

# SALES & USE TAX ALERT

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## COMING SOON

- Perennial sales tax problems
- Tennessee Supreme Court finds catalysts are industrial machinery
- Illinois incentives

## ■ YEAR IN REVIEW

### Five issues of 2004 reveal what sales tax managers should watch in 2005

As another calendar year winds down, sales tax managers may realize that another year—and potentially new issues in the ever-changing world of sales tax compliance—will begin. *SUTA* board members take a look back at 2004 to give readers a quick review of some of the most important sales and use taxation issues with which to be acquainted. *SUTA*'s experts also offer advice on what to be watching in the upcoming year, as some trends gain momentum and carry forward into 2005. Review the five topics listed, not ranked.

#### 1. Forced registration

Several states have passed legislation forcing out-of-state contractors doing business with state governments to register to collect sales and use tax as a requirement in obtaining state contracts. In some instances, registration is necessary to make contracts with local governments and even school districts, as in New Jersey. Affiliates of contractors may be caught in the net of such legislation, also. Georgia, New York and New Jersey passed forced registration laws in 2004. California, Connecticut, Illinois, Indiana, North Carolina and Virginia passed forced registration laws earlier.

Look for this trend to continue in 2005, warns **Jeremiah T. Lynch**, a principal with **Ryan & Company** in New York City.

"It's got momentum till *Quill* gets overturned or the SSTP (Streamlined Sales Tax Project) gets passed," Lynch says.

**Ned A. Lenhart**, of **Sales Tax Advisors of Georgia PC** in Atlanta, agrees. "That's a very clever tactic, a strategic backdoor approach," Lenhart states, "And more and more states may get on the bandwagon."

#### 2. Class-action lawsuits

The spread of class-action lawsuits pertaining to sales and use tax is a troubling phenomenon, notes Lynch. The so-called "whistleblower" lawsuits utilized states' false claims acts, purportedly blowing the whistle on failure to collect use tax by online affiliates of retailers. Initiated by Chicago law firm Beeler, Schad & Diamond, the suits cropped up in Illinois, Tennessee and most recently Nevada. Tennessee and Nevada moved to dismiss the suits, but Illinois pursued its suits, with Wal-Mart and others seeking to settle the suits.

Meanwhile, class-action suits were lodged against telecommunications companies, such as *P.J.'s Concrete Pumping Service Inc. v. Nextel West Corp.* in Illinois and *AT&T v. Allen* in Oklahoma.

The U.S. Supreme Court declined review of both cases, therefore leaving unanswered the question of whether a state court can claim jurisdiction for a tax-related class action involving other states.

In Illinois, the suit claimed Nextel committed common law fraud when it collected municipal taxes from customers who lived in unincorporated areas.

In Oklahoma, AT&T challenged an Oklahoma court's authority to certify a class action involving municipal taxes collected in 27 other states.

"These cases are getting heard, and the Supreme Court is not stopping it," Lynch says.

While the whistleblower suits involved Internet transactions, the telecom class actions did not. Other industries besides telecom could face similar legal pressures in the future.

"I don't know that there is a single industry that could not also be affected," Lynch adds.

Escalation of class-action lawsuits like those in the telecom industry turns conventional wisdom upside down.

"Companies can't necessarily take a conservative viewpoint toward the taxing of different items with the threat of these class-action lawsuits," he says.

### 3. Manufacturing exemptions for telecom

A number of court cases this year involved telecommunications companies seeking manufacturing exemptions for equipment. The Minnesota Supreme Court in *Sprint Spectrum LP et al., Relators, v. Commissioner of Revenue* declared electronic telecommunications signals tangible personal property, making Sprint's underlying equipment eligible for the sales and use tax exemption for capital equipment. In Oklahoma, Midwest Cellular Telephone, OK-3 Cellular, OK-5 Cellular and AT&T Wireless Services of Tulsa failed to obtain exemptions for machinery and equipment in the Court of Civil Appeals. The court ruled that the companies were engaged in manufacturing, but not "primarily engaged" in manufacturing. The Pennsylvania Supreme Court ruled in *Bell Atlantic Mobile Systems Inc. v. Commonwealth* that cellular telecommunications service did not qualify for a manufacturing exclusion because the provider did not transform tangible personal property into a different form or product.

These cases have a telecom focus relating to whether signals or electronic pulses can constitute manufacturing, with underlying machinery exempt, Lynch notes. More such cases are likely. And they may bear relevance to other industries including software, information services, media and entertainment.

"A court case in one industry can potentially create opportunity in another industry," Lynch says.

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#### 4. Streamlined Sales Tax Project

Although the fate of the Streamlined Sales Tax Project remains to be seen, the SSTP still proved to be one of the biggest issues of 2004 for sales tax managers, says **Beth Ann Kendzierski**, director of tax for **Apria Healthcare Inc.** in Lake Forest, Calif. The reason why is because states have already passed implementation legislation. Some legislation became effective as of July 1, 2004. Other laws will become effective Jan. 1, 2005.

"Whether this is a go or not, states have already changed their statutes or have effective dates in the near future," Kendzierski says. "Many companies think this doesn't affect them because the SSTP hasn't gone into effect. There are changes that are already happening."

Industries across the board are affected in states that have changed sourcing sales.

Also, product definitions may have changed, particularly for food, clothing and medical items. That in turn could affect taxability for those selling at retail, she says.

#### 5. Internet Tax Nondiscrimination Act

Essentially the continuation of the Internet Tax Freedom Act, the Internet Tax Nondiscrimination Act was passed by Congress and recently signed by President Bush—a year after ITFA expired. The new law comes as long-awaited guidance and clarification for sales tax managers left waiting while the bill hung in limbo, notes Lenhart.

"I think this could affect passage of the SSTP," says **Diane Yetter**, president of **Yetter Consulting Services Inc.** in Chicago.

Yetter notes that one of the complaints about ITNA—and reasons for the delay—was the controversy over ITNA constituting an unfunded federal mandate.

"The federal government is mandating a state cost," she says. "That was one of the big complaints about it. That's one reason why it only got extended for three more years."

Conceivably, federal legislators might pass the SSTP to offset state losses from ITNA, she says.

**Editor's note:** *Lynch can be reached at (212) 871-3901; Lenhart at (770) 985-9573; Kendzierski at (949) 639-2012; Yetter at (312) 701-1800. ♦*

■ DSL TAX PHASED OUT; VOIP UNCHANGED

## Congress extends Internet access tax ban through 2007

Congress has reinstated the moratorium on state and local Internet access taxes more than a year after it expired. S150, the Internet Tax Nondiscrimination Act, and Senate Concurrent Resolution 146 extend the moratorium until Nov. 1, 2007. President George W. Bush has signed the measures.

The legislation phases out state and local taxes on digital subscriber line service and leaves the rules on taxation of Voice Over Internet Protocol applications untouched.

First adopted in October 1998 as the Internet Tax Freedom Act, the previous moratorium expired Nov. 1, 2003. In April, the Senate approved legislation to expand the moratorium and reinstate it until 2007. However, the House of Representatives had refused to concur, holding out for a permanent tax ban. In mid-November, the Senate made two minor amendments to its previously passed legislation, which the House has now accepted.

#### Terminology irrelevant

The legislation prohibits state and local taxes on Internet access and multiple or discriminatory state

and local taxes on electronic commerce, retroactive to Nov. 1, 2003 and ending Nov. 1, 2007. This provision reinstates the original ITFA moratorium.

S150 and Sen. Con. Res. 146 adopt a new definition of "tax on Internet access" to state specifically that the term applies regardless of whether the tax is imposed on a provider or a purchaser of Internet access and that it applies regardless of the terminology used. However, the definition specifically excludes taxes on, or measured by, net income, capital stock, net worth or property value.

#### Grandfather clauses and DSL

The bill and resolution extend until Nov. 1, 2007, the original ITFA grandfather clause allowing states that imposed Internet access taxes prior to Oct. 1, 1998 to continue imposing those taxes. However, the grandfather clause for Wisconsin's telecommunications service tax is extended only until Nov. 1, 2006.

S150 and Sen. Con. Res. 146 expand the definition of exempt Internet access to include telecommunications services "to the extent such services

are purchased, used, or sold by a provider of Internet access to provide Internet access." The language narrows the moratorium exception that allows taxes on telecommunications services. Some states had used the exception to tax digital subscriber line service.

However, the legislation enacts a new grandfather clause to allow for some Internet access taxes imposed as of Nov. 1, 2003. For instance, states and localities that have been taxing DSL service may continue to do so until Nov. 1, 2005, despite the narrowed exception for taxes on telecommunications services.

### Status quo for VOIP

The legislation specifically states that it does not change the taxation of charges for voice service or similar services using Voice Over Internet Protocol applications. This exception for taxation of VOIP services specifically does not apply to services incidental to Internet access, such as voice-capable e-mail or instant messaging.

As such, the legislation does not prevent states from taxing VOIP services, but it also does not specifically authorize states to do so.

"It's not making any inference that it's taxable or exempt in any particular state," says

**Deborah Bierbaum**, director of external tax policy with AT&T.

The current taxation picture for VOIP is varied among states, largely because definitions for taxable telecommunications vary, Bierbaum explains. One state may define it as telephony of any nature while another might declare that telecommunications includes voice transmissions over cable, wire or any other media ever devised.

"Two people could look at the same statute and one will say VOIP is subject to tax and the other will say it is not," Bierbaum says. "It's a really foggy area right now."

Some states already tax VOIP applications by default. **Ned Lenhart**, president of **Sales Tax Advisors of Georgia**, explains that many telecommunications providers collect taxes on VOIP, sometimes under a sales tax on information services, sometimes under a tax on telecommunication services, depending on how a state's statutes are written.

"In many respects, states can tax Voice Over Internet because it looks like a traditional phone call," Lenhart says. "Any state that can tax a telephone call is probably taxing Voice Over Internet because it uses a public switch."

### Bundled services, other provisions

S150 and Sen. Con. Res. 146 also allow the taxation of otherwise exempt Internet access services bundled with taxable services, unless the Internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business.

In addition, S150 also specifies that Texas municipal access line fees are unaffected.

The legislation directs the federal Government Accountability Office to study the impact of the moratorium on state and local government revenues and to assess whether the tax ban has had an impact on the deployment or adoption of broadband Internet access services.

### Permanent ban on hold

**Harley Duncan**, executive director of the **Federation of Tax Administrators**, predicts that in 2007 or before, lawmakers will attempt to make the tax ban permanent.

"There are some issues we'd like to see addressed on the state side if it's going to be made permanent," Duncan adds. "We want to take a look at the definition of Internet access to make sure it covers only access and not content." ♦

#### HIGHLIGHTS OF INTERNET ACCESS TAX BAN

- Reinstates until Nov. 1, 2007 the original ban on state and local taxes on Internet access and multiple or discriminatory taxes on electronic commerce
- Extends the grandfather clause allowing states that imposed Internet access taxes prior to Oct. 1, 1998 to continue imposing those taxes
- Ends the grandfather clause for Wisconsin's telecommunications service tax on Nov. 1, 2006
- Phases out state and local taxes on digital subscriber line services by Nov. 1, 2005
- Does not change the tax status of Voice Over Internet Protocol applications
- Allows the taxation of otherwise exempt Internet access services bundled with taxable services, unless the provider can identify Internet access charges from its books and records

■ LOCAL TAX CAPS TO GO

## Approaching SSTP compliance adds to Arkansas business woes

Joining the Streamlined Sales Tax Project may mean more sales tax revenue for Arkansas, but the ramifications of compliance may have disastrous consequences for the business community in the state, experts say. SSTP compliance under Act 1273 becomes effective Jan. 1, 2006.

The business community must deal with two big issues: the removal of caps on city and county gross receipts (sales) tax and the switch from origin-based imposition of sales tax to destination-based imposition.

This could worsen a tax environment for business in Arkansas that suffered a rate increase in 2004 from 5.125% to 6% as well as broadening of the tax base to include a host of new services, says **B.J. Pritchett** of **Pritchett Sales Tax Consulting** in Hot Springs National Park, Ark. Businesses must now pay taxes on services like security and alarm services, cleaning parking lots and gutters, some initial installations, pest control services and collection of waste.

### Battle in Legislature?

The Arkansas Legislature convenes in January. Expect business to push for legislation that pushes back the effective date for Arkansas SSTP compliance, pegging it to federal SSTP action, says Pritchett. But don't be surprised if some in the Legislature introduce legislation to move the date forward, to July 1, 2005, perhaps, she adds.

More time would be better for businesses to adjust, Pritchett says. Still, other states with local caps that also ratified SSTP legislation have enacted rebates. This could work for Arkansas.

### Adding up local taxes

Local tax rates in Arkansas vary widely, Pritchett notes, and some can be rather substantial. But caps that kept local taxes levied only on the first \$2,500 kept local taxes in bounds for businesses. But take away the caps, and local taxes sky rocket on big dollar items. Take for instance tiny Dumas City, which levies a 3.5% sales tax. Add 2% for Desha County. And, of course, don't forget the state tax rate of 6%.

"It's going to be a huge hit on manufacturers," says **Denton Childs**, director of non-income taxes

for **Tyson Foods Inc.** "We make a lot of purchases over \$2,500. Removal of that cap is going to cost us a lot of money."

Consider utility bills. Subject the entire amount to local taxes, and companies will feel the pinch.

"We get some gas bills that are \$300,000," Childs says.

Pritchett notes an essential item like racks in so-called big box stores could become very costly with uncapped local taxes and installation charges taxed, too.

### Under the radar

Many small businesses across Arkansas may not be aware that implementation of the SSTP brings with it a change in sourcing of sales taxation, Childs notes. And small municipalities may not yet be aware of what the change will do to their revenue stream.

"I think this whole thing is happening under the radar screen," Childs says.

**Kenny Hall** of the **Arkansas State Chamber of Commerce** acknowledges that the removal of caps will affect most industries—something that wasn't touted along with the increase of state revenue from tax collected on remote sales.

"The atmosphere around this SSTP (legislation) was that it was a major new source of revenue," says Hall. "You've got to have some way to avert the tax increase that the loss of the caps causes."

**Tom Atchley**, excise tax administrator for the **Dept. of Finance and Administration**, said some of the effective dates included in Act 1273 of 2003 were necessary to keep Arkansas on the governing board of the SSTP.

He downplays the concern over the change in sales tax sourcing, saying businesses in the state have seen destination changes before—two in the last two decades.

"A service provider performing taxable services already collects on destination," Atchley states.

Utilities in particular must collect based on destination, he notes.

**Editor's note:** *Pritchett can be reached at (501) 922-4327. ♦*

### AUDIT GUIDE

CCH's *Multistate Guide to Sales and Use Tax Audits (2004-2005)* provides state-specific information for preparing for and handling an audit in all states that impose sales and use taxes. Pages: 644. Price: \$239. Volume discounts available. Call (800) 248-3248.

## STATE UPDATES

### ARIZONA

A taxpayer's gross proceeds from the lease of computer software and maintenance agreements that were delivered to customers outside Arizona for use exclusively outside the state were not subject to Arizona transactions privilege (sales) and use tax. The agreements constituted leases, rather than outright sales, because they provided customers with the rights to use the software for a defined period without any transfer of title. Also exempt were the proceeds from agreements under which the software was on dedicated computer equipment at an independent data center in Arizona but was made available to the customer via the Internet for use by the customer exclusively out-of-state at the customer's location. However, the taxpayer's proceeds derived from providing installation, assessment, hosting, maintenance and support fees, and other professional and consulting services in connection with leases were taxable. Although a professional services exemption exists for outright sales, that exemption is not available in the case of leases. The tax did not apply to those services provided to non-residents regardless of whether they were related to leases of the taxpayer's software. (*Private Taxpayer Ruling LR04-007, Dept. of Revenue*)

The Dept. of Revenue has issued a notice that reviews procedures for seizure of packages of cigarettes on which the tobacco products tax has not been paid. (*Luxury Tax Notice LTN 04-5, DOR*)

Use fuel that has been used in an exempt manner but that has been determined to be subject to Arizona use tax, becomes subject to the tax on the date that a consumer has been issued a use fuel tax refund. (*R15-5-127 and R15-5-2327, Dept. of Revenue, effective Dec. 4, 2004*)

### ARKANSAS

The Dept. of Finance and Administration has promulgated a regulation that clarifies the requirements for claiming a refund of overpaid gross receipts (sales) tax. The regulation details who may claim a refund, requirements and procedures for claiming a refund, procedures for vendor assignment claims, and the remedies available following a denial of a refund claim. The regulation also provides related definitions. Refund claims must be filed within three years from the date the return was filed or two years from the date the tax was paid, whichever is later. (*Reg. 2004-6, DFA, effective Nov. 15, 2004*)

### COLORADO

The Dept. of Revenue has issued guidance regarding the cigarette and tobacco tax rate increases that take effect Jan. 1, 2005. The new rates will be 84 cents (currently, 20 cents) per pack of 20 cigarettes and 40% (currently, 20%) of the manufacturer's list price as invoiced for tobacco products. (*New Cigarette and Tobacco Tax Rates, DOR*)

### FLORIDA

The floating rate of interest on liabilities and refunds for the period from Jan. 1, 2005, through June 30, 2005, is 8%, unchanged from the rate imposed from July 1, 2004, through Dec. 31, 2004. (*Tax Information Publication No. 04ADM-02, Dept. of Revenue*)

### IDAHO

The State Tax Commission has launched an online International Fuel Tax Agreement renewal service for motor fuel tax. Idaho-based truckers who travel in the United States and Canada and are licensed under IFTA can renew their license and order decals at no extra charge through the state's motor carrier Web site at [trucking.idaho.gov](http://trucking.idaho.gov). The current renewal period ends on Feb. 28, 2005. (*News Release, State Tax Commission, Nov. 22, 2004*)

### ILLINOIS

Effective Nov. 3, 2004, a number of Illinois sales and use tax regulations are amended to reflect statutory changes. Some of the changes are retroactive. Beginning July 1, 2004, through June 30, 2005, sales of motor vehicles are not subject to the commercial distribution fee sales tax exemption if the motor vehicle: (1) is a second division motor vehicle, (2) does not exceed 8,000 pounds, (3) is subject to the commercial distribution fee, and (4) is used primarily for commercial purposes. Previously, the test did not include the element requiring the vehicle to be used primarily for commercial purposes. Beginning on and after Sept. 1, 2004, the manufacturer's purchase credit, which allows manufacturers to earn a credit when purchasing exempt manufacturing machinery and equipment, is reinstated for purposes of Illinois sales tax. Also effective Sept. 1, 2004, the graphic arts machinery and equipment exemption is reinstated. Previously, both of these credits were effective through June 30, 2003. Effective November 3, 2004, regulations also are amended to clarify that when a person is engaged in the

business of leasing watercraft or aircraft and, in connection with such business, sells any used watercraft or aircraft to a purchaser for use and not for resale, he or she is considered a retailer engaged in the business of selling tangible personal property at retail to the extent of the value of the watercraft or aircraft sold. Also effective Nov. 3, 2004, liquor distributors and manufacturers may provide monthly sales totals to liquor retailers by electronic means, unless the retailer is unable to receive the information by electronic means. The distributor must notify the retailers of the method that will be used. Finally, effective Nov. 3, 2004, the definition of "gasohol" is modified to more accurately reflect the industry definition of the term. (*86 Ill. Adm. Code §§130.101 through 130.552 (nonconsecutive), Dept. of Revenue, effective as noted, for a maximum of 150 days*)

Emergency amendments are made to use tax, service use tax, and service occupation tax regulations to reflect P.A. 93-1033 (HB714) of 2004, which reduced the commercial distribution fee, amended the qualifications for the sales tax exemption for certain vehicles subject to the fee, and repealed the exemption effective July 1, 2005. The CDF is reduced from a surcharge of 36% of the motor vehicle registration taxes and fees incurred by a vehicle to 21.5% for the registration year beginning after June 30, 2005, and to 14.35% for registration years beginning after June 30, 2006. The sales tax exemption for certain vehicles subject to the CDF is amended effective July 1, 2004, through June 30, 2005, to add the requirement that vehicles primarily be used for commercial purposes. Effective July 1, 2005, the exemption is repealed. The regulations provide examples of uses that would qualify as use for commercial purposes. (*86 Ill. Adm. Code §§140.124, 150.311, and 160.111, Dept. of Revenue, effective Nov. 3, 2004, for a maximum of 150 days*)

### INDIANA

A car manufacturer was not entitled to a refund of sales tax for sales tax paid back to purchasers as a result of the state's lemon law. The intent of the lemon law was to make the manufacturer suffer financially. Further, the manufacturer was not in the place of the retail merchant when making the refund, and the refund statutes only allowed for refunds of sales tax between the retail merchant and the purchaser. Allowing the manufacturer to collect a sales tax refund would expand the language of the refund statutes to situations beyond

## STATE UPDATES

transactions between a retail merchant and a buyer. (*DaimlerChrysler Corp. v. Dept. of Revenue, Tax Court, Dkt. No. 49T10-0307-TA-38*)

### KANSAS

Beginning Jan. 1, 2005, the sale of custom software is exempt. Custom software is computer software that is designed to meet a specific purchaser's unique requirements and is sold to that purchaser. Custom software includes modifications to prewritten software that are designed for a certain purchaser's specifications if the charges for such modification work are separately stated on the billing to that purchaser. (*Revenue Ruling No. 19-2004-03, Dept. of Revenue*)

The following trailers and vehicles do not qualify for the sales tax exemption for motor vehicles, semitrailers, pole trailers, or aircraft sold to a nonresident: trailers that do not meet the definition of "semitrailer" or "pole trailer," such as pop-up campers, RV trailers, travel trailers, and utility trailers; all-terrain vehicles; utility vehicles, such as John Deere Gators, Kawasaki Mules, and Yamaha Side X Sides; dirt bikes; motorized bikes; boats; boat trailers; personal watercraft, such as Jet Skis and Wave Runners; and all other tangible personal property that is not specifically exempted from Kansas sales tax. Beginning Dec. 1, 2004, the tax must be collected and remitted on these nonexempt trailers and vehicles. However, retailers will not be required to self-audit their records for the past three years. (*Notice 04-13, Dept. of Revenue*)

### LOUISIANA

To qualify for the sales and use tax exemption for dental devices, an item either must be (1) an orthotic, prosthetic, or restorative device or a prosthesis used or prescribed by a dentist for health care treatment or for personal use or consumption by the dental patient; or (2) a dental device exclusively used by, or administered to, the dental patient by a dental professional for dental or health care treatment. The "exclusive use or administration" requirement contemplates that the exemption may only be permitted on the sale or use of nondurable goods used once on one patient and disposed of or given to the dental patient. (*Revenue Ruling No. 04-008, Dept. of Revenue*)

### MICHIGAN

When a taxpayer's attempt to make a sales or use tax payment by electronic

funds transfer fails, there is an alternative method for making a same-day payment so as to avoid a penalty and interest. If the payment fails for a reason not related to the taxpayer's operations, such as a power failure, act of God, or other similar circumstances determined by the Dept. of Treasury, payment will be considered timely if received on the next business day following the due date on which the reason for the failure is corrected. Written notice must be provided to the department containing the name and account number of the taxpayer, the tax period involved, the specific taxes and amounts that were remitted late, and a description of the date, time, and manner that the failed EFT was initiated, as well as the reason it failed, and the date the failure was corrected. (*Internal Policy Directive 2004-6, DT*)

### NEW YORK

A management company was not liable for sales tax on its facility rental receipts, even though the rental fees appeared on catering contracts executed by its related catering company. Although the law imposes sales tax on certain charges by caterers, the rental fees in question were charged by the management company, not the catering company. The catering contracts made it clear that the rental charges were separate from the costs of the catering and that a separate check had to be issued to the management company for the rental charges. (*Oheka Management Corp., Div. of Tax Appeals, Administrative Law Judge Unit, DTA Dkt. Nos. 819166, 819167 and 819168*)

The 2005 aggregate tax rates, effective Jan. 1, 2005, for motor fuel and aviation gasoline rates are increased from 14.6 cents to 15.2 cents per gallon. The automotive diesel fuel rate is increased from 12.85 cents to 13.45 cents per gallon. The rate for nonautomotive diesel motor fuel is increased as follows: for commercial gallonage, from 7.9 cents to 8.2 cents per gallon; for nonresidential heating, from 4.3 cents to 4.4 cents per gallon; and for an electric corporation without a direct pay permit, from 13.7 cents to 14.2 cents per gallon. The tax on residual petroleum product is increased as follows: for commercial gallonage, from 6 cents to 6.3 cents per gallon; for nonresidential heating, from 3.2 cents to 3.4 cents per gallon; and for an electric corporation without a direct pay permit, from 11.8 cents to 12.3 cents per gallon. (*Publication 908 [Fuel Tax Rates], Dept. of Taxation and Finance*)

### OHIO

A release provides guidance on filing motor fuel tax refund claims for agricultural, industrial, and miscellaneous refundable use. The state recommends that taxpayers file their refund claims for fuel used in an exempt manner on a monthly, calendar quarter, or semi-annual basis. If taxpayers file a refund claim that includes gallons purchased for a period that has multiple tax rates, their claims must be processed manually and may be delayed. (*Motor Fuel Tax Information Release XT 2004-03, Dept. of Taxation*)

### PENNSYLVANIA

Persons making sales of cigarettes through the mail or through any telecommunications means, including telephone, facsimile or the Internet, must collect and remit Pennsylvania cigarette tax on such sales, unless proof is obtained that the taxes have already been paid to the Commonwealth. Failure to adhere to the provisions relating to mail and Internet sales will result in a fine of \$1,000 for the first offense, and a fine in an amount between \$1,000 and \$5,000 for subsequent offenses. (*Act 150 [SB921] of 2004, effective Jan. 22, 2005*)

A contractor's purchases of items used to install water and sanitary sewer lines for a private developer were exempt from sales tax because the developer planned to dedicate the sanitary sewer installation to a public utility, municipality, or municipal authority upon its completion. In order to claim the exemption, the contractor must provide the supplier with a properly executed exemption certificate (Form REV-1220) and a list containing the identity of the developer, description of the job, the exempt entity to which the property will be dedicated, and a list of the exempt items purchased. A copy of the legal letter ruling should also be provided. (*Legal Letter Ruling No. SUT-04-025, Dept. of Revenue*)

### TEXAS

The deadline for claiming a refund of motor fuel tax paid on dyed or undyed diesel fuel is Dec. 31, 2004. Beginning on Jan. 1, 2005, tax paid on diesel fuel used in off-highway equipment, stationary engines, and other non-highway purposes will no longer be eligible for refund. Any refund claim postmarked after Dec. 31, 2004, will not be approved. (*Motor Fuels Tax Refund Claim Reminder —Diesel Fuel, Texas Comptroller of Public Accounts*)

## Sales and use tax incentives—Alabama

The following is excerpted from the Business Incentives Guide, a CCH book and online service detailing state-by-state business exemptions, incentives and credits. Unless otherwise indicated, all statutory references are to the Code of Alabama (1975), as amended, and "Reg." references are to the regulations of the Alabama Department of Revenue.

### **MANUFACTURING (§§ 40-23-1 AND 40-23-2; REGS. 810-6-1-.91, 810-6-1-.137, 810-6-2-.41, 810-6-2-.42, AND 810-6-4-.17)**

Property that becomes an ingredient or component part of products manufactured or compounded for sale is exempt from sales and use taxes. Machines used for compounding, processing, and manufacturing are subject to a reduced rate of tax. "Processing" means to subject to some special process or treatment. Examples of processes include the following: heating products such as fruit under pressure, so as to cook or sterilize; subjecting raw material to a process of manufacture, development, or preparation for market; converting to a marketable form, such as the slaughtering of livestock, the milling of grain, the spinning of cotton, the pasteurizing of milk, or the sorting and repacking of vegetables; or making waste matter usable, such as the processing of rancid butter, rayon waste, coal dust, or beet sugar.

### **COMPUTER SOFTWARE (REG. 810-6-1-.37)**

Custom computer programming (software) is exempt from sales and use tax. "Custom computer programming" encompasses:

- software programs created specifically for particular users and prepared to the special order of those users;
- programs that contain preexisting routines, utilities, or other program components integrated in a unique way to the specifications of particular users; and
- services represented by separately stated charges for modifications to canned computer software that are prepared to the special order of customers.

The sale of a software maintenance agreement in conjunction with the sale or rental of canned computer software, if optional to the purchaser, is also exempt. Maintenance contracts sold in connection with custom computer programming are exempt whether required or optional.

### **ADVERTISING (REG. 810-6-1-.02)**

Advertising is considered a service and is not taxed. Advertising agencies pay tax as consumers on the materials used in producing brochures or other presentations for clients. The furnishing of such materials to clients is not taxable.

### **PACKAGING (§§ 40-23-1, 40-23-4, 40-23-60, AND 40-23-62; REGS. 810-6-1-.69 AND 810-6-1-.137)**

Containers sold to manufacturers or retailers that will package tangible property and will be delivered along with the property to the ultimate consumer are exempt. Containers include bags, barrels, baskets, bottles, boxes, cans, cartons, cores, crates, cups, cylinders, drums, kegs, pails, plates, reels, sacks, and spools. Containers sold for one-time use are exempt, whereas returnable bags are taxable. Crowns and caps for one-time use to seal marketable containers are also ex-

empt. One-time use containers that are used by manufacturers and compounders to package their products and that become the property of the purchaser may be purchased tax-free at wholesale while purchases of returnable containers are taxable. Pallets intended for one-time use may be purchased tax-free at wholesale. Labels that will be attached to one-time use containers may be purchased tax-free at wholesale. Manufacturers and compounders also may purchase labels tax free that will be affixed to tangible personal property manufactured or compounded for sale or to the furnished containers of the property.

### **TAX INCENTIVE REFORM ACT OF 1992 (§§ 40-9B-1 TO 40-9B-8; REG. 810-4-3-.06)**

The Tax Incentive Reform Act of 1992 allows a company to reduce or eliminate certain sales, use, and/or *ad valorem* property taxes in exchange for building or expanding an industry. The municipal and county governments or public industrial authority has discretion in granting the different forms of tax abatements available under the act and fixing the length of abatements. Taxes earmarked for educational use or for capital improvements of educational facilities cannot be abated under the Tax Incentive Reform Act of 1992. New industrial and research enterprises are qualified to apply for the available tax abatements. Major additions to an industrial or research enterprise are also eligible. While no minimum size or cost threshold is required for new businesses, a "major addition" is defined as an expansion, the cost of which is the lesser of 30% of the value of the property before expansion, or \$2 million.

### **FUEL EXEMPTIONS (§§ 40-23-4(A)(9) AND 40-23-62(11), 40-23-62(15))**

Wood residue, coal or coke for use in manufacturing, power plants, or transportation are not taxed. Fuel oil for use in kilns for manufacturing purposes is also exempt. Coal and coke to be stored or used by manufacturers, electric power and transportation companies are exempt from use tax.

### **AIR AND WATER POLLUTION CONTROL DEVICES (§§40-23-4(A)(16) AND 40-23-62(18))**

Air or water pollution control devices are not taxed. The exemption extends to all identifiable components of the control device and all materials or components used in a structure built primarily for the control, reduction or elimination of air or water pollution.

### **WARRANTY REPAIR PARTS (§§ 40-23-4(A)(18) AND 40-23-62(19))**

Sales by dealers and distributors of parts to make free warranty repairs are not taxed. Property used in such repair transactions is not subject to the use tax.

### **SALES OF AIRCRAFT, COMPONENTS, AND SUPPLIES TO OR BY IN-STATE HUB OPERATIONS (§§ 40-23-4(A)(40), 40-23-4(41), AND 40-23-62(32), 40-23-62(33))**

Aircraft, replacement parts, components, systems, in-flight food and beverages, supplies and ground support equipment sold to or by a licensed air carrier with an in-state hub operation are exempt.