Purchasing Digital Products – A Comparison of Canadian and U.S. Taxes

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I. INTRODUCTION TO THE TAXING SYSTEMS

A. U.S. SALES & USE TAXES

1. Currently, there are forty-five (45) states, plus the District of Columbia and Puerto Rico, which impose sales and use taxes. New Hampshire, Oregon, Montana, Alaska, and Delaware do not impose sales and use taxes at the state level. Each state's rules regarding the taxability of products and services differ; however, in general, sales and use tax is imposed on all sales of tangible personal property (unless otherwise exempt), enumerated services, and more recently, some states are imposing tax on digital goods. Currently, there are over 20 states that tax the download of digital goods in some form, be it movies, music, books, ringtones, etc.

2. There are several nuances impacting the taxability of software related transactions:

   a. Canned v. Custom Software - Most states tax canned software (a.k.a. prewritten computer software) if delivered in tangible form, but many will exempt the sale of custom software also delivered in tangible form. The rational behind the exemption for custom software is that the sale of custom software represents a professional service, rather than a sale of tangible personal property. Each state provides its own definition of what is canned and custom software, and as a result, these definitions vary by state.[1]

[1] The Streamlined Sales Tax Project, of which over 20 states are members, defines "canned software" as "computer software, including prewritten upgrades, that are not designed and developed by the author or other creator to the specifications of a specific purchaser." While many states have a similar definition, there are some states with exceptional differences. For example, up until March 1, 2010, the State of Colorado defined canned software as "software that is pre-packaged for repeated sale or license; and the use of the software is governed by a tear-open non-negotiable license agreement." This extremely narrow definition resulted in software which was available for repeat use to many different customers (which would generally be treated as taxable canned software in many states), to possibly be exempt custom software in Colorado merely because the license agreement was, in fact, negotiable. Such confusion and inconsistencies led the State to change their definition to a more standardized one.

In Wisconsin, the definition of tangible personal property was amended effective March 6, 2009 to include prewritten computer software, regardless of how it is delivered to the purchaser. Wis. Stat. § 77.51(10r). Under prior law, tangible personal property included computer programs except custom computer programs. The new provisions effectively reversed the Wisconsin Supreme Court's *Menasha* decision,

b. Delivery Method (Tangible, Electronic Delivery, Load and Leave) - The manner in which software can be transferred today may also change the taxability of canned software. Many states will exclude from sales and use taxes the sale of software which is transferred by electronic means (i.e. downloaded from the internet), as well as software transmitted by the load and leave method (i.e., software which is loaded by the vendor, but not transferred in tangible form to the customer). The rationale for these exclusions is that because the software is not provided in tangible form, it does not meet the definition of tangible personal property. Generally, states which tax software delivered by electronic means have amended their definition of tangible personal property to expressly include canned or prewritten computer software.[2]

c. New Technology Models – An increasingly complex area exists regarding new technology models which center around hosted software, in particular, Application Service Provider's (ASP), also commonly referred to as cloud computing or software as a service (SaaS). Users of the software hosted by an ASP typically will access the software via the Internet. The software is owned and hosted by the ASP. The ASP also owns and maintains the server and networking equipment required for the user to access the software. This arrangement is generally documented with a services agreement, as opposed to a software license agreement. There have been a plethora of rulings in the sales and use tax arena analyzing whether such arrangements represent the sale or license of prewritten

which held that canned software consisting of an integrated business application software system that had to be significantly modified before it could be used by a user was exempt as custom software. *Wis. Dep't. of Rev. v. Menasha Corp.*, No. 2004AP3239 (7/11/ 2008). The SAP software at issue in the case was made up of standard software modules and was mass marketed to thousands of different businesses, but always had to be significantly modified to fit a client's particular business needs. The Wisconsin Supreme Court had held in *Menasha* that the software was custom software because the purchaser made significant investments in presale consultation and analysis, testing, training, written documentation, enhancement, and maintenance support, and therefore the significant cost of the system weighed in favor of a finding that the software was custom software. However, the Department's adoption of the new definition changes effectively reversed the decision rendered in *Menasha,* making significantly modified canned software, such as the SAP software at issue, taxable in Wisconsin.

[2] *See*, e.g., Ala. Reg. 810-6-1-.37(4); Me. Rev. Stat. § 1752(17); Wy. Stat. § 39-15-101(a)(ix).

computer software or the sale of a service. Many of these rulings' decisions are based on what type of agreement is executed to document the arrangement, a software license agreement, or a services agreement. There is a significant amount of inconsistency, and the states are getting aggressive in their policy decisions in this area.[3]

d. Services Ancillary to the Sale of Software – In many instances, otherwise non-taxable services are taxable if the service charges are performed "in connection with" the sale of tangible personal property, such as consulting, installation or programming charges made in conjunction with the sale of canned software. Determining whether the sale of the service is made "in connection with" the sale of the software is an area ripe with controversy.[4]

B. CANADIAN SALES TAXES

1. Canada imposes a 5% federal value added tax called the Goods and Services Tax ("GST") on most goods and services in Canada, including most sales of software and related services. Certain provinces, including Ontario, British Columbia, Newfoundland and Labrador, New Brunswick and Nova Scotia, have harmonized their provincial sales taxes with the GST to form a single Harmonized Sales Tax ("HST"). Generally, the HST applies in the same manner as the GST (it is imposed under the same act, the *Excise Tax Act*, it is the same registration number, etc.). The HST includes both the 5% federal GST component, and a provincial component which ranges from 7% in British Columbia to 10% in Nova Scotia, for a combined HST rate of 12% to 15%. As the GST/HST is a value added tax, most companies which are registered for GST and are engaged in "commercial activities" (which excludes exempt activities such

[3] New York holds that prewritten computer software is included within the definition of tangible personal property, "regardless of the medium by means of which such software is conveyed to the purchaser" (N.Y. Tax Law §1101(b)(6)), and therefore, taxes ASP's as the sale of prewritten computer software. *See* TSB-A-09(33)S (8/13/2009). New York's position is that the customer exercises "constructive use" of the software. These rulings are directly contrary to the ALJ determination *In the Matter of the Petition of VOICEMATE.COM, INC.*, Docket No. 819864, New York Division of Tax Appeals (06/02/2005).

[4] Texas takes the position that a service is taxable as part of the sale of software if the service is performed by the vendor who sold the underlying software. *See* Tex. Reg. 34 TAC §3.308(b)(1)&(4).

as most financial transactions) can claim an input tax credit (in effect a refund) for any GST/HST which they pay.

2. The province of Quebec has a separate value added tax called the Quebec Sales Tax ("QST") which generally mirrors the GST/HST and applies in the same manner, however it is imposed under a different Act, and uses a different registration number.

3. The provinces of Prince Edward Island, Manitoba and Saskatchewan impose a separate provincial sales tax which applies in a similar manner to most US state taxes (i.e. on tangible personal property, including software, and on limited taxable services). Ontario and British Columbia had similar legislation, although their provincial sales taxes were effectively repealed as of July 1, 2010 when the provinces harmonized their sales taxes with the GST.

4. The province of Alberta, and the 3 territories do not have provincial sales taxes.

II. DISTINGUISHING TANGIBLE PERSONAL PROPERTY FROM SERVICES OR DIGITAL PRODUCTS

A. Historical View

1. Before the advent of information technology, distinguishing sales of tangible personal property versus services, and now, digital products, 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 or digital product 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.

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

   b. Magazines.

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

c. Newspapers.

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

d. Software.

i. 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

i. Music can be downloaded directly via the internet.

f. Mailing lists

i. Mailing lists can be delivered in electronic form, or can be accessed remotely.

g. Databases

i. Databases can now be delivered in electronic form, or can be accessed remotely.

B. If the Transaction Is Not Taxable as the Sale of Tangible Personal Property, is it Taxable as a Service of Something else and Why is Categorization So Important?

1. U.S. SALES & USE TAXES

a. State sales and use tax laws are often too outdated or antiquated to address many of the new technology models available in today's environment, which might often be taxed as a service. 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.

b. 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:

i. Connecticut imposes tax on computer services at a reduced rate of 1%.[5]

ii. Maryland passed legislation, which was subsequently repealed that would have begun taxing computer services effective July 1, 2008 through June 30, 2013.[6]

iii. Texas provides a 20% exemption from the tax base for data processing and information services.[7]

2. CANADIAN SALES TAXES

a. The provinces of Manitoba, Saskatchewan and Prince Edward Island have provincial taxes which generally apply to tangible personal property (including software), and specific taxable services (which include most services relating to software) such that the same issues mentioned above for sales and use taxes in the various States are issues in these provinces as well. This was also historically an issue in Ontario and British Columbia which had similar provincial sales taxes until July 1, 2010.

b. Many of these issues are not nearly as significant now under the GST/HST/QST regime, as these taxes apply to most goods and services. Thus, the issue of whether something is tangible or intangible "property" or a

[5] Conn. Gen. Stat. §12-407(a)(37)(A).
[6] Md. SB 2 (11/19/2007).
[7] Tex. Code §151.351.

"service" is often only relevant for determining which province a supply is made in (in order to determine the applicable GST/HST/QST rate) and not for determining whether taxes are payable in the first place (with the exception of supplies to non-residents where the supply may be "zero-rated", i.e. no GST/HST is payable, if certain conditions are met.

c. As the GST and HST are imposed under the same act, the rules for determining whether a supply is property or a service, and where the supply is considered to be made are the same for all of the HST jurisdictions. Similarly, for QST purposes, Quebec applies virtually identical rules and interpretations to the GST/HST provisions.

C. 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:

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

         a) U.S.: 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.

         b) Canada: Canada takes the same approach as the U.S.

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

         a) U.S.: Depending on the state, it may be taxable as the sale of tangible personal property, expressly exempt, not taxable due to its intangible status, or taxable as a service.

1. 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.[8]

2. 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).[9]

3. Some states tax the electronic delivery of prewritten computer software as the sale of a computer service.[10]

b) Canada: In Canada, the Canada Revenue Agency ("CRA") takes the view that a supply made by electronic means is not a supply of tangible property, despite the fact that the digital product may be one that would traditionally be viewed as tangible personal property (such as a book

[8] *See*, for example, N.C. Gen. Stat. §105-164.13(43a) and Ok. Rev. & Tax. Stat. §1357(32).
[9] *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).
[10] *See*, for example, Conn. Pol. Stmt. 2004(2) (10/21/2004).

or music). As a result, a supply made by electronic means is characterized as either a supply of intangible personal property or a supply of a service (both of which, for GST/HST/QST purposes are still generally taxable). The electronic delivery of software would generally be considered a supply of intangible personal property.

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

1. 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.[11]

2. 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.[12] Some states will make this distinction based solely on the agreement executed between the ASP and the customer – if it's a software agreement, the state will treat it as prewritten computer software.

[11] *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).
[12] *See*, Mass. Reg. 830 CMR 64H.1.3 (14)(a).

3. At least one state, South Carolina, views an ASP as a taxable telecommunications service.[13]

b) CANADA: For GST/HST/QST purposes, various factors are looked at when determining whether a supply made by electronic means is a supply of intangible personal property or a supply of a service. For example, if a right in a product is provided, or the product has already been created or developed, this suggests that the supply is intangible property. If the supply does not involve the provision of a right, or there is human involvement in making the supply, this suggests that the supply is a service. In general, the CRA would take the view that the above example is essentially the provision of a right to use software and is therefore characterized as a supply of intangible property.

III. WHERE ARE DIGITAL PRODUCTS / SERVICES TAXED?

A. U.S. SALES & USE TAXES

1. The Destination Principle

a) 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.

b) 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.

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

[13] S.C. Rev. Rul. #03-5 (12/9/03).

d) 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.

2. Where are services delivered?

a) State statutes and regulations are not likely to be as explicit about where services are taxed as they are regarding taxation of property transactions. However, most states that have considered the question opt for a destination principle similar to property transactions, in effect treating the transaction as sitused where it is received.

b) However, unlike sales of tangible personal property, the location of the delivery of a service is a little harder to pinpoint.

c) 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.

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

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

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

a) 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 <u>Goldberg v. Sweet</u>, 488 U.S. 252 (1989) and the transportation industry in <u>Oklahoma Tax Commission v. Jefferson Lines, Inc.</u>, 514 U.S. 175 (1995).

b) Constitutional Limitations

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

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

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

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

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

(2) Goldberg v. Sweet

(a) 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.

(b) 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.

(c) 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.

(d) 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.

(e) 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.

(f) 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.

(g) 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.

(h) 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.

(i) 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.

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

(a) 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.

(b) 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.

(c) 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.

(d) 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.

(4) Oklahoma Tax Commission v. Jefferson Lines, Inc.

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

(b) 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.

(c) 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.

(d) 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.

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

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

(g) 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.

(h) 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.

(i) 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.

(5) 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.

B. CANADIAN GST/HST/QST PLACE OF SUPPLY RULES

1. Tangible Personal Property

a) Similar to the Destination Principle, for GST/HST/QST purposes, tangible personal property is considered to be supplied in the province where it is delivered or made available, received (if shipped) or ordinarily located if possession is given for more than 3 months (e.g. a lease of equipment).

2. Intangible Personal Property

a) General Rules

(1) Intangible personal property that can be used only primarily (over 50%) outside of Participating Provinces (provinces which have HST, being: Ontario, British Columbia, Nova Scotia, Newfoundland and New Brunswick) – for instance, if software is restricted to use in a non-Participating Province such as Alberta – then the supply is deemed to be made in a non-Participating Province and only GST (and QST if in Quebec), and not HST would normally apply.

(2) If intangible personal property can only be used primarily in Participating Provinces, then the supply will be deemed to be made in a Participating Province. In this case, taxpayers will have to determine which Participating Province the supply

is made in as different HST rates apply to the different provinces:

(a) The place of supply is the province where the greatest portion of use of Canadian rights would occur if all rights were exercised. Thus, if intangible personal property can be used only in one Participating Province, then this province is the place of supply. This rule, and the rule in (1) above only apply if the rights in question are specifically limited to a particular province. If this is not the case, for example, if the rights can be used in any province in Canada, this rule would not apply, and the rule in (3) below would apply.

(b) If the Participating Province of greatest portion of use cannot be determined, the place of supply is:

(i) If the value of the consideration for the supply of the intangible personal property is $300 or less, the supply is considered to be made in a particular Participating Province if the supply is made through a permanent establishment of the supplier located in the province in the presence of an individual who is, or who acts on behalf of, the recipient, or through a vending machine situated in the province, and the intangible personal property can be used in the Participating Province.

(ii) If the above rule does not apply (because the value is over $300 or there is no permanent establishment, etc.), generally the place of supply will be the address of the recipient (assuming the intangible personal

property can be used in this province).

(iii) If the above 2 rules do not apply (i.e. over $300 and the address of the recipient has not been obtained), then the highest applicable HST rate for a Participating Province in which the intangible personal property can be used will apply.

(3) If intangible personal property is not limited to Participating or Non-Participating Provinces, then the place of supply is:

(a) If the value of the consideration for the supply of the intangible personal property is $300 or less, the supply is considered to be made in a province if the supply is made through a permanent establishment of the supplier located in the province in the presence of an individual who is, or who acts on behalf of, the recipient, or through a vending machine situated in the province, and the intangible personal property can be used in that province. Note that this applies to both Participating and Non-Participating Provinces.

(b) If the above rule does not apply, generally the place of supply will be the address of the recipient (assuming the intangible personal property can be used in that province).

(c) If the above 2 rules do not apply, then the highest applicable HST rate among the provinces in which the property can be used will apply (up to 15%).

3. Special Rules For Intangible Personal Property Relating To Tangible Or Real Property Or Services

a) There are special rules if the intangible personal property is in relation to real or tangible property located in a particular province (generally the place of supply will be based on the location of the real or tangible property).

b) There is a special rule such that if intangible personal property is in relation to services to be performed, and the supplier can determine that the services would all be supplied in a single province (based on the rules for services), this province would be the place of supply for the intangible personal property as well.

4. Services

a) General Rule

(1) Under the general rule, if a supplier has obtained the recipient's business address, this address generally determines the place of supply.

(2) If the recipient's business address has not been determined, then if the service was not performed primarily in Participating Provinces, only GST (and QST if in Quebec) would normally apply.

(3) If the service was performed primarily in Participating Provinces, and no business address is obtained, then the province where the greatest part of the service was performed is the place of supply if the greatest part was performed in a single province. If the greatest part of the service was not performed in a single Participating Province, the highest HST rate for a province in which the service is performed will apply (up to 15%).

b) Special Rules For Services Relating To Real or Tangible Property

(1) There are special rules if the service is in relation to real or tangible property located in a particular province (generally based on the location of the real or tangible property).

c) Special Rules For Computer-Related Services And Internet Access

(1) If there is a single final recipient (i.e. a person who acquires the supply for a purpose other than resupplying it to another person) of a supply of a computer-related service or Internet access, the supply is made in a province if the final recipient avails itself of the service or access at a single location in that province and the supplier keeps information sufficient to determine this location or it is the normal business practice of the supplier to obtain information sufficient to determine this location. In any other case (i.e. this information is not available), the supply will be made in a province if the mailing address of the recipient is in that province.

(2) A different rule applies if there are multiple final recipients of a supply of a computer-related service or Internet access made by a particular supplier, and in the case of each final recipient, there is a single location at which the final recipient avails itself of the service or access and the supplier keeps information sufficient to determine this location or it is the normal business practice of the supplier to obtain information sufficient to determine this location. In these circumstances, the place of supply for computer-related services is made under the general rule for services set out above (i.e. generally the billing address of the recipient). The place of supply rules for Internet access in these circumstances is based on the rules for intangible personal property set out above (as if the Internet access were available in each province to which the final recipients avail themselves of the access).

(3) In any other case (i.e. this information is not available), the supply will be made in a province if the mailing address of the recipient is in that province.

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.