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**Via E-mail (Sam.Portera@dor.ms.gov)**

Mr. Sam Portera, CPA  
Mississippi Department of Revenue  
Deputy Office Director – Policy  
500 Clinton Center Dr.  
Clinton, MS 39056

**Re: Public Comments for Regulatory Hearing  
Regulation 35.IV.5.06 – Computer Equipment, Software and Service  
November 3, 2021 – 1:30 p.m.**

Dear Sam:

Thank you and the Department for scheduling a public hearing on the proposed amendments to Sales Tax Regulation 35.IV.5.06 – Computer Equipment, Software and Services (the “Proposed Amendments”). Previously we requested a hearing on behalf of multiple Mississippi trade associations identified below, and since then have received numerous inquiries from other businesses and organizations as to the potential scope and application of these Proposed Amendments.

We aggregated the questions and comments below from the various trade associations and their constituent members, and they are intended to raise a number of practical and context-specific concerns associated with these new policies. We hope that the information provided in this letter will better enable the participants and the Department to have a meaningful dialogue about the many practical and procedural questions raised by those changes.

Many of the participants believe the breadth of these questions and the significance of these proposed changes in historic Mississippi tax policy suggest that the issues are best addressed by the Legislature after broad public input and debate, rather than by regulation or on an *ad hoc* basis through future taxpayer audits and litigation. In the event the Department decides to proceed with these changes, however, our hope is that this information will assist the Department in providing more definitive and helpful regulatory guidance for taxpayers.

To that end, we respectfully submit the following questions for the Department’s consideration, and we look forward to discussing them at next week’s hearing.

## **Predicate for Proposed Amendments**

Considering the significance of the Proposed Amendments and the potential impact on so many Mississippi citizens and businesses, many participants would like additional insight on the following questions surrounding the reasons for these changes.

1. Did any specific legislative or judicial developments precipitate or necessitate the Proposed Amendments? These could include any events such as new legislation, court decisions, administrative appeals decisions, audits, etc. that produced or generated new guidance or insight on any of the following questions:
  - a change to the official definition or understanding of what constitutes “software”;
  - the treatment of remote access of software held on a server outside Mississippi;
  - the scope of computer-related services subject to sales or use tax; or
  - the identities of any parties responsible for collecting or remitting sales or use tax on computer software or services.
2. In developing the Proposed Amendments, did the Department consult with the Legislature, the Governor’s office, or any other state officials as to whether these changes properly reflect Mississippi’s intended tax policy?
3. Why does the Department believe it is appropriate to enact tax policy changes of this magnitude and scope via regulation rather than legislation?
4. Finally, how have other surrounding states addressed these issues?

## **Economic Impact Statement**

The Department’s notice filed with the Secretary of State indicated that no economic impact statement was required for the Proposed Amendments. The Administrative Procedures Act requires such a statement be prepared with respect to “any amendment to a rule for which the total aggregate cost to all persons required to comply with that rule exceeds One Hundred Thousand Dollars (\$100,000.00).”<sup>1</sup>

The Proposed Amendments appear to reverse the Department’s historic position regarding the use tax implications of accessing via the internet software that housed on a server outside the state. The Proposed Amendments also significantly expand the definition of “computer software” to encompass many items previously outside that definition, such as data. These changes could directly and significantly affect every individual or business consumer of internet-based computer software or services, regardless of the physical location of the provider. Thus, this proposal appears to represent a significant sales and use tax

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<sup>1</sup> Miss. Code Ann. § 25-43-3.105(1).

increase on Mississippi citizens and businesses. To that end, the participants would like to know the following:

1. How much additional sales or use tax revenue does the Department estimate the Proposed Amendments will raise?
  - What information was used in the above calculation?
  - Did the Department use any external resources or consultants?
2. If the anticipated new revenue exceeds \$100,000, what is the Department's basis for asserting that no economic impact statement is required?
3. Was any report (internal or external) prepared explaining the Department's calculations, assumptions, or reasons that the Proposed Amendments were exempt from the economic impact statement requirements?
4. If the Department has not made any estimates or calculations, why did it not do so?

### **Scope and Application of Proposed Amendments**

The participants have numerous questions regarding the scope of the Proposed Amendments and circumstances in which the amendments might levy the sales or use tax. Many of these questions suggest the need for additional clarification and guidance to enable taxpayers to determine which transactions are taxable versus nontaxable, and to accurately collect and remit those taxes. The following are examples of several such unanswered questions:

1. Impacted Users. Do the Proposed Amendments apply just to individual consumer transactions, or also to business-to-business transactions?
2. Software versus Services. Does the use tax now apply to traditional computer services, or just computer software?
  - Are those terms now considered synonymous?
  - If not, what criteria should taxpayers use in determining if a transaction represents computer software (i.e., tangible personal property per the use tax statutes) or a service?
  - What are examples of the "certain services" that are now taxable under subsection 101(2)(a) of the Proposed Amendments?
3. Internal Software. Do 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?

- Does the result change if internal software is maintained on a server located inside or outside Mississippi?
4. Intercompany Services. Do the Proposed Amendments now render common intercompany administrative services subject to sales or use tax?
    - If so, what specific types of administrative services are taxable versus nontaxable and under what circumstances (e.g., accounting, legal, HR, payroll, marketing, advertising, customer support, etc.)?
  5. Intercompany Overhead. How will the Proposed Amendments impact the ordinary “charge out” of administrative overhead to multiple affiliates or business locations?
  6. Valuation Issues. 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 the Department contend it has authority under the Proposed Amendments to restate the value of any intercompany computer software or services if it does not believe the price actually charged or accrued between those affiliates reflects an arm’s length value?
    - Would that authority to revalue an item also extend to third-party transactions?
  7. Double Taxation. Will 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?
  8. Data Issues. The new definition of computer software specifically includes “data” whereas it previously only defined the term to mean a set of instructions that permitted a computer to process data. In other words, data was the object of the computer software, but was not considered software in its own right. Can the Department identify any other jurisdictions that consider data to be the same as software?

Additionally, please clarify how the Proposed Amendments would 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? What if it is located outside Mississippi?
  - A Mississippi user accesses a third party database housed on a server or other computer located inside Mississippi? What if it is located outside Mississippi?
9. Export Exemption. 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)?

10. State Agencies. Will companies that provide information technology services, software, cyber security services, and/or data analytical services etc. to state agencies be exempt from the new proposed tax regulation changes?
  - If not, how would this apply to companies that provide computer services, software, and equipment to state agencies here in Mississippi?
11. Multi-User / Multi-Jurisdictional Licenses. 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?
12. Bundled Transactions. 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?
13. Financial Institutions. When a bank customer accesses a bank's core software, is that now a taxable transaction?
  - Does the tax apply when a bank employee utilizes the bank's core software in its day-to-day operations?
  - Under what circumstances would a bank be considered a vendor to its customers and be required to collect sales or use tax?
14. Other Service Providers. 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 the service provider utilizes 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 services taxable when provided remotely, and if so, under what circumstances?
15. Payment Processing Services. Please confirm that electronic payment services (e.g., debit, credit, ACH services) remain non-taxable software or services, in Mississippi, under the Proposed Amendment when either the purchaser, seller, or intermediary financial institution are located in Mississippi - following the practice of all other states.
16. Internet Service Providers. Are internet access services provided by an internet service provider ("ISP") subject to sales or use tax under the Proposed Amendments?
  - Is an ISP now required to collect sales or use tax on transactions or data travelling over their systems?
  - If so, how are they to collect that tax?
17. Advertisements. Do the Proposed Amendments encompass online or electronic advertising so as to render those services subject to the use tax?

- If so, how will the tax base be determined when the advertising is available in or the purchaser/targets are located in multiple jurisdictions?
18. Disaster Preparedness. Many Mississippi companies maintain backup computer systems in locations outside Mississippi in the event of natural disasters. These systems may contain the company's databases as well as duplicate software systems. If a local disaster strikes that requires the company to access and utilize that remote system via the internet or other cloud-based systems, would that event result in a Mississippi use tax liability under the Proposed Amendments?

## Procedural Questions

In addition to the above technical issues, numerous procedural issues appear to arise with respect to the Proposed Amendments. These include but are not limited to the following:

1. Retroactivity. The participants are aware that the Department 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?
2. Wholesale Transactions. 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?
  - Does the tax treatment vary depending on whether the ultimate service/product is taxable or nontaxable?
3. Multiple Collection Points. 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?
  - How can an end consumer under audit discover whether the Department 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 the Department to collect the tax from multiple parties on audit?
4. Procedural Safeguards. 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 the Department directly, what recourse does the customer have if the vendor refuses to cooperate?
5. Anticipated Deference in Appeals. Does the Department currently have any audits or appeals involving the issues addressed in the Proposed Amendments?

- If so, does the Department intend to claim that either the Board of Tax Appeals or courts should grant deference to the new regulation in ruling on those issues?
6. Constitutionality. Has the Department studied the impact of the Internet Tax Freedom Act or other federal laws on the constitutionality of the Proposed Amendments?
- If so, what conclusions did the Department reach?
  - Was that review performed internally or were external resources utilized?

Again, we thank you for scheduling the hearing next week and for your consideration of these questions. We look forward to participating at the hearing and welcome any comments or questions you or the Department may have in advance of the meeting. With kindest regards, I remain,

Very truly yours,

*/s/ John F. Fletcher*

John F. Fletcher

Cc: Derek Easley – Business and Industry Political Education Committee  
Scott Waller – Mississippi Economic Council  
John McKay – Mississippi Manufacturer’s Association  
Mark Leggett - Mississippi Poultry Association  
Eric Bennett - Mississippi Bankers Association  
Patrick Nelson - Home Builders Association of Mississippi  
Bob Wilson - Mississippi Association of General Contractors  
Jennifer Hall - Mississippi Manufactured Housing Association  
Dawn Starns McVea - National Federation of Independent Businesses  
Pat Fontaine - Mississippi Hospitality & Restaurant Association  
Craig Carter - American Council of Engineering Companies of Mississippi  
Michael Callahan - Electric Cooperatives Of Mississippi  
Beth Hanson – Mississippi Realtors  
Pat Reynolds - Council on State Taxation