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Vermont Bill Would Repeal Cloud Software Tax Exemption

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On January 16, a bill (H. 756) was introduced in the Vermont Assembly that would repeal the sales and use tax exemption for remotely accessed prewritten computer software. If enacted as introduced, the exemption would no longer protect Vermont taxpayers from this legally suspect tax beginning July 1, 2020.

This is not the first time the Vermont Legislature has considered the issue of taxing cloud software. After the Department of Taxes administratively issued guidance interpreting the sales tax to apply to all prewritten software (including cloud-based software) in 2010, legislative actions were taken to curtail this administrative overreach—including a 2012 temporary moratorium and the aforementioned 2015 exemption—to preclude the imposition of sales tax on the mere accessing of prewritten computer software.

Practice Note: With the introduction of H. 756, Vermont is at risk of reverting back to the dark ages of cloud tax uncertainty that existed throughout the first half of the past decade. As noted below, there are substantial policy and legal flaws with this proposal that counsel against repeal of the exemption. Vermont Legislative Counsel estimates that repealing the sales tax exemption for cloud software would generate six to seven million dollars of revenue in FY 2021—hardly enough to justify the additional administrative complexities and disputes that will arise on audit (and potential litigation arising therefrom). Specifically, *even if* the cloud tax exemption is repealed, substantial uncertainty remains under Vermont law as to whether there is sufficient authority to impose sales or use tax on cloud service providers. Disturbing the existing certainty created under current law will take Vermont from one of the most favorable jurisdictions to do business in United States to one of the worst from a cloud service provider point of view. In a world where relocation can be accomplished at the click of a button, Vermont would be putting itself at a disadvantage over its neighboring states and incentivize new and relocating businesses to avoid consumption in Vermont in favor of states with more favorable (and more certain) tax laws.

Currently, Vermont sales tax applies to the retail sale of tangible personal property, unless an exemption applies. 32 V.S.A.§ 9771(1). In 2015, an exemption enacted prohibiting the taxation of “charges for the right to access remotely prewritten software shall not be considered charges for tangible personal property.” 2015 Acts and Resolves No. 51, Sec. G. 8. This amendment sought to eliminate confusion for customers and businesses of prewritten computer software that stemmed

from administrative positions taken by the Department in the first half of last decade. If the 2015 exemption is repealed, it would precipitate uncertainty once again, in addition to numerous potential disputes and litigation.

Assuming the 2015 exemption is repealed as proposed, a few legal issues will inevitably arise. Most notably, the Permanent Internet Tax Freedom Act (PITFA) bans discriminatory taxes on electronic commerce; states are prohibited from imposing a sales tax on the online version of something that is tax exempt offline. Vermont generally does not tax offline services, and thus a sales tax on remotely accessing cloud software runs the risk of a legal conflict with PITFA's congressional mandate. For example, consider the use of an internet-based tax return preparation service: if H. 756 is passed, this software service would be subjected to a sales tax, even though offline tax return preparation in Vermont is not taxed. This inconsistency opens the door for audit disputes and costly litigation, which will harm state coffers and not result in the revenue generation that is being projected.

Prior to moving forward with the proposed cloud tax exemption repeal, Vermont legislators should carefully consider the potential externalities that may arise from this action and whether it would result in one step forward and two steps back.

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