State of Louisiana
Department of Revenue

Revenue Ruling
No. 10- 001
March 23, 2010

Sales and Use Tax

Taxability of Transactions for Remotely Accessed Software, Digital or Media Products, and Other Items of Tangible Personal Property, and the Sale, Use, or Lease of Software and Program Content

The purpose of this Revenue Ruling is to examine the taxability of transactions involving the purchase or use of software, stored data, and other tangible personal property, located in-state and out-of-state.

The use of computers and internet within homes and offices has grown exponentially since the 1990's with consumers able to acquire all manner of material or data, software, or other products from providers or vendors. An abundance of technological advances have enabled many means of acquiring tangible personal property for purchase or use from remotely located vendors throughout the country and beyond. The intent of this Revenue Ruling is to provide analysis of the basic components that comprise taxable events and transactions.

Issue:

Whether Louisiana's sales, use, and/or lease tax is due on the purchase or use of products, computer software and applications, or stored media and/or other materials electronically delivered into Louisiana to be accessed from instate or out-of-state providers or vendors.

Analysis/Discussion:

The purpose of customers' transactions with the vendor is to acquire and transfer computer readable materials, media, or stored materials or data to a computer or other such equipment located within Louisiana. The materials and objects are either stored in-state or out-of-state, and provided by vendors through servers or other data locations and electronically delivered into Louisiana. The transactions vary from purchase of media, such as movies or music compilations, to accessing programs, data, or other property. Such property can be either stored on the user's computer equipment or immediately consumed as seen, weighed, measured, felt or touched, or is in any other manner perceptible to the senses.

In ***South Central Bell Telephone Company v. Sidney J. Barthelemy, et al.***, 94-0499 (La. 10/17/94), 643 So. 2d 1240, the Supreme Court analyzed the question of whether computer software was tangible or intangible to determine the taxability thereof. South Central Bell disputed the taxability of certain custom switching software installed in various locations and used by Bell to move customers' phone calls through its system from point of origin to destination. Bell obtained the technology through licensing agreements which agreements limited Bell's use of the technology, prohibited sublicensing, assignment, sale or transfer, terminated Bell's rights when the license expired, and reserved to the vendors' ownership and proprietary rights in the software. This software was delivered via magnetic tape. Bell obtained

a second type of software to be used for data processing to include accounting functions, processing billings and payments, and storing and managing customer data, among other functions. This software was also obtained through licensing agreement and was delivered electronically from an out-of-state location through telephone lines to Bell's modem in Orleans Parish.

In order to analyze the issue of whether the property was tangible or intangible, the Supreme Court had to break it down into its most elemental binary form. It rejected the 4th Circuit's analysis positing the software as being incorporeal intellectual property. First, it defined 'software' as "encompassing all parts of the computer system other than the hardware". It then described software as "a complete set of instructions that tells a computer how to do something". The court found, at p 1246:

> The software at issue is not merely knowledge, but rather is knowledge recorded in a physical form which has physical existence, takes up space on the tape, disc, or hard drive, makes physical things happen, and can be perceived by the senses. As the dissenting judge at the court of appeal pointed out, "in defining tangible, 'seen' is not limited to the unaided eye, 'weighed' is not limited to the butcher or bathroom scale, and 'measured' is not limited to a yardstick. [Citations omitted.]
>
> The purchaser of computer software neither desires nor receives mere knowledge, but rather receives a certain arrangement of matter that will make his or her computer perform a desired function. This arrangement of matter, physically recorded on some tangible medium, constitutes a corporeal body.

The Supreme Court further held that the <u>form of delivery</u> was of no consequence, "whether it be by magnetic tape or electronic transfer via a modem." *At* 1246. Significantly, in finding that the licensing agreement for the electronically delivered data processing software was a taxable transaction, the court held that the transaction of electronically delivered media from out-of-state was a Louisiana transaction and subject to use tax in Louisiana.

This court also dispelled the notion that there was a difference between the acquisition of books, films, video and audio tapes, etc, purchased as tangible things, and such works when delivered electronically. It rejected the reasoning of the circuit court "that the true essence of such transactions is the purchase of the tangible medium, not the intangible property (the artist's expressions) contained in that medium, and that without specific tangible medium, the artist's expressions are useless." The Supreme Court adopted, *at* 1247, the circuit court judge's dissent:

> It is now common knowledge that books, music, and even movies or other audio/visual combinations can be copied from one medium to another. They are also available on computer in such forms as floppy disc, tape, and CD-ROM. Such movies, books, music, etc... can all be delivered by and/or copied from one medium to another, including electrical impulses with the use of a modem. Assuming there is sufficient memory space available in the computer hard disc drive such movies, books, music, etc... can all be recorded into the permanent memory of the computer such as was done with the software in this case.

Thus, the transactions were found in the content of the media, not the artistic expressions therein. Additionally, the court found that the medium of delivery was irrelevant. The *South Central Bell* Court considered only that the transactions of Bell were recorded for use to establish that the property had come to rest in Louisiana, but did not consider the question of that use without recordation. However, its decisions laid the ground for that ultimate question that can now only be decided as confirmed by the Court's own view on electronically delivered entertainment media. If the electronically delivered property is deemed tangible upon conversion from electrical impulse, then even if it is only viewed in Louisiana on a computer screen, it has taken tangible form, has been "felt" by the senses of sight or sound or both, and has been used or consumed and is subject to tax, even if it is never stored in tangible form. Thus, the 'use' would be taxed as a lease transaction, because never having been stored in the form of movie, music or reading material, it is not owned, but enjoyed by only use or possession.

In *South Central Bell*, the essential issues revolved around operating and functioning software that was in continuous use by Bell. Because of the claims by Bell that the transaction involved only a licensing agreement for a right of use, the court focused on the copy of the "code of instructions" that was placed on Bell's computers, hence the recordation element. However, a copy of the data is irrelevant to the issue of what constitutes tangible property. As stated above, the court found that "[t]he software at issue is not merely knowledge, but rather is knowledge recorded in a physical form which has physical existence." In establishing what constituted tangible property on magnetic tapes, the court established the significant factor for determination of "use" when the "body of information" is not stored before use, or even stored at all, at page 1246:

> When stored on magnetic tape, disc, or computer chip, this software, or set of instructions, is physically manifested in machine readable form by arranging electrons, by use of an electric current, to create either a magnetized or an unmagnetized space. The computer reads the pattern of magnetized and unmagnetized spaces with a read/write head as "on" or "off", or to put it another way, "0" and "1". This machine readable language or code **is the physical manifestation of the information in binary form.** [Emphasis added, citations omitted.]

Thus, the essential element for 'consumption' of electronic or digital media is that the information is "physically manifested in machine readable form" and that "the computer reads the pattern". This occurs, as in the *Bell* case, to either store the information before use, or in the case of subscription or intermittent providers of media content, to view the information directly upon the computer 'reading' the information without storage. The action of the computer, through specific software, reading the pattern of coded instructions and translating it into the product intended to be viewed, heard or otherwise consumed, be it movie, book, music, or any other program providing interactive use, transforms the coded instructions into tangible personal property, capable of being experienced by the senses. The reconstituted matter need not be stored to be recognized as tangible personal property. For transactions where no storage capability is intended or provided, it is the interactive use that establishes the transaction by an acquirer.

"The computer", as spoken of by the court, would include any hardware receptacle of data with software capable of reading coded instructions and transforming them into recognizable and/or interactive form. Software today is defined as a set of instructions that takes specific input and creates a desired output. Software comprises much of the operating system of a computer and is stored on remote, portable, or system equipment to receive and transform coded information or other impulses into comprehendible form. When software 'reads' data input, either from a physical product or electronic impulse, the data is transformed into a physical form. Whether the sequence of instructions is manifested for viewing, or is electronically delivered to be stored, it has taken the physical form that was recognized by the *Bell South* court as tangible personal property. However momentary, the conversion of instructions read, viewed, or used is the taxable event. The taxable transaction is the acquisition of the coded material from the vendor or provider.

The transmission and consumption of electronic or digital data today is increasingly mobile and accessible through computers and mobile phones, and portable devices of the future. The situs for taxation then becomes a quagmire of points incapable of being administered for taxation purposes. The Louisiana legislature has resolved this problem for taxation of communication services by establishing the situs of taxation as the customer's place of primary use. The Department will apply the same principle to transactions of downloaded content. Additionally, licenses acquired for use of software are taxable where they are intended to be principally used.

Sale, Use, or Lease of Software and/or Program Content

Louisiana imposes sales and use tax on retail sales of tangible personal property in Louisiana or on the use of tangible personal property in Louisiana.[1] Louisiana Revised Statute 47:301(7) defines the term "lease or rental", in pertinent part, as "the leasing or renting of tangible personal property and the possession or use thereof by the lessee or renter, for a consideration, without transfer of the title of such property".

Software located on a server, instate or out-of-state, and made available to users (as discussed above) is taxable by this State. Any software installed by vendors or providers electronically onto hardware, be it a PDA-type device or CPU-type device, located in this State would be similarly subject to tax. When a provider enters into a subscription allowing access through a period of time, and abandons the software provided to the customer after termination of the period, the provider has abandoned the software, and the transaction is a sale. Software located on a providers' remotely accessed server and utilized by subscribers in Louisiana without transfer of the data (capabilities for storage and permanent use) characterizes the transaction as one of lease. Therefore, whether the subscriber acquires a use of a software file, or an installed software component facilitating access to the processors, the transaction is subject to tax.[2] When the provider then sells the software or the interactive use of the software to multiple users, it is subject to tax on each of those transactions.

[1] La. Rev .Stat. 47:302(A).
[2] Most often, software solicited and constructed by a vendor to provide to multiple users is custom software and generally not taxable to the purchasing vendor.

The same concepts apply to the download of media products and other materials. One can purchase a software program to prepare a tax return from a retail outlet, or purchase the same software program directly from the creator-vendor electronically downloaded from the vendor's website. Data, entertainment media, and other products, including software, are delivered electronically via the internet and received and transformed into comprehendible or usable form by browsers or other types of software to the Louisiana user. If the material is recorded in the Louisiana user's computer or other storage medium or if the material is only viewed by the Louisiana user, the transaction is subject to tax. The determination of whether the software license agreement is subject to a sales or a lease tax would be determined by a review of the terms and conditions of the software agreement between the parties, the application of the agreement's terms to the definitions of a sale and lease as provided in Title 47, and the relevant jurisprudence. Any installation fee, initiation fee, or other fee related to the transaction is part of the transaction and incidental to the sale or lease of the tangible personal property and cannot be segregated from the transaction to avoid taxation by separation from the transaction.

Conclusion

Tangible personal property includes, but is not limited to, all electronically delivered products, including computer software and applications, stored media, and entertainment media or products, to equipment located in Louisiana. Taxable transactions include, but are not limited to, remotely accessed software, information materials, and entertainment media or products, whether as a one-time use or through ongoing subscription, and whether capable of only being viewed, or being downloaded when that transfer requires payment of consideration in any form.

Any consideration paid for electronic receipt or access to data, information, materials, media or other form of communications that are converted to readable, viewable, or usable form by browsers or software installed on mobile hardware or system hardware located in Louisiana is subject to sales, use, or lease tax in this state.

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