



M2K - USA Sales Tax Series

Sales tax on software and SaaS

ALERT #7

Foreword

Sales and Use tax compliance is a major challenge for businesses operating in the United States. Unlike many countries with a single national sales tax, US sales tax being a local levy, there are **thousands of taxing jurisdictions**. This means businesses must navigate a maze of different tax rates, taxability rules, filing schedules, and exemption requirements just to sell the same product in different states.

The complexity doesn't stop there. The **2018 Supreme Court Wayfair decision** changed the game by requiring businesses to collect and remit sales tax even if they have no physical presence in the state. Now, simply exceeding a certain number of sales or revenue in a state can trigger a tax obligation, making it even harder for remote sellers and online businesses to keep up. States have moved quickly to enforce these "economic nexus" rules, and the risk of audits and penalties for non-compliance is higher than ever. Further, certain states levy sales tax on enumerated services, which is unknown to many businesses operating in the United States.

M2K's US Sales Tax Series is designed to educate the readers/ businesses & simplify the complexities. In the series, we will explain how sales and use taxes work, when should you get registration, what are the compliances that would apply, etc.





Background

1

Historically, sales tax was primarily levied on sale of tangible personal property (goods). However, many states expanded their sales tax laws to include services, computer software and software as a service (SaaS) within the definition of taxable goods and services.

2

The taxability of software generally hinges on its delivery method (physical or electronic) and its classification (prewritten or custom software).

3

The taxability of SaaS is also treated inconsistently across states i.e., some states tax SaaS as a service or as a tangible personal property, while others exempt it entirely.

4

Given the varied treatment of software & SAAS across the states, it is pertinent to understand the state law and collect sales tax if applicable



Taxability of prewritten software

- ❑ Prewritten software or canned software refers to off-the-shelf software not designed for specific use of any purchaser.
- ❑ Prewritten software could include accounting software, video games, browsers, etc.
- ❑ Prewritten software sold on physical media (such as CD) is generally treated as tangible personal property and subject to sales and use tax.
- ❑ Prewritten software which is downloaded electronically is treated as tangible personal property in certain states and hence subject to sales and use tax.

State	Taxability
New York	Prewritten software is taxable, regardless of the mode of delivery.
California	Prewritten software is taxable, if delivered through physical media. However, it is not taxable if it is delivered electronically.



Taxability of custom software



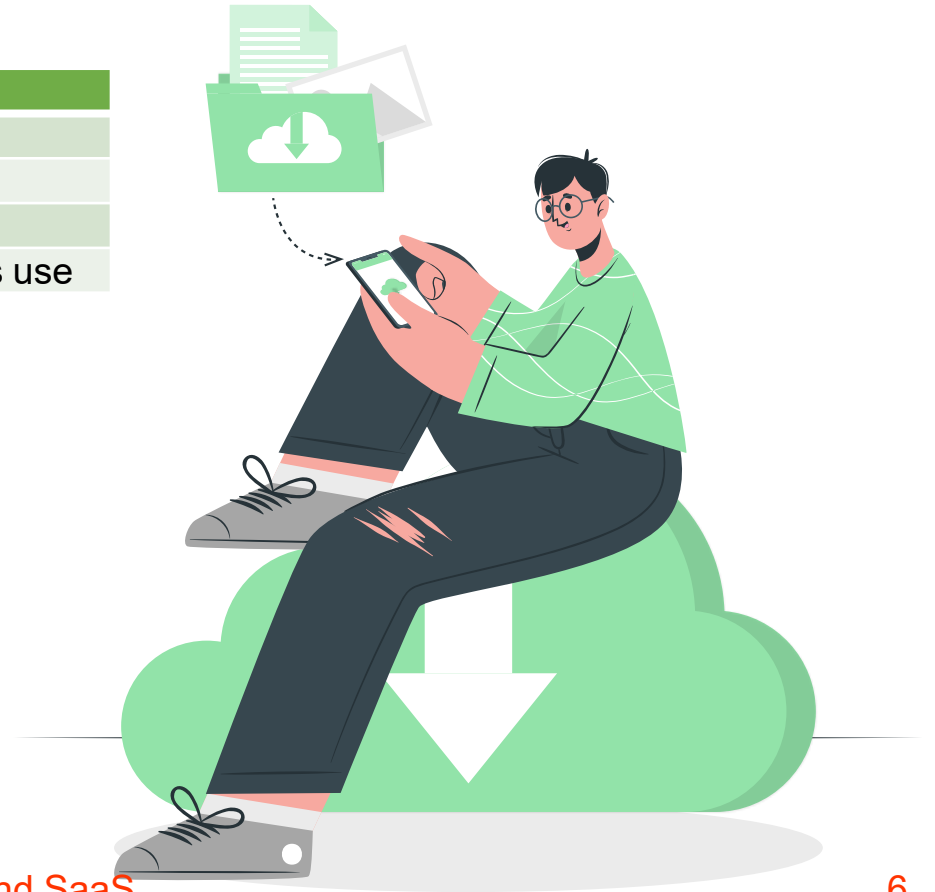
- ❑ Software designed and developed to meet a specific customer's needs is classified as custom software.
- ❑ Custom software is typically exempt from sales tax in most states.
- ❑ If the custom software is sold to someone other than the person for whom it was originally developed, it may become subject to sales and use tax.

State	Taxability
Illinois	Custom software is not taxable
Tennessee	Custom software is treated as tangible personal property and hence taxable.

Taxability of SaaS

- ❑ SaaS refers to software which is accessed on the cloud through a license / subscription without the customer owning or downloading the software.
- ❑ Given that the customer does not “own” the software, some states treat it as renting a service rather than buying a product.

State	Taxability
New York	Taxable
California	Does not tax digital goods
Iowa	Not taxable if it is purchased for business use
Connecticut	Taxed at a reduced rate if it is purchased for business use



Stay tuned for more updates on Sales & Use Tax

Please find below the list of alerts proposed to be released in the series (every Tuesday & Thursday). In case you have missed the previous alerts, click on the [hyperlink](#).

General overview

1. **Introduction to sales & use tax**
2. **Situs of sale**
3. **Sales tax exemptions**
4. **Determining nexus**
5. **Registration & compliances**
6. **Voluntary disclosure agreements**
7. Sales tax on software & SAAS

State wise overview

- | | | |
|----------------|--------------------|--------------------|
| 1. Alabama | 18. Kentucky | 36. North Dakota |
| 2. Alaska | 19. Louisiana | 37. Ohio |
| 3. Arizona | 20. Maine | 38. Oklahoma |
| 4. Arkansas | 21. Maryland | 39. Oregon |
| 5. California | 22. Massachusetts | 40. Pennsylvania |
| 6. Colorado | 23. Michigan | 41. Rhode Island |
| 7. Connecticut | 24. Minnesota | 42. South Carolina |
| 8. Columbia | 25. Mississippi | 43. South Dakota |
| 9. Delaware | 27. Missouri | 44. Tennessee |
| 10. Florida | 28. Montana | 45. Texas |
| 11. Georgia | 29. Nebraska | 46. Utah |
| 12. Hawaii | 30. Nevada | 47. Vermont |
| 13. Idaho | 31. New Hampshire | 48. Virginia |
| 14. Illinois | 32. New Jersey | 49. Washington |
| 15. Indiana | 33. New Mexico | 50. West Virginia |
| 16. Iowa | 34. New York | 51. Wisconsin |
| 17. Kansas | 35. North Carolina | 52. Wyoming |

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Thank You



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