OPTIMIZING TAX PAYMENTS *on* PURCHASES
of MPU SOFTWARE *and* CLOUD COMPUTING SERVICES

Jeff Heyel

March 13, 2020

WE'RE HERE *to* DIG DEEP *on* YOUR BEHALF

Paying the correct amount of sales and/or use tax on purchases of multiple points of use (MPU) software and cloud computing services is challenging because it requires that taxpayers:

— Keep up with ever-changing state tax regulations

— Deal with the lack of public state tax guidance

— Gather sufficient supporting documentation for available tax incentives

— Review documentation that is often voluminous and cryptic

— Create tools to take advantage of tax incentives on an ongoing basis without incurring a high administrative burden

Not having the time, resources, and tools for the sleeve rolling and deep digging required to identify and support tax benefits often costs taxpayers millions of dollars.

A SAVVY EXEMPTION FOR MULTIPLE POINTS OF USE (MPU) SOFTWARE

There are a handful of states, including Washington, that allow prewritten software and software-as-a-service (SaaS) that are concurrently used in and outside of the state to be sourced to the locations of the users. At the time of purchase, the buyer provides the vendor with an exemption certificate and does not pay sales tax. The purchaser then accrues use tax in the states where the software users are located. Utilizing the MPU exemption can provide substantial benefits to a taxpayer because:

— Many states do not tax electronically delivered software, so there is no need to accrue use tax in those states

— Tax is not due in states that do not impose a sales tax (e.g., AK, OR, MT, etc.)

— Apportioning the purchase to multiple states often results in an overall lower tax rate

EXPLORING CLOUD COMPUTING SERVICES

It is common for taxpayers to purchase data center resources (e.g., storage, compute power, etc.) from cloud computing service vendors. Often these services are purchased on a flexible (i.e., "as needed") basis where a taxpayer is only paying for the resources that are consumed. With the proper exploratory efforts, taxpayers can identify and extract material tax benefits (e.g., nontaxable services, exemptions, etc.) from the jungle of cloud computing purchase documentation.

## CHALLENGES WITH OPTIMIZING TAX PAYMENTS ON PURCHASES OF MPU SOFTWARE AND CLOUD COMPUTING SERVICES

1. *What am I Buying, Who are the User Groups, and Where are They Located?*

Problems

When reviewing purchase documentation for software and cloud computing services, it can be difficult to determine the name of the product purchased and then gain a high-level understanding of how the product is used. It is common for purchase invoices and other source documentation to provide product descriptions that are limited to:

— Part numbers and severely abbreviated product names

— Cryptic product names listed as a series of letters, hyphens, and numbers

Cloud computing service invoices often contain numerous pages and product offerings that make them burdensome to research and review. It is a common misconception that large cloud computing service companies are applying the appropriate tax treatment to the product offerings on these invoices.
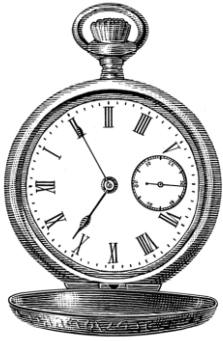
Utilizing the MPU software exemption requires a taxpayer to identify the user groups (e.g., store employees, IT employees, etc.) and their locations. This often requires tracking down and communicating with the right internal IT contact or vendor contact. When speaking with IT personnel, there can often be a language barrier, as IT is typically unfamiliar with statutory definitions (e.g., the definition of "use" and "users") and may incorrectly rely on industry definitions when answering questions about use and user locations.

Solutions

We suggest implementing the following solutions:

— Utilize web research

  – Software vendors and cloud computing service vendors provide a lot of useful information on their websites, including product descriptions and white papers

  – It is helpful to have high-level familiarity with common "tech speak"

— Carefully review contracts and scope-of-work documents

— Create an open line of communication with internal IT personnel and vendor contacts

  – These resources can provide valuable information regarding how software products and cloud computing services are used and where users are located

— Create an open line of communication with HR

  – HR can often provide useful information about software user groups and software user locations
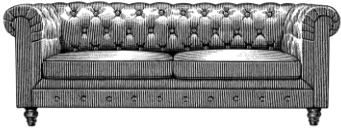
2. *How do I Gather Defensible Supporting Documentation?*

Problems

Taxpayers are often sitting on sizable MPU software and cloud computing service tax benefits but are faced with challenges in gathering documentation that will hold up to a state audit. Common challenges include:

— Obtaining itemization for bundled charges that contain both taxable and nontaxable elements

— Peeling the source document onion to drill down to the appropriate level of support (e.g., invoice summary, itemized invoice, electronic billing detail, etc.)

— Issues with data refinement to arrive at the population of interest

— Having the time to track down the right internal or vendor contact to obtain additional information

— Having the time to track down and review multipage agreements

Solutions

— Utilize relationships with internal IT personnel and vendors to explore whether itemization of bundled charges is available

— Run extensive data analytics (e.g., summaries by GL account, vendor, cost center, department, etc.) to better understand how to identify software and cloud computing spend of interest

— If time and bandwidth is an issue, outsource the initial review to an experienced third-party partner

3. How do I Take Advantage of Available Tax Incentives on an Ongoing Basis without a High Administrative Burden?

Problem

It is common for taxpayers to perform or outsource reverse audits of MPU software and cloud computing service purchases that cover past periods. However, some taxpayers struggle to implement process improvements to ensure they receive tax savings on a routine and recurring basis. It is important for a taxpayer to be able carry all of the investigative time and work to identify tax benefits into the future.

Solutions

— Develop templates for MPU software that automate the process of accruing use tax at locations of use

— Develop matrices to memorialize knowledge of vendors and products

— Work with vendors on charge itemization and the language contained in invoices, contracts, and scope-of-work documents

ABOUT CPRS

Hello. We're CPRS, a savvy team of accounting pros specializing in recovery, tax, and contract compliance across the U.S. and Canada. We live and breathe to help companies like yours maximize payments with tailored—never canned—solutions. And unlike a lot of the "big guys," the people you meet are the people you work with. No bait and switch. Just folks who genuinely love what they do; folks our clients tell us quickly become a natural and welcome extension of the team. Maybe that's why 99% of our customers would work with us again.

ABOUT THE AUTHOR

Jeff Heyel, CMI, CPA

Between working for the Washington State Department of Revenue and CPRS, Jeff has two decades of state and local tax auditing experience. He has executed and managed numerous custom audit programs that have resulted in impressive tax savings. Jeff believes in pursuing only defensible overpayment tax recoveries that are client approved and in providing clients with the transparency needed for improvement that leads to future tax savings. Results, transparency, defensibility, and value-added services (provided at no additional cost) have translated to success by Jeff and the CPRS tax team in building and maintaining long-term relationships with clients, vendors, and state revenue departments.

For additional information:

www.cprs-inc.com

contact@cprs-inc.com

425-968-6100