

Alert 10-198



Reed Smith Asks PA High Court to Reconsider Taxation of Electronically Delivered Software – Refund Opportunities Available – Win or Lose

Background

On August 3, Reed Smith filed an Application for Reargument with the Pennsylvania Supreme Court requesting that the court reconsider its July 20 decision in *Dechert LLP v. Commonwealth*¹, wherein it held that purchases of licenses to use canned computer software, however delivered, are subject to sales tax. The court indicated that it arrived at its decision by giving "substantial deference" to the Department of Revenue's interpretation of the sales tax statute. In our Application for Reargument, we assert that the court's conclusion that the Department of Revenue is entitled to substantial deference cannot be reconciled with its holding that purchases of licenses to use electronically delivered canned computer software are subject to sales tax.² The Department did not file an Answer in opposition of our Application.

Since the enactment of the sales tax statute in 1971, the Department's interpretation has been that purchases of canned computer software delivered on a tangible medium, such as a disc, are purchases of tangible personal property, and thus, subject to tax. Conversely, the Department's interpretation of the taxing statute since that time has been that purchases of electronically delivered canned computer software are not purchases of tangible personal property and are not subject to tax. Although the court said it was giving substantial deference to the Department, it ignored these long-standing, published interpretations of the tax statute, and held in *Dechert LLP* that all purchases of canned computer software, even purchases of canned computer software delivered electronically, are subject to tax.

Refund Opportunities – Win or Lose

Taxpayers will certainly be entitled to a refund of sales tax paid on their purchases of electronically delivered canned computer software if the court issues a corrected decision clarifying that such purchases are not subject to tax, and timely refund claims are filed.³ However, even if the court refuses to issue a corrected decision, refund claims should still be filed because the Department is not currently imposing sales tax on all canned software programs. This selective application of the sales tax by the Department violates the Uniformity Clause of the Pennsylvania Constitution. But perhaps more importantly, it generates refund opportunities for any taxpayer that has paid sales tax on canned computer software—regardless of the method of delivery—for all open periods. Reed Smith is representing clients in appeals currently pending at Pennsylvania Commonwealth Court that raise this issue. If your company has paid sales or use tax on canned computer software, regardless of the method of delivery, over the past three years, you should file refund claims to protect your rights.

For more information on the Application for Reargument in *Dechert LLP*, and the potential refund opportunities for companies that have paid Pennsylvania sales tax on canned computer software, contact one of the authors of this Alert or another member of the Reed Smith State Tax Group. For more information on Reed Smith's Pennsylvania tax practice, visit www.reedsmith.com/patax.

1. No. 12 MAP 2008; 2010 WL 2817174 (Pa.)

2. Although only four Applications for Reargument have been granted in the past 10 years, we believe the issue we have raised has significant merit and deserves additional review by the court.

3. The Department began collecting sales tax on purchases of electronically-delivered canned computer software November 1, 2005, following the Commonwealth Court's decision in *Graham Packaging Co., LP v. Commonwealth*, 882 A.2d 1076 (Pa.Cmwlt. 2005).

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