OF SERVICES

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I. OVERVIEW - TAXATION OF SERVICES

A. In one form or another, 47 states, the District of Columbia, and Puerto Rico impose some type of tax on the sale or use of tangible personal property. The majority of these states also impose a tax on certain types of services (e.g. telecommunications, and other utility services). However, only a handful of these states have extended their sales and use tax statutes to include the taxation of services other than "utility type" services.

B. States have been hesitant to impose a blanket sales tax on services and have met strong resistance in the few instances where they have attempted to do so (Florida in 1987 and Massachusetts in 1991). Part of the resistance can be associated with some of the inherent problems associated with the taxation of the sale of a service versus the sale of tangible personal property. However, as the states seek additional revenue, they will surely attempt to increase the tax base rather than continually increasing the tax rate. In addition, their may be a movement to put service providers on the same playing field as sellers of tangible personal property.

II. HOW DO STATES TAX A SERVICE?

A. Historical View

1. Before the advent of information technology, distinguishing sales of tangible personal property versus services was relatively straightforward.

However, with new technology models constantly emerging and the widespread use of the internet, the distinction between the sale of tangible personal property and a service is no longer straightforward. Consider the following examples of items that, historically, were provided in only tangible form, but are now equally available in electronic form:

a) Books.

(1) Books can now be downloaded for either reading or listening to both handheld devises and computers.

b) Magazines.

(1) Magazine subscriptions can now be purchased for either internet only access, or both delivery in tangible form and internet access.

c) Newspapers.

(1) Newspapers can now be purchased for either internet only access, or both delivery in tangible form and internet access.

d) Software.

(1) Software can be now be utilized in several different forms – it can be delivered in tangible form, downloaded electronically, installed via a load and leave or load and return transaction, or accessed via the use of an application service provider (“ASP”).

e) Music

(1) Music can be downloaded directly via the internet.

f) Mailing lists

(1) Mailing lists can be delivered in electronic form, or can

be accessed remotely.

g) Databases

(1) Databases can now be delivered in electronic form, or can be accessed remotely.

B. Example

1. Today, a company may have several options when purchasing / licensing software. Consider the following example.

a) QuickBooks, an accounting system utilized by many small businesses, is available to its users in a variety of forms:

(1) Tangible Personal Property – A QuickBooks user may purchase / license the software in CD form.

(a) Taxable as the sale of tangible personal property (prewritten / canned software) delivered in tangible form. This is consistent in every state that imposes a sales and use tax.

(2) Electronic Delivery – A QuickBooks user may download the software directly to their computer / server via a secure web site.

(a) Depending on the state, it may be taxable as the sale of tangible personal property, an express exemption, not taxable due to its intangible status, or taxable as a service.

(i) The majority view is that prewritten / canned software is tangible personal property, by virtue of the term being expressly included in the state's definition of tangible personal property.

(a) In those states that have included prewritten computer software in their definition of tangible personal property, some have enacted an exemption for prewritten computer software when delivered in electronic form.[1]

(ii) Some states have not included prewritten computer software in their definition of tangible personal property. In many of these states, the electronic delivery of prewritten computer software is exempt from tax as there in no tangible personal property associated with the sale (exceptions exist for those states that tax computer services).[2]

(iii) Some states tax the electronic delivery of prewritten computer software as the sale of a computer service.[3]

[1] *See*, for example, N.C. Gen. Stat. §105-164.13(43a) and Ok. Rev. & Tax. Stat. §1357(32).
[2] *See*, for example, Fla. TAA 07A-022 (7/19/2007) and Md. Ann. Code §11-101(h)(i)(j) & (k), Md. Ann. Code §11-102(a).
[3] *See*, for example, Conn. Pol. Stmt. 2004(2) (10/21/2004).

(3) Application Service Provider ("ASP") – A QuickBooks user may access the software via a secure web site. The software is not "delivered" in any form, and the data is stored on a secure server hosted by the seller.

(a) Some states treat this transaction as the sale of data processing services, some as electronically delivered software, and some as a telecommunications service.

(i) The majority of states treat ASP's as a data processing service due to the fact that the user is inputting data and receiving that data in some alternative form.[4]

(ii) A few states treat ASP's the same as electronically delivered software. These states have broad imposition language regarding the taxation of software, and may expressly include ASP's, or access, in their definition of taxable prewritten computer software.[5]

(iii) At least one state, South Carolina, views an ASP as a taxable telecommunications service.[6]

[4] *See*, for examples, Pa. SUT Ruling No. 05A-029 (11/17/2007), Tenn. L.R. No. 07-5 (2/13/2007), and Tex. Comp. of Pub. Accts. Letter No. 200401223L (1/14/04).
[5] *See*, Mass. Reg. 830 CMR 64H.1.3 (14)(a).
[6] S.C. Rev. Rul. #03-5 (12/9/03).

C. Thus, as demonstrated above, while some questions exist on what constitutes tangible personal property for sales/use tax purposes (e.g. computer software, electricity, etc.) even more questions exist with respect to what constitutes a taxable service.

1. Whereas most states have a general imposition clause imposing a tax on the transfer of tangible personal property for consideration, few states have imposed a similar tax on the provision of “services” for consideration. Instead, states have been limited to identifying specific types of services (e.g. consulting, financial, lawn care, etc.) that are subject to tax. In other words, generally, all sales of tangible personal property are taxable unless specifically excluded, whereas sales of services are generally exempt unless specifically enumerated as taxable by a state statute.

2. State sales and use tax laws are often too outdated or antiquated to address many services available in today’s environment. While there are some states that tax all services, such as Hawaii, New Mexico and South Dakota, most states tax only those services that are specifically enumerated as taxable. Even when states tax enumerated services, there is no guarantee that the states have developed sufficient guidance to keep up with newly emerging

services and technologies that may or may not fall under a previously defined category of enumerated services.

3. Determining whether a sale fits into a specifically enumerated service can be a daunting task. Not only will this determination impact whether the sale is taxable as a service, but it can also impact the taxable amount or rate applicable to that transaction. Consider, for example:

    a) Connecticut imposes tax on computer services at a reduced rate of 1%.[7]

    b) Texas provides a 20% exemption from the tax base for data processing and information services.[8]

4. By specifically listing services which are subject to tax, states have created additional questions with respect to definitions of certain services.

    a) For example, what is a consulting service? Does that include accounting and legal services?

    b) Can the provision of a service be an "occasional sale"? Does a one time clean up of leaves in your yard by your next door neighbor's kid constitute "lawn services"?

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[7] Conn. Gen. Stat. §12-407(a)(37)(A).
[8] Tex. Code §151.351.

D. If tangible personal property is transferred as a part of a sale of service, is this taxed as a sale of a service or a sale of tangible personal property?

1. Transactions in which tangible personal property is transferred to the consumer as part of a service presents a unique state sales tax issue.

2. If tangible personal is transferred in a nontaxable service transaction and the transfer of property is a consequential element of the transaction, then some states declare the entire transaction taxable, even if that state does not impose a tax on services.

3. By contrast, where the transfer of property is an inconsequential element of the transaction, then the charge for the service is exempt from tax only if the charge is separately stated by the retailer. This rule is generally referred to as the “true object” or “object of the transaction” test. For example, the sale of transcripts by court reporters has been found to be exempt from tax under the theory that the “true object” of this transaction is the reporting service rather than the transcripts themselves.

4. In those states that have adopted the true object test, the person rendering the service is subject to tax on the purchase of the property transferred.

5. Materials used in rendering services, as contrasted with property transferred to the ultimate consumer as part of the service transaction, are generally subject to tax even in those states that do not impose a tax on the particular service in issue. For example, the purchase of shampoo by a hair stylist would be subject to tax as the consumer of the shampoo.

6. New Jersey Revenue Statute Section 54:32B-2(e)(4)(E) provides "the term retail sale does not include professional, insurance, or personal service transactions which involve the transfer of personal property as an inconsequential element, for which no separate charges are made."

7. Ohio Revenue Code Annotated Section 5739.01(B)(5) provides "sales and selling do include professional, insurance or personal service transactions which involve the transfer of tangible personal property as an inconsequential element for which no separate charges are made."

E. What types of services are subject to tax?

1. Computer software and related installation and maintenance services (e.g. Connecticut).

2. Cleaning services (e.g. Arizona).

3. Painting, polishing and finishing tangible personal property (e.g. California).
4. Telephone and telegraph (e.g. Colorado).
5. Credit services (e.g. Arizona).
6. Transportation services (e.g. Georgia).
7. Computer and data processing services (e.g. Connecticut)
8. Processing and printing services (e.g. New Jersey).
9. Installation, maintenance and repair to tangible personal property (e.g. New York).
10. Photographic services including film processing and video taping (e.g. Wisconsin).
11. Business analysis, management consulting and public relations (e.g. Connecticut).
12. Information services (e.g. District of Columbia).

III. WHERE ARE SERVICES TAXED?

A. The Destination Principle

1. The destination principle holds that the sales or use tax will apply at the destination of the taxable property or service irrespective of where title transfers.

2. Destination generally means where the property is delivered to the ultimate consumer. Delivery to the ultimate consumer may include delivery to a purchaser's agent.

3. This principle is generally followed throughout the country even though virtually every state's statute imposes tax on the transfer of title or possession.

4. Although their are some issues with respect to where delivery occurs and who is responsible to collect the tax (e.g. drop shipments), it is generally easier to pinpoint the state in which tangible personal property is delivered. The same cannot be said of services.

B. Where are services delivered?

1. As stated above, services are generally taxed where they are delivered to the ultimate consumer or the consumer's agent. However, unlike sales of tangible personal property, the location of the delivery of a service is a little harder to pinpoint.

2. Obviously, when the service provider is in the same state as the ultimate consumer and the service is not provided outside of that state, the service is delivered in that state. However, what happens when more the service provider and the customer are in different states or the service is provided in more than one state.

a) For example: An architect/engineer based in New York visits Illinois to oversee a project and to make modifications to the blueprints.

b) A consulting firm has staff in five states working on a project at multiple locations.

C. Allocation or apportionment of services for sale/use tax purposes

1. If a service is provided in more than one location, where should the service be subject to tax. The United States Supreme Court has looked specifically at this issue with respect to the telecommunications industry in Goldberg v. Sweet, 148 U.S. 252 (1989) and the transportation industry in Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175 (1995).

2. Constitutional Limitations

a) Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)

(1) The tax must be applied to an activity with a substantial nexus with the taxing State;

(2) the tax must be fairly apportioned to activities carried on by the taxpayer in the taxing state;

(3) the tax must not discriminate against intestate commerce; and

(4) the tax must be fairly related to the services provided by the State.

b) Goldberg v. Sweet

(1) Illinois imposed upon the "act or privilege" of "originating" or "receiving" interstate communications in Illinois so long as the call was charged to an in-state service address (i.e. to equipment in Illinois. The tax was imposed at a rate of five percent of the gross charge for the telecommunications.

(2) The Appellants contended that the Illinois tax violated the apportionment prong of Complete Auto because the tax was levied upon the gross charge for each telephone call instead of the portion of the gross charge that reflected the ratio of in-state activity to total activity associated with the telecommunication.

(3) The Supreme Court, however, viewed the issue as to whether the tax was internally and externally consistent; meaning whether the tax was rationally related to the activity in the state and whether if all

states imposed the same method of taxation there would be double taxation.

(4) The Court recognized only a limited opportunity for multiple taxation since only two types of states had a sufficient nexus to impose a tax on telecommunications: (a) those like Illinois that keyed the imposition of the tax to the service address and (b) those like Arkansas that taxed calls either billed or paid within their boundaries.

(5) The Court doubted that a state could tax a call merely because electronic signals passed through it, or that the termination of an interstate call, by itself, provided a substantial enough nexus for taxation.

(6) Illinois avoided “actual multistate taxation” pitfalls by providing a credit for the amount of tax any taxpayer paid in another state on the same call that triggered the Illinois tax.

(7) In determining that the tax was fairly apportioned among the states, even though based on the gross charge for the call and not just the portion attributable to mileage traveled within Illinois, the

Court likened the tax to a sales tax: it was assessed on individual consumers, collected by the retailer providing the service, and accompanied the retail purchase of an interstate telephone call.

(8) The Court noted that if all states passed the same statute, only one state would tax each interstate telephone call. Even with different statutes, the credit provision in the Illinois statute avoided multiple taxation.

(9) The Court further found that the tax was fairly related to benefits provided by the state to its taxpayers and, since it fell only on in-state consumers, did not discriminate unfairly against interstate commerce.

c) Central Greyhound Lines, Inc. v. Mealey et al., 334 U.S. 653 (1948)

(1) The State of New York sought to tax the total receipts of Greyhound Lines from transportation of which 43 percent of the mileage lay in New Jersey and Pennsylvania.

(2) The Court held that transactions that substantially took place in New Jersey and Pennsylvania could not be deemed legally to have taken place in New York.

(3) If New York were to have been allowed to impose a tax on the gross receipts for the entire mileage of a trip that had not taken place totally in New York, this would have subjected interstate commerce to an unfair burden of being taxed as to portions of its revenue by states that gave protection to those portions, as well as by a state that did not give such protections.

(4) Additionally, if neither Pennsylvania nor New Jersey had sought to tax their proportionate share of the revenue from this transportation, it would still not have justified the taxing by New York of the entire revenue.

d) Oklahoma Tax Commission v. Jefferson Lines, Inc.

(1) Jefferson Lines, Inc. is a Minnesota corporation that provided bus services as a common carrier in Oklahoma.

(2) Jefferson Lines, Inc. did not collect sales tax on tickets it had sold in Oklahoma for bus travel from Oklahoma to other states, although it did collect and remit taxes for all tickets it had sold in Oklahoma for travel that originated and terminated in that state.

(3) Oklahoma imposes a tax on certain services including transportation for hire and assessed Jefferson Lines, Inc. tax on the tickets it sold in Oklahoma that originated Oklahoma, but terminated outside of Oklahoma.

(4) Jefferson Lines, Inc. objected to the assessment and claimed that: (a) the tax imposes an undue burden on interstate commerce by permitting Oklahoma to collect a percentage of full purchase price of all tickets for interstate bus travel, even though some of the value derives from bus travel through other states, and (b) the danger of double taxation exists because any other state through which a bus travels while providing the services sold in Oklahoma will

be able to impose a tax of their own upon Jefferson Lines, Inc. or its passengers.

(5) Jefferson Lines, Inc. relied upon the Court's decision in Greyhound Lines for support.

(6) The Court, however upheld the tax as being constitutional and distinguished Greyhound Lines.

(7) The features that distinguished the New York tax from the Oklahoma tax were (a) the identity of the taxpayers and (b) the opportunities that existed for multiple taxation of the same taxpayer. The taxpayer in New York was the interstate carrier and the carrier was subject to possible taxation on its income in other states. The taxpayer in Oklahoma was the purchaser who was not subject to tax in other states.

(8) In Oklahoma, the taxable event comprised an agreement, payment and delivery of some of the services. Because no other state could claim to be the site of such a combination, there was no threat of multiple taxation.

(9) The Court reserved the question as to whether the Commerce Clause would sanction taxes for tickets sold in Oklahoma for travel wholly outside of the state for travel on routes originating in other states and terminating in Oklahoma.

e) Origination, termination and payment or billing appears to be the key to situsing the sale of service when the service takes place in more than one state. However, how will this formula work with e-business remains to be seen.

IV. ELECTRONIC COMMERCE

A. When trying to source sales of e-mail and similar services, situsing the sale is complicated by the fact that a consumer's computer may not be located in one jurisdiction but may instead be moving (e.g. laptop computers, cellular phones, pagers, personal communications networks).

B. When a vendor of Internet access or on-line services is considered the consumer of purchased telecommunication services, not the reseller, should the call be sourced to where the vendor is headquartered, or to the locations of the ultimate consumers of the end product? Does it make a difference if the on-line vendor has centralized server or switching pin through which all calls are routed?

C. A computer software company sells a multistate customer the right to utilize its software in 500 different "user" locations in ten different states. The computer software company then electronically transfers a single version of the software to a single server site from which the software is accessed by the 500 employees. Is the sale of the software taxable in just the single jurisdiction where the server is located? What if that jurisdiction considers such a transaction to be the sale of nontaxable intangible property? Would a use tax be due in some or all of the other nine states from which the purchaser's employees access the software?

V. IMPACT OF THE STREAMLINED SALES TAX PROJECT ("SSTP")

1. While the SSTP has, with some exceptions (i.e., bundling, sourcing, etc.), avoided addressing services, SSTP has offered some clarity in participating states at least with respect to prewritten computer software and digital goods. These definitions have introduced a greater degree of predictability for both sellers and purchasers transacting business in these areas. It is unlikely, however, that the SSTP will venture too far into the broader enumerated services arena and the problem of state tax legislation failing to keep pace with rapidly changing technology and business models is likely to continue to be a challenge for businesses struggling to meet their state tax compliance responsibilities.

   a) Prewritten Computer Software

(1) The SSTP has defined tangible personal property to include prewritten computer software (regardless of form of delivery). However, the SSTP has also developed definitions for both “delivered electronically” and “load and leave.” States have the ability to carve out exemptions for prewritten computer software delivered via one of these alternative methods.

b) Digital Goods

(1) The SSTP has defined specified digital products. The definition is somewhat narrow in scope, including the terms digital audio visual works, digital audio works, and digital books. However, of significance is the fact that the digital products provisions expressly state that no state shall include specified digital products, among those items defined with specified digital products, in its definition of ancillary services, computer software, telecommunications services or tangible personal property.

c) Sourcing

(1) SST has developed sourcing rules for both sales of tangible personal property and services. While guidance is still being developed to further clarify the sourcing rules related to services, in general, specific sourcing rules have been developed addressing computer services and software maintenance agreements. See *Appendix* for the SST sourcing rules.