

Michigan Appeals Court rules online tax research tool is an information service exempt from use tax

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In brief

On May 13, 2014, in an unpublished decision, the Michigan Court of Appeals held via summary disposition that an online tax research tool was not subject to use tax since the taxpayer was in the business of selling an information service and not taxable prewritten computer software.

Companies purchasing or selling online information services in Michigan should review whether such transactions are currently being taxed. [[Thomson Reuters Inc., v. Department of Treasury, Michigan Court of Appeals, No. 313825, 05/13/2014](#)]

In detail

Thomson Reuters (Reuters) sells an online tax and accounting research program, called Checkpoint, that provides subscribers access to a wide collection of information. Subscribers can search, retrieve, browse, and link to different sources through the use of a web browser. The Michigan Department of Treasury audited Reuters and issued an assessment for use taxes due on subscriptions sold to Michigan users based on a determination that the sale of Checkpoint constituted the sale of taxable prewritten computer software.

Department asserted Checkpoint is taxable prewritten software

At the Court of Claims the Department moved for summary disposition, arguing that Checkpoint subscriptions should be considered the sale of taxable prewritten computer software since: (1) Michigan customers used and controlled the computer code that resided on the web browser interface and on the server side, (2) the use of tangible personal property was the primary object of the transactions, and (3) Reuters failed to adequately support constitutional claims. The Court of Claims granted the Department's motion, reasoning that this matter involved an evolution of services and because this product was

taxable when it was in book or CD format, it is also taxable when accessed online. Reuters appealed to the Court of Appeals.

Michigan use tax imposed based on object of transaction

The Court of Appeals (Court) noted that Michigan's use tax is generally imposed on the "privilege of using, storing, or consuming tangible personal property." The Court noted that tangible personal property includes prewritten computer software. However, transactions with the transfer of both tangible personal property and services follow the 'incidental to service test' established by the Michigan Supreme Court in *Catalina Mktg Sales Corp v*

Dep't of Treasury, 470 Mich 13, 24-25; 678 NW2d 619 (2004). In determining whether the transfer of tangible property was incidental to the rendering of personal or professional services, one “looks objectively at the entire transaction to determine whether the transaction is principally a transfer of tangible personal property or a provision of a service.” An analysis includes examining what the buyer sought as the object of the transaction, what the seller is in the business of doing, whether the goods were provided as a retail enterprise with a profit-making motive, whether the tangible goods are available for sale without the service, and other factors.

The Court determined that Reuter’s transfer of tangible personal property was incidental to the service provided - the access of information. The Court found no evidence that any *de minimis* amount of software transferred was the object of the transaction, or that customers sought to own or otherwise have responsibility for the prewritten computer software. Further, the fact that the license agreement entitles users to access and use the Checkpoint program did not establish that users primarily sought the physical software. What they sought was access

to up-to-date information and the expert knowledge of Checkpoint’s content creators in synthesizing, compiling, and organizing materials.

Checkpoint is a nontaxable portion of Reuter’s overall business

Both parties agreed that Reuter’s sold taxable print and software products. However, the Court found that the manner in which Checkpoint was marketed indicated that its sale was distinct from the print and software products. The evidence demonstrated that Reuter’s motive was to profit from selling an information service, rather than the sale of prewritten computer software. Any transfer of software was an insignificant part of the overall transaction aimed at providing a service. The Court also noted the software was not marketed or separately sold from the Checkpoint service and the intangible service greatly contributed to the value of the physical item transferred.

Constitutional claims not addressed

Reuters also raised Due Process and Commerce Clause claims in the taxation of Checkpoint. The Court declined to review these issues since tax was determined ‘improper’ in the case.

The takeaway

The Michigan Court of Appeals concluded that the usage of online software to provide an information service is not subject to Michigan sales and use tax. Although the facts in the case are related to providers of online information services, the Court’s reasoning may apply to other forms of remotely accessed software.

As mentioned in our summary of [Auto-Owners Insurance Company v. Department of Treasury, State of Michigan Court of Claims, No. 12-000082-MT \(March 20, 2014\)](#),

Michigan has provided minimal public guidance in the past regarding the taxability of cloud computing and remotely accessed software.

Nonetheless, many taxpayers currently treat such offerings as taxable within the state. In *Auto-Owners*, the Michigan Court of Claims held that remotely accessed software is not subject to tax in Michigan. The decisions in both *Auto-Owners* and *Thomson-Reuters* provide support that cloud computing transactions may not be subject to Michigan sales and use tax.

Companies purchasing or selling online information services in Michigan should review whether such transactions are currently being taxed.

Let’s talk

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