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If A Product or Service is Delivered Via the Internet, It's Not Subject to Sales Tax, Right?

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As not-for-profit organizations try to meet the growing needs of members and non-members by selling products and services delivered via the Internet, they may not realize that such products and services are subject to sales and use tax in a number of states. If the organization has nexus in one or more of these states, it is required to collect sales tax on sales of these products and services. These taxable products and services include information services, software as a service and digital goods.

Many not-for-profit organizations provide access to a database of information or documents that can be accessed by all subscribers. This service may be treated as a taxable "information service" in some states. For example, in a 2015 New York Technical Service Bulletin, TSB-A-15(5)S, the New York State Department of Taxation and Finance (the Department) determined that a not-for-profit organization's provision of a healthcare registry that provided healthcare providers and suppliers with access to a database that contained common standards to locate products and potential trading partners was an information service subject to New York state sales tax. The Department explained that the collecting, compiling and analyzing of information and reporting the information to others constituted a taxable information service under New York sales tax law. Furthermore, the Department stated that the service did not meet the statutory exclusion from the provision of information services because the information was not personal or individual in nature and could be substantially incorporated into reports furnished to others.

In addition to being subject to sales tax in New York, information services are taxable in a number of other states including, but not limited to, Ohio and Texas.

There is also a trend among not-for-profit organizations to provide cloud-based software that allows subscribers to analyze their own data. A growing number of states impose sales tax on such service as "software as a service." The following describes the typical software as a service situation.

1. The seller owns and operates the software application.
2. The seller operates and maintains the server that hosts the software.
3. Subscribers access the software application through the Internet. The software is not transferred to the subscriber, and the subscriber does not have the right to download, copy or modify the software.
4. The seller bills subscribers for the use of the software.

The major factor in determining whether a service is software as a service or some other service for sales tax purposes is the amount of control that the subscriber has over the software's features. The more control the user has over the software, the more likely the service will be characterized as software as a service. Some of the states that impose sales tax on software as a service include Massachusetts, New York, Pennsylvania, Ohio and Texas.

Finally, providing information digitally rather than on paper or CD does not exempt the sale from sales tax in a number of states. These states impose sales tax on "specified digital products." These products include digital audio works, digital audiovisual works and digital books that are transferred electronically to a customer. Some of the states that impose sales tax on sales of digital goods include New Jersey, North Carolina, Ohio, Tennessee and Texas.

Summary

In order to avoid potential sales tax exposure, in addition to focusing on where they have sales tax nexus and are selling tangible items such as CDs and periodicals, not-for-profit organizations need to also examine where they are providing products and services delivered via the Internet to determine if those products and services are taxable in the various states in which the organization conducts activities.