

March 6, 2015

Hon. Jack Brandenburg, Chair
Hon. David Robertson, Vice-Chair
Michigan Senate Finance Committee
125 West Allegan Street
Lansing, MI 48933

SB 0082 & SB 0083

Dear Senator Brandenburg, Senator Robertson and Members of the Committee:

Please accept the following letter as my testimony in support of Senate Bills Nos. 0082 and 0083 (hereinafter, the “Bills”), which would clarify the Legislature’s intent that remote access to software is not subject to the Michigan sales and use tax. As Michigan courts have repeatedly concluded, remote access to software has never been taxable but the Department of Treasury has continued to try to force businesses to pay tax on these transactions.

My name is Stephen Kranz and I am a Partner at the Washington, DC office of the law firm of McDermott, Will & Emery, where I specialize in state and local tax. I also served as the President of the Business Advisory Council to the Streamlined Sales Tax Governing Board and have worked as an advisor to that group on behalf of the business community since the inception of the Streamlined Sales Tax Project in 2000. I submit this letter to you as an expert in the field of state taxation of software and digital products to express the technical and policy concerns that support adoption of this exemption.

Michigan’s sales and use tax is imposed on the sale or use of tangible personal property and certain enumerated services. As an initial point, remote access to software is not among the enumerated services subject to sales and use tax. A sale of tangible personal property, which is defined to include prewritten computer software, is subject to sales and use tax only if there has been some transfer of ownership or possession of the property. In providing remote access to software, service providers will grant customers the right to use prewritten software that is installed on the service provider’s servers. However, the remotely accessed software is not downloaded by the customer. While the law appears clear that the granting of a right to use software in this situation is not taxable, the Michigan Department of Treasury has aggressively pursued imposing taxes on these transactions.

Within the past year, there have been three cases decided in Michigan on this issue, two in the Michigan Court of Claims and one at the Michigan Court of Appeals. Fortunately, in each

Hon. Jack Brandenburg, Chair
Hon. David Robertson, Vice-Chair
March 6, 2015
Page 2

of these three cases that seller was successful and the courts concluded that remote access to software was not taxable.

On March 20, 2014 the Michigan Court of Claims held in *Auto-Owners Ins. Co. v. Dep't of Treasury* that remote access to various third-party providers' information and software in the provision of their insurance services to their clients was not subject to use tax under the prewritten computer software regime. Specifically the court held that because the clients did not download any software, it was not "delivered by any means" within the meaning on the statute.

The Michigan Court of Claims decided a subsequent case, *Rehmann Robson & Co. v. Dep't of Treasury*, on the exact same basis on November 26, 2014. In that case, the judge's opinion was extremely clear that tax cannot be imposed on such transactions until the Legislature has expressed a clear intent to do so.

Shortly after the *Auto-Owners* decision, the Michigan Court of Appeals decided *Thomson Reuters, Inc. v. Dep't of Treasury* on May 13, 2014. The decision again found that remote access to online services is not taxable in Michigan. Notably the court held that the taxpayer's provision of online tax and accounting research services accessed online were not subject to tax because any tangible property involved was *merely incidental* to the nontaxable information services provided. The court did not conclude whether remote access to software was the sale of tangible personal property or not.

Although the sellers were successful in these cases, legislation is still needed. Because much of tax enforcement occurs at the audit and administrative levels, the Department of Treasury continues to systematically assess businesses for the use of remote access software. Businesses may not be able to afford to challenge a Department's position even when there is clear case law supporting the business' position. Clear statutory language is more important than ever to make it clear to the Department of Treasury what the statute means and provide clarity to businesses regarding their obligation.

Businesses are rapidly adapting their enterprise systems and other software platforms to be accessed over the Internet. Providers of this access are seeking newer, larger, and more flexible data centers from which they will provide these services to a national, and sometimes worldwide, business community and are also seeking the most advantageous places to locate them. Michigan can gain an advantage over other states in attracting such businesses by enacting this clarifying legislation and thereby sending a strong message to the high-tech and business communities that Michigan is a good place to do business.

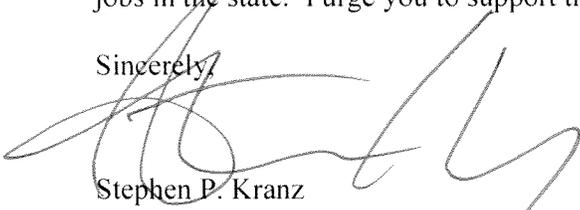
Imposing a tax on remote access to software harms economic development in Michigan. Under the current law regarding nexus, only a company with physical presence in Michigan is subject to sales and use tax. Thus, the sales and use tax on remote access to software falls primarily on in-state companies, putting them at a disadvantage against out-of-state companies

Hon. Jack Brandenburg, Chair
Hon. David Robertson, Vice-Chair
March 6, 2015
Page 3

when both are competing for Michigan customers. The tax thus restricts the innovation of this burgeoning field of technology and hampers growth. Continuing to impose tax on remove access to software would limit the amount of jobs created in Michigan in this field because of the increased cost. Passage of these bills would alleviate this concern.

Language in the Bills indicates that they are “curative and . . . intended to express the original intent of the legislature concerning the taxation of prewritten computer software.” As such, the Bills clarify the Legislature’s intent regarding the tax treatment of a service for which the Department has never been granted the authority to tax. Enacting the Bills provides certainty regarding sales and use tax collection obligations for businesses currently in Michigan and for those contemplating a new business location in the state. At a time when Michigan’s economy is in great need of new industries, enacting the Bills is a strong step towards the creation of new jobs in the state. I urge you to support this legislation.

Sincerely,



Stephen P. Kranz

Cc: Senator Steven M. Bieda (MVC)
Senator Marty Knollenberg
Senator Tom Casperson
Senator John Proos
Senator Rebekah Warren