

**Report to the Mississippi Legislature**  
by the  
**Taxation of Remote and Internet-Based  
Computer Software Products and Services Study Committee**

**October 1, 2022**

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The Taxation of Remote and Internet-Based Computer Software Products and Services Study Committee (the “Committee”) is pleased to submit this report to the Mississippi Legislature offering certain recommendations for Mississippi’s policies regarding the sales and use taxation of software and related services.

**I.**

**Introduction / Background**

The Mississippi Legislature empaneled the Committee pursuant to Senate Bill 2831 (2022) with the charge “to examine and develop recommendations regarding the taxation of remote and internet-based computer software products and services under the Mississippi Sales Tax Law and the Mississippi Use Tax Law.” See, *Senate Bill 2831 (2022)*, attached as **Exhibit A**. The Legislature also instructed the Committee to make “recommendations for which of such products and services should be taxable and the manner in which the products and services should be taxed.”

The Committee consisted of the following individuals and organizations:

- (a) The Commissioner of the Mississippi Department of Revenue (“MDOR”);
- (b) The Chief Executive Officer of the Mississippi Association of Realtors (“Realtors”);
- (c) The Executive Director of the Business and Industry Political Education Committee (“BIPEC”);
- (d) The President of the Mississippi Manufacturers Association (“MMA”); and
- (e) The President of the Mississippi Bankers Association (“MBA”).

The Legislature formed the Committee following MDOR’s proposal in September 2021 to update its regulations concerning the sales and use taxation of Computer Equipment, Software, and Services. See, *MDOR Notice re Proposed Amendment to Miss. Admin. Code 35.IV.5.06, September 24, 2021*, attached as **Exhibit B**. Several of the proposed changes raised concerns and questions among the Mississippi business community, and MDOR conducted an oral proceeding / public hearing on November 3, 2021 to discuss those concerns. See, *MDOR Notice Setting Date for Hearing on Proposed Amendment to Miss. Admin. Code 35.IV.5.06, October 12, 2021*, attached as **Exhibit C**.

Numerous parties submitted questions and comments prior to or following that public hearing. Among those submissions were the following:

1. Letter from Thirteen Mississippi Trade Associations dated October 28, 2021, attached as **Exhibit D**;
2. Letter from the Council on State Taxation dated October 12, 2021, attached as **Exhibit E**;
3. Letter from TechNet dated November 2, 2021, attached as **Exhibit F**; and,
4. Letter from the Mississippi Bankers Association dated December 17, 2021, attached as **Exhibit G**.

While MDOR was reviewing and considering the various submissions and questions raised by the public, Senate Bill 2831 was introduced to amend the sales and use tax statutes in a manner intended to preserve Mississippi's historic policies regarding the taxation of certain computer software products and related services. See, *Committee Substitute for S.B. 2831*, attached as **Exhibit H**. During that process, the Legislature conducted various hearings and amended Senate Bill 2831 to form the Committee to study the complex issues surrounding the taxation of these items. Governor Reeves signed Senate Bill 2831 on March 28, 2022, becoming effective upon passage.

The Committee conducted its first meeting on May 19, 2022, at MDOR's offices in Clinton, Mississippi. At this meeting, the Committee adopted its by-laws and elected BIPEC President and CEO Derek Easley as the Chairman, and MDOR Commissioner Chris Graham as Vice-Chairman. The Committee held additional meetings on the following dates:

1. June 29, 2022 – BIPEC offices
2. August 4, 2022 – Mississippi Realtors office
3. August 29, 2022 – Mississippi Manufacturer's Association office
4. September 9, 2022 – Mississippi Realtors office
5. September 26, 2022 – Mississippi Department of Revenue
6. September 29, 2022 – Telephonic meeting

The agendas and minutes from those meetings are attached collectively as **Exhibit I**.

## II.

### Executive Summary of Committee Recommendations

The Committee adopted the following general policy recommendations to the Legislature:

#### Taxation of Software

##### *Taxation of business transactions - software*

Mississippi should exclude from the sales/use tax all sales of software to business consumers and used as a business input. Under this policy, Mississippi would NOT tax software delivered or downloaded into the state, or software located remotely and accessed via the Internet, if it is used as a business input.

##### *Taxation of business transactions - services*

Mississippi should exclude from the sales/use tax all software-related services to business consumers and used as a business input. Under this policy, Mississippi would NOT tax software related services provided to customers in the state if it is used as a business input, even if provided in-person within the state.

##### *Taxation of non-business consumer transactions*

The Committee adopted no specific recommendation as to Mississippi's sales/use tax policy on sales of software and related services to non-business consumers.

With regard to recommendations concerning definitions and examples of taxable and nontaxable items, the Committee did not propose specific language to codify, but based on discussions and information exchanged during the meetings the members believe these are topics on which all could reach a consensus during the legislative drafting process:

#### Definitions and General Topics

1. The statutes should specifically define the term "computer software."
2. The statutory definition of "computer software" should not include data or databases.
3. The statutory definition of "computer software" should not include apps or similar programs downloaded to a computer or mobile device that merely enable the user to access software housed remotely.
4. The statutory definition of "computer software" should not include Platform-as-a-Service ("PaaS") or Infrastructure-as-a-Service ("IaaS") even though those may be commonly understood as elements of "cloud computing."
5. The statutes should specifically define the term "computer software sales and services."
6. The definition of "computer software sales and services" should not include data processing services.

7. The statutes should include a non-exclusive list of items that are considered non-taxable. This list might include, for example, items such as research databases, credit reports, real estate listings, rating reports and services, title abstracts, wire services, consumer banking, etc.
8. The statutes should include a general statement of principle that in the context of software and related services, any ambiguities or uncertainties as to whether an item, service, or transaction is taxable or nontaxable shall be presumed to be nontaxable unless and until the Legislature affirmatively acts to clarify the statutes.

### III.

#### Overview of MDOR Proposed Regulatory Amendments

As noted above, MDOR's original proposal to update the state's regulation on the taxation of computer equipment, software and services sought to modernize that regulation to address new technologies. The Committee acknowledged that the regulation was outdated and should be updated, and specifically addressed and discussed several of MDOR's proposed changes as noted below.

One of the first changes contained in the proposed amendment would have modified the definition of "computer software" and added a number of new defined terms such as cloud computing, Software as a Service ("SaaS"), Platform as a Service ("PaaS"), and Infrastructure as a Service ("IaaS"): <sup>1</sup>

#### 101 Computer Program and Software Sales and Services

1. Definitions.~~—"Computer Program" is a series of instructions that are coded for acceptance or use by a computer system which are designed to permit the computer system to process data and provide results and information. The series of instruction may be contained in or on magnetic tapes, printed instructions, or other tangible or electronic media or downloaded via the Internet. This definition includes computer game cartridges or discs which that allow certain games to be played on a television set through interaction with a computer or on home computers.~~
  - ~~b.~~ "Computer Software" means any computer data, program or routine, or any set of one or more programs or routines, which are used or intended to cause one or more computers, pieces of computer-related peripheral equipment, automatic processing equipment, or any combination thereof, to perform a task or set of tasks, is a collection of computer programs which work in cooperation with one another to perform automated tasks. Computer software may be contained in or on magnetic tapes, discs or other tangible or electronic media or downloaded online.
  - b. "Cloud Computing" describes the delivery of computing resources, including software applications, development tools, storage, and servers over the Internet. The term includes the software as a service model (SaaS), platform as a service model (PaaS), infrastructure as a service model (IaaS), and similar service models.
  - c. "Software as a Service" is software hosted and maintained by a third-party provider and delivered to customers over the internet as a service. The provider hosts and maintains the databases and code necessary for the application to run, and the application is run on the provider's servers.
  - d. "Platform as a Service" is a cloud computing model where a third-party provider delivers hardware and software tools to users over the internet. The provider hosts the hardware and software on its own infrastructure.
  - e. "Infrastructure as a Service" is a cloud computing model that delivers fundamental computing, network, and storage resources to consumers on-demand, over the internet.

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<sup>1</sup> In these images from the MDOR notice, strikethrough items represent proposals to remove existing language from the regulation, while underlined items are proposed additions.

The proposed amendment appeared to clarify that cloud computing was not necessarily software *per se*, but rather a modern means of delivering software. When read in conjunction with the definition above, however, it appears that SaaS could be construed as both software and a means of delivery under the proposed regulation:

- a. The gross income received from computer ~~program or~~ software sales and services is taxable at the regular retail rate of sales tax. Computer ~~program software~~ license fees (one-time or annual) and/or maintenance contract income are taxable regardless of how billed. Taxable services ~~also~~ include the design and creation of a web page regardless of the location of the hosting server and certain services, delivered through SaaS, PaaS, IaaS and other cloud computing models.

Perhaps the most significant change contained in the proposed amendment, however, was the removal of the following provision addressing the use tax ramifications of remotely accessed software (e.g., SaaS). This change was perhaps the most heavily discussed issue before the Committee as it goes to the heart of the Legislature's instruction to study and report on the taxation of remotely access software products.

300301 ~~Use Tax.—~~Section 27-67-3(i), defines computer software programs as tangible personal property for use tax purposes. The regular rate of use tax is due and payable from every person using, storing, or consuming such property within this state, possession of which is acquired in any manner. ~~However, software maintained on a server located outside the state and accessible for use only via the Internet is not taxable.~~

While the proposed amendments at face value appear not to be particularly extensive, they presented a number of questions and issues that many in the business community believed should be addressed in a public hearing and most likely by the Legislature. To that end, the organizations noted above submitted several letters outlining concerns and points of clarification that they addressed with MDOR at its November 3, 2021 hearing. Those issues are addressed in more detail in the following section.

#### IV.

#### Concerns and Questions Raised by the Business Community

In the submissions presented to MDOR by the multiple trade associations and other business organizations, those parties raised a wide range of concerns with the proposed amendments. See, *Exhibits D – G above*. These concerns generally consisted of questions related to the practical application of the new rules in common business settings, and evidenced the complexity of the broader issue of how the state proposed to tax multi-jurisdictional, multi-functional, multi-user software products across a number of different business contexts. The specific questions presented in those submissions included but were not limited to the following:

- What specific legislative or judicial developments precipitated or necessitated the proposed amendments?
- Did MDOR consult with the Legislature, the Governor’s office, or any other state officials as to whether these changes properly reflect Mississippi’s tax policy?
- How have other surrounding states addressed these issues?
- How much additional sales or use tax revenue does MDOR estimate the proposed amendments will raise?
- Was any report (internal or external) prepared explaining MDOR’s calculations, assumptions, or reasons that the proposed amendments were exempt from economic impact statement requirements?
- Would the proposed amendments apply only to individual consumer transactions, or also to business-to-business transactions?
- Would the use tax now apply to traditional computer services, or just computer software?
- What are examples of “certain services” that would now be taxable under subsection 101(2)(a) of the proposed regulation?
- Would the proposed amendments apply only to payments to third parties for computer software, or also to a company’s access to or use of its own internal software?
- Does it matter if the internal software was self-developed versus acquired or licensed from external sources?
- Would the proposed amendments now render common intercompany administrative services subject to sales or use tax?
- If so, what specific types of administrative services would be taxable versus nontaxable and under what circumstances (e.g., accounting, legal, HR, payroll, marketing, advertising, customer support, etc.)?
- If a Mississippi user accesses its own computer software maintained on a server outside Mississippi and that results in a taxable transaction, how is the “value” of that determined for use tax purposes?

- Does MDOR contend it has authority under the proposed amendments to restate the value of any taxable intercompany computer software or services if it does not believe the price actually charged reflected an arm's length value?
- Would the sales tax credit apply with respect to computer software now subject to Mississippi use tax, when certain elements of that software might previously have been taxed or assessed by other states? If so, how will that credit be computed and applied?
- The proposed definition of computer software specifically includes "data" whereas it previously only referenced a set of instructions to permit a computer to process data. Do any other jurisdictions consider data to be the same as software?
- How would the proposed amendments apply in the following common situations:
  - A Mississippi user accesses a company's internal database housed on a server or other computer located inside Mississippi;
  - A Mississippi user accesses a company's internal database housed on a server or other computer located outside Mississippi;
  - A company utilizes a self-created database versus a third-party database
- If software was maintained on a server or computer equipment in Mississippi, what events would qualify or disqualify it from being considered "first used" outside Mississippi for purposes of the export rule referenced in new Subsection 101(2)(c)?
- If a company has a single master license agreement authorizing use by both Mississippi and non-Mississippi employees, how will vendors or the companies determine that portion of the license fee subject to Mississippi tax?
- If a license fee encompasses a range of features, only some of which are used in Mississippi, how will vendors or the companies determine that portion of the license fee subject to Mississippi tax?
- When a bank customer accesses a bank's core software, is that now a taxable transaction?
- Many other types of services that are not subject to sales tax theoretically could be subject to tax under the proposed amendments to the extent they are provided utilizing remote software and computer equipment. These could include legal, accounting, engineering, architecture, medicine and many other traditional professional services. Could the proposed amendments render those software-reliant services taxable when provided remotely, and if so, under what circumstances?
- Would automated payment processing services (e.g., debit, credit, ACH services) be considered taxable software or services under the proposed amendments when either the purchaser, seller, or intermediary financial institution is located in Mississippi?

- If so, what portion of the total processed payment might be taxable - the full amount of the processed payment, just the merchant discount, or just a portion of the merchant discount?
- Are internet access services provided by internet service providers (“ISP”) subject to sales or use tax under the proposed amendments? If so, would an ISP now be required to collect sales or use tax on transactions or data travelling over their systems?
- Has MDOR studied the impact of the Internet Tax Freedom Act or other federal laws on the constitutionality of the proposed amendments?
- Would the proposed amendments encompass online advertising so as to render those previously non-taxable services taxable? If so, how will the tax base be determined when the advertising is available in or the purchaser/targets are located in multiple jurisdictions?
- The participants are aware that MDOR has been providing written instructions to various vendors to collect sales and use tax on transactions that would not be taxable under the existing regulation. What is the effective date of the proposed amendments and do they potentially have retroactive effect?
- How should taxpayers determine if a software-related transaction is made at retail or wholesale when it is provided to a customer or affiliate that utilizes that item in providing a broader service or product?
- How many different parties could be held liable for sales or use taxes on remote-accessed computer software or services? The provider? Any intermediaries? The end user? All three?
- How can an end consumer under audit discover whether MDOR has already collected a tax on a particular transaction via an audit of the vendor, or vice versa?
- What credit mechanisms are available to mitigate the potential for MDOR to collect the tax from multiple parties on audit?
- If a vendor over-charges or over-collects tax on a transaction, what recourse does the customer have to recover those taxes?
- If the customer is limited to obtaining a refund or credit only from the collecting vendor, rather than from MDOR directly, what recourse does the customer have if the vendor refuses to cooperate?
- Given that every transaction processed by a bank runs through its Core system, does the processing and posting of transactions within this “Core” rise to a taxable event every time a transaction is initiated, and if so, would each level of vendor used to facilitate these transactions be a taxable event?
- If the “Core” is treated as taxable tangible personal property, then is it purchased for the ultimate benefit of customers by virtue of the transaction processing being performed on their behalf?

- Would the use of remote deposit capture services, which often involve special scanners the depositor must use with fees associated with this hardware, create a new tax on deposit transactions if the customer chooses to use these services?

Many of these questions were addressed and clarified in the public hearing on the proposed amendments on November 3, 2021, with several being taken under further advisement by MDOR for later incorporation into an updated proposal. The scope and complexity of the issues originally presented, however, clearly demonstrated the need for comprehensive study and debate on these policy issues.

These questions were condensed into a master list of issues that was circulated among the Committee members prior to its June 29, 2022 meeting. See, *Preliminary List of Issues to Address in Taxation of Software and Related Services*, attached as **Exhibit J**. At that meeting, the Committee agreed to use this list as a template for soliciting additional input from the public that would assist the members with better understanding the practical implications and consequences of the proposed amendments for the local business community.

## V.

### Committee Fact-Finding Efforts and Discussions

#### A. Solicitation of Public Input

The first substantive external step taken by the Committee was to solicit public input on a number of topics previously addressed at the November 3, 2022 hearing and in subsequent discussions. The Committee circulated a list of specific questions to interested parties to solicit that feedback. See, *List of Topics for Feedback Intake Form*, attached as **Exhibit K**.

The Committee posted this intake form online and interested parties uploaded their comments to be reviewed at the following meeting. The various responses were compiled and presented to the Committee for review and discussion at its August 4, 2022 meeting. See, *Compiled Responses to Intake Survey*, attached as **Exhibit L**.

The responses to the public survey conveyed the following perceptions of the proposed regulation and how those changes could be expected to impact Mississippi businesses:

- Respondents were generally opposed to increasing taxes on business inputs.
- The widespread view was that the MDOR regulation would constitute a tax increase.
- Some respondents noted that MDOR had honored prior refund claims on remote software, further substantiating the perception that the proposed regulations represent a clear shift in tax policy.
- Some respondents felt that software should be taxed.
- Software is so integral to business and day-to-day operations that it is now indispensable, in many cases being mandated by law or regulation.
- The proposed regulation and change in tax policy would impact virtually every aspect of a business's operations.
- All upfront and continuous maintenance of software would appear to be taxable.
- There is a general inability to distinguish service v. software in many settings.
- There is a general practical inability to distinguish or segregate SaaS v. PaaS v. IaaS under many ordinary contracts.
- There is a common inability to distinguish software v. data as those often are too integral and vendors may not provide information sufficient to segregate the bundled transactions.
- Most respondents did not know or had difficulty identifying the extent to which their software is actually downloaded locally, if at all, as compared to accessed remotely.
- Often there was no way to easily identify where software is physically housed, especially when servers were at remote locations or the business maintained redundant servers.

- Many submitted questions about whether apps allowing access to remote software were taxable or whether that app constituted “software” in its own right.
- There was no practical way to track use of software used by mobile workers, although those concerns were not as prevalent for the fixed-location workforce.
- Any proposed method to allocate a license to multiple locations has to be consistent and objective.
- Compliance costs will be significant especially for small businesses and nonprofits. Some estimated the proposed regulations could cost \$1,500-\$2,000 more to administer per year, while some estimated the impact to be as high as \$20,000-\$30,000 per year.
- The proposal creates an incentive to locate software-intensive activities in other states.
- Large multistate companies could be at an economic advantage over their smaller competitors by being able to spread costs across multiple jurisdictions.
- The proposal presented a significant risk of double taxation across states.

#### B. Committee Position Statements

The Committee reviewed and discussed this feedback at its August 4, 2022 meeting and then began the process to solicit each member’s preliminary positions on the Committee’s ultimate recommendations. The Committee prepared and distributed a template form that itemized the specific issues the members agreed were relevant and for which the members would submit position statements. See, *Issues Requiring Committee / Public Input*, attached as **Exhibit M**. Those specific issues included the following:

##### Issues Requiring Committee / Public Input

- Does “software” include PaaS (platform as a service) or IaaS (infrastructure as a service), recognizing that those are non-software elements of the broader concept of “cloud computing”?
  - Note: Committee has agreed not to include data in definition of computer software and that data processing services should not be taxable.
- How should Mississippi define SaaS and what should or should not be taxed?
  - How do we distinguish between licensure of remote software (traditional SaaS) and acquisition of services provided via the Internet?
- Should Mississippi levy sales tax on software used as a business input?
  - Should a different rule apply to non-business consumer transactions?
- If software is to be taxed:
  - Should it be taxed at traditional rates or a uniform special rate?
  - Should taxation depend on whether the software is actually physically downloaded into the state, or should the traditional Internet-access exception remain in place?

- Should an exception be made for intercompany use of software or provision of services?
- Should an exception be made for redundant / emergency backup systems?
- Does the phrase “computer software sales and services” need clarification?
  - Should there be a distinction between taxation of on-site and remotely-provided services?

Derivative Issues Committee Should Be Able to Resolve

- How to allocate or apportion multistate licenses / mobile workforce usage;
- How to separate bundled transactions that include both taxable and nontaxable items;
- How to source that portion allocated to Mississippi (e.g., billing address, employee location, etc.);
- Mechanics of offering credits for taxes paid to other states;
- Direct pay /accrual mechanism (e.g., remove vendor from collection role)

Each member submitted its formal position statement prior to the Committee’s August 29, 2022 meeting. The members’ position statements reflected not only a wide range of tax policy perspectives, but also broader concerns about Mississippi’s economic competitiveness. Each member’s report containing its specific position statements is presented in the following exhibits, summaries of which are produced below:

1. *BIPEC position statement* – **Exhibit N**

BIPEC’s recommendation was to exclude from sales and use taxes all software used as a business input, regardless of the means of delivery or how Mississippi employees access it. This position was guided by the detailed information and practical experiences submitted by Mississippi businesses during the information gathering process, and reflected several important tax and business development principles.

First, the policy should promote economic competitiveness and distinguish Mississippi from other states that might be perceived as imposing higher tax burdens on businesses and the means of production. Our policy should reduce the overall tax burden on Mississippi businesses and avoid “stacking” of taxes on multiple levels of business inputs or “hidden” taxes that become embedded in the cost of the end product or service. That tax policy should be broadly applicable to all in-state businesses rather than select industries, and should be clear and unambiguous as to what is and is not taxed. The policy should promote simplicity and ease of administration by both businesses and the state, and should focus on how and whether we tax the output of a business, and not the resources that must be invested to generate those end products and services

2. *MDOR position statement* – **Exhibit O**

Senate Bill 2831, 2022 Mississippi Regular Session of the Legislature, created a remote and internet-based computer software and services study committee. This committee was created to “develop recommendations regarding the taxation of remote and internet-based computer software products and services under the Mississippi Sales Tax Law and the Mississippi Use Tax Law.”

The Department of Revenue has served as a member of this committee and has participated in all meetings of the committee. The Department believes that the final report and its recommendations transcend the specific task assigned to the committee by the Legislature. The committee’s report does not make any recommendation specific to the taxation of remote and internet-based computer software products and services, and instead recommends that all software purchases made by a business should be exempt as a business input. The committee also voted not to take any position concerning the taxation of software purchases made for non-business use. Current law very clearly taxes all purchases of “computer software sales and services” whether for business or personal use. See Section 27-65-23. The Department believes that crafting a business-use only exemption on all software is a major policy decision for the Legislature.

The Department further recommends that any such decision by the Legislature should be part of a larger discussion concerning overall tax policy of the state. Given the tremendous growth in use tax that is directly attributable to online transactions, the Legislature should consider the cost of eliminating or reducing taxation related to computer software purchases. This is especially true considering the Legislature’s ongoing elimination of the corporate franchise tax that began in 2018, the newly enacted reduction of the state income tax set to occur over the next five years, and the clear policy decision by the Legislature to consider further income tax reductions before 2026. See House Bill 531 (2022 Regular Session).

3. *MMA position statement – Exhibit P*

The issue of taxing remote and internet-based computer software products and services is extraordinarily complex and there is no consensus across states of how best to implement such a tax. As Mississippi works towards our own solution, we need to consider the implications from multiple viewpoints. Hasty implementation of such a change in tax policy could be detrimental to the business community, with the greatest burden falling on the small-to-mid sized businesses that rely so heavily on software products and services to survive.

The Mississippi Manufacturers Association recommends that the Mississippi State Legislature consider legislation in the 2023 session that clearly defines what “software” is and what is taxable in our state under that definition. Furthermore, regardless of the ultimate definition(s) settled upon, MMA recommends that manufacturers be exempt from these taxes because it would simply add another input cost to the final product, ultimately increasing prices and reducing market competitiveness.

4. *MBA position statement – Exhibit Q*

Mississippi banks use technology every day to support thousands of business and consumer commercial transactions. Our members are very concerned that as the state considers taxation statutes and regulations that address this space, regular consumer and commercial activity should not be burdened by new or unexpected taxes. We are concerned any new statutes or regulations that begin to tax the use of this technology could create significant additional costs to regular daily commercial activity, and we encourage policy makers to be mindful of this risk.

Taxing services, like SaaS, PaaS, IaaS, and other cloud-computing services is even more complicated when the performance of the service and the underlying software all take place outside Mississippi, but benefit Mississippi users. Policy makers must be careful to not tax the benefit of the actual service (not the underlying software itself) being purchased and received by the Mississippi user. The MBA believes that any proposed changes, such as those contained in the 2021 DOR proposal, would be best addressed by the Mississippi Legislature after broad public input and debate, rather than by regulation or on an *ad hoc* basis through future taxpayer audits and litigation.

We emphasize that any broad changes in Mississippi's tax policy should be made by the Legislature, while we also urge the Legislature to codify existing regulatory exclusions/exemptions and clarify that cloud computing services should remain nontaxable. While each state is grappling with the difficulty of adapting its tax laws to the digital age and consistently rapid advancements in technology, remaining economically competitive with other states is vital to Mississippi's future. We hope the arguments made in the MBA position statement, Exhibit Q, provides beneficial insight into the crucial role that technology plays in helping our states' banks facilitate all types of commerce, especially in rural, low-income, and economically depressed communities.

#### 5. *Realtors position statement* – **Exhibit R**

As the largest trade association in Mississippi, the Mississippi Association of REALTORS® serves as the primary voice for homeownership, private property rights, and the betterment of communities. We believe in the free enterprise system and oppose undue intervention by government in the affairs of American business. We oppose counterproductive taxation, governmental guidelines, regulations, rules and procedures that unnecessarily increase consumer costs and overburden the business community. Without proper clarification and attention to language, thousands of realtors/small business owners could be subject to complicated new tax calculation and collection processes.

The initial proposed regulations from the Mississippi Department of Revenue in 2021 raised many troubling interpretations of tax policy, and the Mississippi REALTORS® strongly believe additional clarification language is required to allow realtors and other business operators clarity and the least restrictive means to operate their business. Without a clear prohibition on taxing inputs, realtors could be subject to countless new taxes/user fees associated with products necessary to perform their fiduciary duties. One glaring example of complications with a proposed tax on software as a service is with the Multiple Listing Service (“MLS”).

While many perceive the MLS as a pure data service, the MLS is a comprehensive lifeline in the real estate industry capable of generating reports, sending emails, and providing the most accurate information to real estate licensees and their clients.

We believe the State of Mississippi should be looking for ways to reduce the cost of doing business, not increasing the costs in an already financially burdensome business.

Some of the proposed statutory changes should include:

- Prohibition/exclusion of “data” as a taxable item.
- Prohibition/exclusion of a tax on software used as a business input.
- Any data storage/backup/redundancy activity should be excluded from any taxation.

C. Preparation of Committee Ballot and Vote on Formal Recommendations

Based on the members’ preliminary position statements, the Committee prepared a ballot outlining the issues to be voted on during its meeting on September 9, 2022. See *Committee Ballot*, attached as **Exhibit S**. It should be noted that several of the options/positions presented in the ballot were anticipated to render other options and issues irrelevant or moot. For example, if the recommendation was that software used as a business input should be exempt from sales tax, there would be no need to address certain the derivative issues such as how to source the use of that software, how to accrue and report it, how to separate bundled transactions, etc.

As noted in the Executive Summary above, the Committee ultimately voted to recommend to the Legislature that all software and software related services that are used as a business input be excluded from the sales and use tax, thereby rendering many of the other ballot questions moot. The Committee made no specific recommendation regarding the taxation of software products and related services sold or provided to non-business consumers.

## VI.

### Statutes at Issue

In S.B. 2831, the Legislature also instructed the Committee to “provide the provisions of the current Mississippi law that will need to be amended to adopt the measures described in this section and any other measures recommended by the committee.” Based on the recommendations noted above, the Committee believes the following statutes, at a minimum, could be amended to enact those recommendations. Additional relevant statutes may be addressed during the bill drafting process depending on the Legislature’s preferences on certain issues.

#### Sales Tax Code Sections:

- 27-65-3 To incorporate definitions for the terms “Computer Software” and “Computer Software Sales and Services” and to provide non-exclusive list of items that do not constitute computer software sales and services
- 27-65-7 To exclude from the term “Retail Sales” sales of software and related services that are used as business inputs
- 27-65-19 To remove the existing reference to “software” in the list of other taxable electronically delivered items currently enumerated in that section
- 27-65-23 To incorporate by reference the definition of “Computer Software Sales and Services” as newly defined in Section 27-65-3

#### Use Tax Code Sections:

- 27-67-3 To incorporate by reference the definitions of “Computer Software” and “Computer Software Sales and Services” and to update present reference to “computer software programs” to conform

## VII.

### Committee Research and Background Information

Mississippi's history of taxing software and recent developments in other states on the topic are all relevant to the Committee's work, so it researched and discussed that as part of its review. The following is a brief summary of that history and its relevance to the current project, and is offered to assist the Legislature in understanding the Committee's ultimate recommendations.

#### A. Mississippi's historic approach to taxing software and related services

An important aspect of the Committee's discussions involved the nature of business software itself and that most modern software merely represents a more efficient substitution for what formerly was human input in the business. For example, financial and accounting software replaced what previously had been accomplished by teams of bookkeepers and accountants. Human resource and payroll software replaced larger teams of HR and payroll professionals. The same can be said for purchasing and sales software, word processing, legal research platforms, and a host of other typical business software products and services. When employees directly rendered those inputs, the state did not levy sales tax on those inputs. Once replaced by software, however, those inputs began to be taxed because the replacement vehicle – software – was typically purchased in tangible form.

Thus, when Mississippi first began taxing software, it was not as a result of any specific determination that software *per se* should be taxed. Rather, it came about because virtually all software at that time was purchased in some form of physical media, i.e., tangible personal property. Thus, there originally was no specific legislative declaration to tax software and it was unnecessary to define it in the statutes. As long as it was sold in a tangible form, the state treated it as taxable just as other types of tangible personal property. This is analogous to books and records. The state never made a specific determination to tax words or songs as such, but when sold in tangible form the books and records were considered taxable items.

The first identifiable legislative act related to software taxation occurred in 1985 when the Legislature added “computer software sales and services” to the list of services traditionally subject to sales tax in Section 27-65-23. See, *Laws 1985, Chapter 351 (S.B. 2876)*, attached as **Exhibit T**. While that act did not define precisely what was meant by “computer software sales and services”, it is generally understood to have captured in the sales tax base programming services that were performed on site in lieu of purchasing pre-written software. The effect of this was that software remained taxable whether purchased off-the-shelf or programmed/customized by a technician. Of course, Internet-based or remote programming services were virtually non-existent when the Legislature amended this law in 1985.

In 1988, the Legislature amended Section 27-67-3 in the use tax statutes to define computer software as tangible personal property and thereby placed out-of-state purchases of software on par with in-state purchases. See, *Laws 1988, Chapter 491 (S.B. 2546)*, attached as **Exhibit U**. As tangible personal property, software thereafter was subject to the use tax if it was physically delivered into the state, on par with other types of tangible personal property.

In 2007, the Legislature amended Section 27-65-19 to incorporate into Mississippi's sales tax laws certain telecommunications-related provisions that had been adopted by the Streamlined Sales Tax Project. See, *Laws 2007, Chapter 329*, attached as **Exhibit V**. Included in these

extensive revisions, along with special rules for intrastate, interstate and international telecommunications services and ancillary services, was a new provision imposing a 7% sales tax upon “all charges for products delivered electronically, including, but not limited to, software, music, games, reading materials or ring tones.”

As noted previously, the current use tax regulation on computer equipment, software and services states that “software maintained on a server located outside the state and accessible for use only via the Internet is not taxable.” See, *Miss. Admin. Code 35.IV.5.06(300)*. MDOR added this provision to the regulation at some point after the legislature clarified that software was tangible personal property for use tax purposes. This addition is consistent with the nature of the use tax in that Mississippi levies that tax when tangible personal property is actually imported into the state.

It is also important to note that Mississippi generally does not levy the sales tax on data or data processing services. Although MDOR’s original proposal to amend the regulatory definition of “software” included a reference to data, they later clarified that there was no deliberate intent to extend the sales tax to data or data processing services. Had MDOR updated the proposed regulation, it was indicated that the data reference would be removed so as to avoid confusion on that issue. The members all recognize that it may be difficult, however, to define clearly where software ends and data begins in many settings.

#### B. Relationship to recent economic nexus legislation and regulations

MDOR’s proposed amendments, especially to the use tax regulation regarding remotely accessed software, related at least in part to Mississippi’s recent adoption of economic nexus and marketplace facilitator legislation. In 2020, the Legislature amended the sales and use tax statutes to shift the traditional collection burden to out-of-state vendors who have a significant “economic” or “virtual” presence in the state. See, *H.B. 379 (2020), Mississippi Marketplace Facilitator Act of 2020*, attached as **Exhibit W**.

Most states adopted similar statutes in anticipation of or following the United States Supreme Court’s decision in *South Dakota v. Wayfair, Inc.*, 585 U.S. \_\_\_ (2018), attached as **Exhibit X**. That decision overturned the longstanding Commerce Clause interpretations that a foreign taxpayer must have an actual physical presence within a state in order to be compelled to collect the state’s sales or use tax. The 2020 legislation altered the statutory “nexus” or “doing business” standard and appears to have precipitated MDOR’s proposed removal of the historic use tax regulation addressing on the remotely accessed software.

#### C. Other states’ positions on taxing software

*COST Study*. On July 18, 2022, the Council on State Taxation (“COST”) published a report detailing how the various states tax digital products and other items such as pre-written, custom and remotely accessed software when used as business inputs. See, Karl A. Frieden, Fredrick J. Nicely, Priya D. Nair, “*Down the Rabbit Hole: Sales Taxation of Digital Business Products*”, July 18, 2022, attached as **Exhibit Y**. In their report, the authors noted “only about two-fifths of the states with sales taxes include software accessed remotely (SaaS) and digital information services in the sales tax base.” *Id.*, p.267. They also noted that “[w]hile there is no consistent pattern, states more frequently impose sales tax on digital products that were previously sold in tangible form (for example, prewritten software, books, movies and music), and less

frequently on digital goods and services that were not (for example, SaaS and data processing).  
*Id.*

The COST study noted several other relevant and important points. “Eleven states impose a sales tax on prewritten software sold in tangible form, but not if the same software is delivered electronically.” *Id.*, p. 269. “Of these states, Iowa exempts business purchases of prewritten software, New Jersey exempts business purchases of prewritten software delivered electronically, and Connecticut applies a reduced rate of 1 percent to business purchases of prewritten software delivered electronically.” *Id.*

With respect to SaaS, the authors found a more even split among the states as compared to prewritten software and custom software categories. “Twenty-two states impose a sales tax on SaaS and two states have no clear position on whether a tax is imposed. Of these states, only Iowa provides an exemption for business purchases, and Connecticut applies a reduced rate of 1 percent for business use. Conversely, Ohio, for SaaS, digital information services, and data processing, imposes the tax on such digital products only if they are purchased for business use.” *Id.*, p. 270.

To summarize the COST report, there appears to be wide inconsistency among the states when it comes to the taxation of software and especially remotely accessed software such as SaaS. Many states have no formal position on the topic, but with respect to those states that do, several have varying exemptions for software and/or digital products used as business inputs (Iowa, New Jersey, Washington, Maryland), and Connecticut imposes a special 1 percent rate, but each of these has its own features and limitations.

Thus, for every basic option considered by the Committee, including the MDOR position reflected in the proposed amendment, there appears to be at least one other jurisdiction having an existing law to support that recommendation.

*Committee member research.* In addition to the COST report, some Committee members independently researched other states’ positions related to the taxation of remote software, SaaS, and related items. MBA in particular undertook extensive research on other states’ experiences and positions on taxing software. That research revealed that Mississippi is not the first state to consider changing its tax code to tax SaaS and other cloud-computing services in an attempt to keep up with the digital age and the resulting, often radical, transformations in how businesses operate. The research suggests that a majority of states do not currently tax SaaS.

If Mississippi were to pass legislation changing the current status quo, it would become only the second state in the country to make a statutory change to affirmatively tax SaaS and other cloud-computing services. Even in the minority of states that currently tax SaaS, many of these states have passed broad statutory exemptions, including both commercial use exemptions as well as broad industry-specific exemptions. Nearly every case BTA found throughout its extensive research where the taxability of SaaS and related cloud-computing services were determined by regulatory or judicial actions rather than through legislative action, these efforts were met with significant confusion, and in many cases, significant backlash from both businesses and consumers. The resulting confusion and backlash highlights the importance of clear legislative direction to determine a state’s tax policy.

Indeed, similar regulatory proposals or interpretations have been met with significant pushback in other states, ranging from our neighboring state of Louisiana to Maryland and Iowa. Below are three examples where regulatory action resulted in the aforementioned confusion and

backlash. In each case, this pushback largely originated from the business community in each state in response to the economic burden such a change would impose on businesses and customers alike, as well as arguments that the agencies in each instance had exceeded their authority or incorrectly interpreted existing statutes.

a.) Louisiana

Similar to the policy position taken by MDOR, the Louisiana Department of Revenue (“LDOR”) attempted to take similar action in 2010, through the implementation of Revenue Ruling No. 10-001, which would have begun taxing SaaS in Louisiana. However, the state temporarily suspended the rule within a few months following widespread criticism, concern, and opposition from professional organizations, taxpayers, and Louisiana’s business community, before LDOR ultimately revoked the ruling to maintain the status quo of software taxation in the state and avoid imposing significant increases in tax liability for the state’s business community and ultimately residents.

In an almost identical situation to the current Mississippi state of affairs, LDOR had already begun assessing sales tax on such software – also retroactively in some cases – against otherwise compliant taxpayers. As is currently being reported in Mississippi, some online vendors and service providers had already begun to charge state and local sales tax as a precautionary measure, at times possibly without even given due consideration to whether the policy statement actually applied to their business activities.

Louisiana formed a working group to study the policy issues and the impact to businesses and consumers from LDOR’s attempt to change longstanding tax policy to begin taxing such software that was only being used or accessed by in-state users. Following the responses, client impact statements, continued opposition from Louisiana’s business community, LDOR revoked the Revenue Ruling within a year of its issuance and Louisiana has made no effort to tax SaaS and cloud-computing services since that revocation.

b.) Maryland

Earlier this year, the Maryland Legislature passed HB 791 to specifically exempt the commercial use of SaaS and cloud-computing services from sales tax in response to concern from the business community that the Maryland Comptroller had exceeded its authority by including SaaS in its interpretation of digital products made taxable by the Maryland Legislature in 2021 through the passage of HB 932. Following this concern and opposition from many businesses and taxpayers in Maryland over the Comptroller’s over-broad interpretation of the Maryland Legislature’s intent in HB 932, the Legislature passed HB 791, which took effect July 1, 2022, and essentially reversed the Comptroller’s interpretation by confirming SaaS and other cloud-computing services used for commercial use are tax-exempt. These exemptions are referenced in greater detail in the 50-state overview of SaaS taxability found in **Exhibit Z**, which was discussed during the study committee’s meeting on August 4, 2022.

c.) Iowa

After Iowa’s state taxing authority began collecting taxes on additional digital products and services, the state legislature responded to this regulatory action by creating two new sales tax exemptions for businesses that apply specifically to specified digital products and related services. Specifically, the Iowa Legislature created broad exemptions for the following:

- Commercial enterprises purchasing these products and services, including SaaS;

- Digital products and services sold to a “non-end user” who intends to resale or otherwise retransmit the digital products.

These exemptions are also addressed in greater detail in Exhibit Z referenced above.

These cases highlight the examples of how state after state has come to the realization that their state revenue agencies did not have authority to tax these products without legislative action being necessary to address this issue instead, while regulatory action also often leads to serious confusion as well as backlash from businesses and consumers alike. The current debate presents the opportunity for Mississippi to get this issue right, the first time, and to continue improving the state’s economic climate and attractiveness to businesses and the jobs they bring to this state.