

With many states enacting statutes that create an economic presence standard, the limitations and extent of this state's jurisdiction to impose tax may be an evolving area and this information release is not intended to be an all-encompassing or all-inclusive description of this subject. This information release may be modified by changes in either federal or state laws or by decisions of state and federal courts.

ST 2017-02 – Sales and Use Tax: Software Nexus and Network Nexus– October, 2017

The purpose of this information release is to describe the nexus standards the Department of Taxation (“Department”) will apply to determine whether an out-of-state seller is subject to Ohio’s use tax collection responsibility under the nexus provisions enacted in Am. Sub. H.B. 49 of the 132nd General Assembly¹. This information release supplements “ST 2001-01 – *Use Tax Information Release – Sales and Use Tax – Use Tax Nexus Standards: September, 2001; August, 2016; October, 2017*” and is not meant to supersede that information release.

In *Quill Corp. v. North Dakota* (1992), 504 U.S. 298, the U.S. Supreme Court held that it was improper for a state to require a mail-order retailer to collect from consumers and remit the state’s use tax when the retailer was not physically present in that state. For purposes of Ohio sales and use tax, Am. Sub. HB 49 provides that the use of software in Ohio, including software located on the consumers’ computers, mobile devices, and the servers of third party service providers (i.e., content distribution networks) provides the requisite physical presence. Additionally, when an out-of-state seller engages in nexus-creating activities which enhance the out-of-state seller’s ability to establish and maintain its market in Ohio, Ohio sales and use tax collection and remission may be required of the out-of-state seller, consistent with the demands of the Due Process Clause and the Commerce Clause. Moreover, the application of these nexus standards to sellers that have a threshold of \$500,000 in gross receipts from sales in Ohio ensures that the out-of-state seller’s connection to its Ohio market is substantial.

ISSUES ADDRESSED

- I. What is the nexus standard the Department will use to determine whether an out-of-state seller is subject to Ohio’s use tax collection responsibility?
- II. When is this information release effective?
- III. What are the registration and filing requirements for a person subject to Ohio’s taxing jurisdiction?
- IV. Once a person meets the criteria to collect and remit use tax, how long does the filing requirement last?

DEFINITIONS

As used in this information release:

¹ As with all information releases of the Tax Commissioner, this document serves to communicate with taxpayers how the Department will administer Ohio taxes mandated by the Ohio Revised Code or relevant statutory changes. No information release has any force or effect of law.

- "Computer software" means a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task. [R.C. 5739.01 (BBB)]
- "In-state software" means computer software, as that term is defined in section 5739.01 of the Revised Code, that is stored on property in this state or is distributed within this state for the purpose of facilitating a seller's sales. [R.C. 5741.01(I)(6)(d) effective January 1, 2018]
- "Content delivery network" or "content distribution system" means a system of distributed servers that deliver websites and other web content to a user based on the geographic location of the user, the origin of the website or web content, and a content delivery server. [R.C. 5741.01(I)(6)(e) effective January 1, 2018]

ISSUES DISCUSSED

I. **What is the nexus standard the Department will use to determine whether an out-of-state seller is subject to Ohio's use tax collection responsibility?**

R.C. 5741.01(H) and (I) set forth the legal standard to be used by the Department to determine whether an out-of-state seller is subject to Ohio use tax collection responsibilities.² Specifically, the new R.C. 5741.01(I)(2)(h) and (i) adds a new legal standard that will be used by the Department to determine whether a person is subject to the Ohio seller's use tax. Subject to a rebuttal presumption, effective January 1, 2018, an out-of-state seller is subject to Ohio's use tax collection responsibility when the out-of-state seller engages in any of the following activities:

In-state Software Nexus

- The seller uses in-state software to sell or lease taxable tangible personal property or services to consumers, provided the seller has gross receipts in excess of \$500,000 in the current or preceding calendar year from the sale of tangible personal property for storage, use, or consumption in this state or from providing services the benefit of which is realized in this state. This standard will hereinafter be referred to as "In-state Software Nexus". [R.C. 5741.01(I)(2)(h)]

For example, a large out-of-state seller (Seller A) that retails clothing to individual consumers through a website, also provides for the sale of the clothing through a catalog application which is downloaded onto the customer's computer or cell phone. The catalog application is software, as is the html and java script coding used in displaying the seller's website on the customer's computer or cell phone. It is the presence of this software owned by Seller A in Ohio that is significantly associated with Seller A's ability to establish and maintain its market and that meets the physical presence standard set forth in *Quill*. In 2017, Seller A had \$2 million of gross receipts related to the sale of clothing to consumers in Ohio. Beginning January 1, 2018, it is presumed that Seller A has substantial nexus with Ohio and should register and begin collecting and remitting tax on purchases by Ohio consumers in 2018. Seller A's first return would be due on February 23, 2018 for the January 1, 2018 to January 31, 2018 tax period.

² Additionally, Ohio law provides that the Department can require an out-of-state seller to collect and remit Ohio use taxes under any set of circumstances allowed by the Constitution of the United States.

Network Nexus

- The seller provides or enters into an agreement with another person to provide a content distribution network in this state to accelerate or enhance the delivery of the seller's website to consumers. The seller must have gross receipts in excess of \$500,000 in the current or preceding calendar year from the sale of tangible personal property for storage, use, or consumption in this state or from providing services the benefit of which is realized in this state. [R.C. 5741.01(l)(2)(i), effective January 1, 2018]

For example, an out-of-state seller (Seller B) sells security services and enters into a contract with a provider of interconnected servers that accelerates the delivery of the seller's website to consumers (Provider CDN). Provider CDN has three servers in Ohio that it will utilize to provide security for uninterrupted service and enhance delivery of Seller B's website and/or web-based services to consumers in Ohio and surrounding states. Seller B also has \$800,000 in sales of taxable security services to Ohio consumers in 2017. Beginning January 1, 2018, it is presumed that Seller B has substantial nexus with Ohio and should register and begin collecting and remitting tax on purchases by Ohio consumers in 2018. Seller B's first return would be due on February 23, 2018 for the January 1, 2018 to January 31, 2018 tax period.

II. When is this information release effective?

R.C. 5741.01(l)(h) and (i) are effective January 1, 2018. This information release is effective when issued and applies starting with the first tax period (January 1, 2018 to January 31, 2018). The Department reserves the right to modify and reissue this information release in order to reflect judicial decisions or to clarify the Department's position.

III. What are the registration and filing requirements for a person subject to this state's taxing jurisdiction?

An out-of-state seller which falls within this state's taxing jurisdiction, and makes taxable sales, will be required to obtain a seller's use tax permit, collect tax on taxable sales made to consumers in this state, and file returns and remit the appropriate tax. Information about registration and permits can be obtained by calling 1-888-405-4039, or from the Department's website by visiting tax.ohio.gov.

The duty to obtain a seller's use tax permit, collect tax on taxable sales made to consumers in this state, and file returns and remit the appropriate tax commences with the month that includes the day of the contact that establishes a physical presence and applies prospectively from that date.

IV. Once the standard is established, how long does the filing requirement last?

When an out-of-state seller no longer has nexus creating contacts for one calendar year, the out-of-state seller may cancel its registration and stop collecting and remitting use tax on its sales in this state. However, if the out-of-state seller reestablishes nexus by engaging in any nexus creating contacts within twelve months of its registration cancellation, the Department will presume that the new contact remains part of a regular presence in this state. Thus, the out-of-state seller continued to have nexus during the interim period. The out-of-state seller will be required to reinstate its registration and pay tax on all its sales in this state during the interim period, and continue collecting tax on a prospective basis.