



HANCOCK ADVISORS
INVESTMENT BANKING & TRANSACTION ADVISORY

THE EVOLUTION OF SALES TAX ON SOFTWARE

THE STRUGGLE TO TAX NEW TECHNOLOGY

States are often ten years or more behind when it comes to taxing technology. For example, Florida and Georgia only charge sales tax for canned software delivered in a physical format, such as a CD. Since that rarely happens today, canned software is effectively exempt in both states. However, many states have updated their statutes and regulations to tax custom software, Software-as-a-Service, digital goods, and electronically delivered software. For example, Georgia began taxing digital products on January 1, 2024. A common mistake that companies selling software make is assuming the taxability of software in their home state applies to all other states or not keeping up with legislative changes.

CUSTOM SOFTWARE

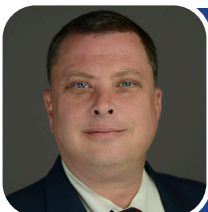
Many companies selling software know that most states exempt custom software from sales tax but often misunderstand the definition. For sales tax purposes, most states require that custom software be coded from scratch to the specifications of a single purchaser. It's not uncommon for companies to incorrectly treat the customization of canned software as custom software. While most states exempt custom software, that is not true of all states. In fact, twelve states plus Washington D.C. tax custom software. These jurisdictions may even tax the implementation and installation of custom software. Prior to the Supreme Court's decision in *South Dakota v. Wayfair*, most companies only had to know how to tax products in their home state. Now, every state that imposes sales tax has passed economic nexus statutes. Companies need to reexamine not only what is taxable but also where they should be registered to collect sales tax because if a company fails to collect sales tax it becomes liable for that tax.

SOFTWARE-AS-A-SERVICE

States commonly tax sales of tangible personal property but only select, enumerated services. To modify their laws to fit new technologies, some states have simply redefined "tangible personal property" to include software. Most companies understand that electronically downloaded software is taxable in most states but some either believe Software-as-a-Service (SaaS) is provided the same tax treatment or believe it is treated as an exempt service. States have reacted to SaaS in various ways. Some have enacted new laws to specifically address it while others have declared it to be taxable tangible personal property. Currently, nineteen states plus Washington D.C. tax SaaS but laws are always changing. For example, Vermont started taxing SaaS on July 1, 2024.

DIGITAL GOODS

The definition of digital goods can vary by state but it generally means intangible goods existing in a digital format. Common examples are e-books, digital music, or digital video. However, it can be more nebulous such as a mailing list, ringtones, or payments to upgrade a character in a video game. Moreover, taxability can depend on whether the customer has temporary or permanent use.



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