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Deloitte Tax LLP | June 8, 2021

MULTISTATE INDIRECT TAX

Massachusetts Supreme Judicial Court rules in favor of taxpayers on sales tax apportionment for software
Tax Alert

Overview

On May 21, 2021, the Massachusetts Supreme Judicial Court ruled in *Oracle USA, Inc. v. Commissioner of Revenue*, No. SJC-13013, 2021 BL 189431 (Mass. May 21, 2021) that Massachusetts taxpayers have a statutory right to apportion sales tax on software transferred for use in more than one state, and taxpayers are not precluded from seeking apportionment and refunds for excess sales tax paid through the general abatement process, even if they did not seek apportionment when tax was due as outlined in the regulations.

This Tax Alert summarizes the court's decision.

Oracle USA, Inc. v. Commissioner of Revenue

The taxpayers in this case are vendors who sold or licensed software to a company headquartered in Massachusetts. Instead of following the regulations prescribed by the Commissioner of Revenue ("Commissioner") for collecting and remitting sales tax when due only on the portion of the value of the transferred software that was to be used in Massachusetts, the taxpayers remitted tax payments to Massachusetts based on the entire value of the transactions. When the buyer notified the taxpayers of the percentage of licensed software users in Massachusetts, the taxpayers applied for refunds through the general abatement process for the portion of sales tax that was attributable to out-of-state use.

Mass. Gen. L. c. 64H § 1 states that the "Commissioner may, by regulation, provide rules for apportioning tax in those instances in which software is transferred for use in more than one state." The Commissioner issued regulations stating that the sales tax on software may be apportioned based on where it is used, and provided methods for apportionment: (1) if the purchaser provides the vendor with a multiple points of use certificate at the time of sale or by the time the return is due, the purchaser must directly report and pay the apportioned use tax; or (2) if the purchaser provides the vendor with a

certification identifying the appropriate apportionment based on Massachusetts use, the vendor may report and remit the apportioned tax.

The Commissioner denied the taxpayers' applications for abatement on the grounds that the taxpayers did not follow either of these regulations for apportionment at the time at which the return was due.

The taxpayers appealed to the Appellate Tax Board ("Board") on the ground that they had a right to apportionment under Mass. Gen. L. c. 64H § 1 and that they were not prohibited from later seeking an abatement for the portion of taxes remitted to Massachusetts that were attributable to out-of-state software users. The Board initially decided in the Commissioner's favor, but on its own motion, reconsidered its decision and granted the taxpayers' requests for abatement.

The Commissioner appealed to the Massachusetts Appeals Court, and the Massachusetts Supreme Judicial Court transferred the case *sua sponte.* The Massachusetts Supreme Judicial Court analyzed the two following issues.

Whether taxpayers in Massachusetts have a statutory right to apportion sales tax on software purchased for use in multiple states

On appeal before the Massachusetts Supreme Judicial Court, the Commissioner maintained that, pursuant to Mass. Gen. L. c. 64H § 1, he had discretion to decide *whether* to allow the apportionment of sales tax when software is transferred for use in multiple states, and that he had the authority to impose restrictions on abatement because the taxpayers did not have a statutory right to apportionment. The taxpayers contended that the statute merely granted the Commissioner the authority to determine *how* the relevant sales tax was apportioned and that the statute itself granted the taxpayers the right to apportion the sales tax to the respective states where the software was to be used.

The court discussed the legislative history of Mass. Gen. L. c. 64H, noting that the legislature recognized the difficulty in classifying the location of a "sale" within the traditional statutory scheme of § 2, which requires payment of sales tax for "sales in the commonwealth," to sales of software, which may be used concurrently in multiple states and are often unaccompanied by a transfer of title. Because of this, the legislature amended § 1 to address sales of software for use in more than one state. The court stated that § 1 can reasonably be read to mean that the legislature intended to allow taxpayers to apportion sales tax on software which is transferred for use in more than one state, and the method of apportionment would be based on the location of the software's use.

The court also concluded that the Commissioner's interpretation of Mass. Gen. L. c. 64H, § 1 was contrary to the Massachusetts Constitution, which vests the legislature with the exclusive authority to decide fundamental tax policy, and the decision to allow the apportionment of sales tax is a fundamental policy decision for the legislature that cannot be delegated to the Commissioner. The Commissioner's authority is limited to implementing that policy, and while he may make rules about how to apportion, he has no discretion to decide whether to apportion sales tax from software used in multiple states.

Whether taxpayers in Massachusetts can utilize the general abatement process to apportion sales tax for software purchased for use in multiple states

Massachusetts law provides for a general abatement remedy for taxpayers to seek refunds of excessive taxes paid. The second issue in the case was whether taxpayers that remitted excessive sales tax for software that was to be used in multiple states could use the general abatement process to receive a refund.

The Commissioner maintained that the vendors' noncompliance with the regulations precluded apportionment.

The court drew a comparison between this case and the exemption certificate procedures outlined in another subsection of the sales tax code, which provides that a seller may pursue a refund of excessive taxes paid through the general abatement process if the seller later shows that the items were purchased for resale because such purchases are not subject to the sales tax. Similarly, here, the court stated that while the regulations set out methodologies for apportionment and relief of vendor liabilities that may be utilized when tax is due, they do not prohibit taxpayers from later seeking apportionment through the abatement process.

Conclusion

The Massachusetts Supreme Judicial Court opinion clarified that Massachusetts sales tax law creates a statutory right to apportionment for software transferred for use in more than one state, and that the general abatement process is available to vendors that paid sales tax in excess of the properly apportioned sales tax due.

Considerations

Massachusetts taxpayers that did not apportion sales tax on software at the time of purchase may consider pursuing refund claims for software purchased for use outside of Massachusetts.

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