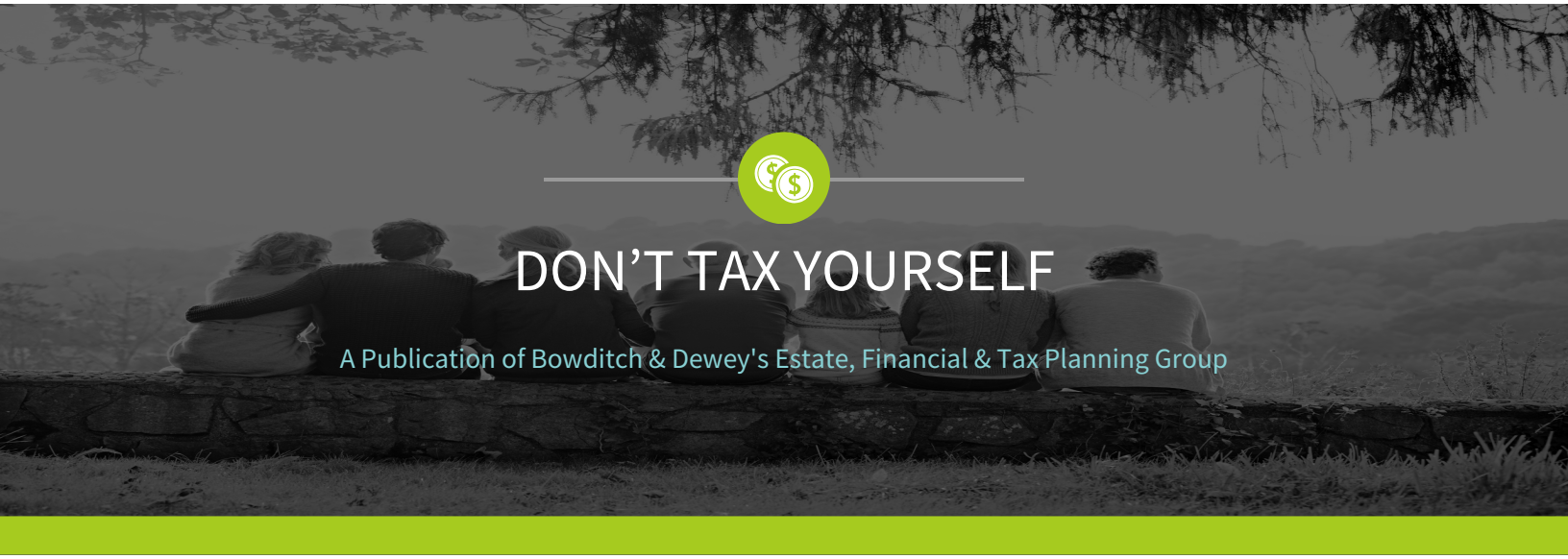

# DON'T TAX YOURSELF

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## Oracle USA, Inc. vs. Commissioner of Revenue: Tax Abatements Available for Out of State Software Sales

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Software vendors and purchasers won an important victory in a decision handed down by the Massachusetts Supreme Judicial Court (SJC) this May. The SJC affirmed vendors can use the normal abatement process to apportion sales tax on software sold for use outside the Commonwealth. The case is a juxtaposition of modern technology tangling with antiquated statutory law. The SJC found that Commissioner of Revenue overstepped his authority and raised "separation of powers concerns" in attempting to legislate whether to allow apportionment of the sales tax, and not just detail **how** to carry out apportionment.

### BACKGROUND

Massachusetts imposes a sales tax on all sales of tangible personal property within the Commonwealth. While this tax made sense for the physical CD-ROMs of the past, most software is now electronically delivered to computers remotely. Further, the 'sale' often no longer involves actual transfer of title. Today, businesses acquire a license or right to use the software, which is then accessed by all users of such business, regardless of their location in or out of state.

To address this change in software transfers, the Massachusetts Legislature amended the sales tax statute by extending the definition of "tangible personal property" to include electronically transferred software, and delegated the duty of determining the apportionment of sales tax for such software to the Commissioner of Revenue. The statute at the crux of this case, *(G.L.c. 64H, Section 1)*, reads as follows:

> "The commissioner may, by regulation, provide rules for apportioning tax in those instances in which software is transferred for use in more than one [S]tate."

The Commissioner offered three potential options for recording such apportionment. All three are unpractical for the

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typical software sales process, because they require taking steps within a short window of time of the sales tax becoming due. In practicality, a purchaser will often not have factual knowledge of how many users of the software are out-of-state until a much later time.

Such was the case in *Oracle*, where the purchaser remitted tax based on the entirety of the sale, and only later, when it received data regarding out-of-state users, forwarded the information to the vendor. When the vendor applied for abatement through the statutory process, the Commissioner denied the request for rebate.

## SEPARATION OF POWERS

The Commissioner argued first that the key word in the above statutory amendment, "the commissioner **may**, by regulation, provide rules for apportioning tax" implied the Commissioner has the discretion to decide not only how, but also whether to apportion taxes on out-of-state software. The SJC concluded this argument runs aground of separation of powers concerns, as only the Massachusetts Legislature has the authority to tax. While the Legislature can delegate to the executive branch (i.e. the commissioner of revenue) the job of implementing a system to enforce such tax, it "may not delegate the making of fundamental policy decisions."

The Commissioner argued next that abatement was not available because the purchaser did not follow the Commissioner's apportion procedure. The SJC concluded to the contrary that the general abatement process that exists for taxpayers who have paid excessive taxes under GL.c 62C, §37 applied in the *Oracle* case. The Court noted the general abatement process already applies to vendors using abatement for refund of taxes paid for sales destined for resale. The Court found no reason why the process should not apply to Oracle in this situation.

## GOOD FOR BUSINESS

The SJC's ruling will be a relief to all purchasers and vendors of software in the Commonwealth. The Commissioner's insistence on such a tight window to report out-of-state sales would harm businesses within state and out of state operations and be contrary to the legislative intent to allow apportionment of sales taxes among instate users and out of state users.

For more information, please contact the alert author or your Bowditch attorney at 508-791-3511.

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