



This Week in State Tax (TWIST)

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Wisconsin: Licensing Software Not Protected Under P.L. 86-272

The Wisconsin Tax Appeals Commission recently addressed a matter involving the licensing of computer software to Wisconsin users by an out-of-state LLC. It addressed two questions: (1) was such licensing a protected activity under P.L. 86-272; and (2) if not, were the LLC and its owner required to withhold and pay Wisconsin income tax on the income generated from licensing activities in Wisconsin. The taxpayers at issue were the individual owner of an LLC that licensed software to customers, including customers in Wisconsin, and the LLC itself. During the 2012-2018 tax years at issue, the taxpayers' only activity related to Wisconsin was the solicitation of orders that were rejected or approved and filled outside of Wisconsin, the delivery of software to Wisconsin customers (by mailing disks or via download), and the licensing software for use in Wisconsin schools. The taxpayers provided customer service from Maryland and did not directly solicit Wisconsin customers. Sales into Wisconsin for each tax year ranged from just over \$17,000 to just over 32,000. The issue arose as to whether the individual owner owed Wisconsin income taxes and (for certain tax years) whether the LLC was subject to pass-through withholding tax.

Before the Commission, the Department's position was that Wisconsin corporate income tax law treated the licensing of software as the sale of an intangible. Although software was not specially included in the definition of intangible property, the Department asserted that the legislature intended software to be treated as an intangible for income tax purposes. The Department also argued that the individual- and the LLC- were deriving income from business transacted in the state and doing business in the state under the individual and corporate nexus statutes. In contrast, the taxpayers argued that the sales of their software licenses were protected sales of tangible personal property under P.L. 86-272. Because P.L. 86-272 is a federal law, the taxpayers' position was that federal definitions and law governed the determination of whether software was tangible personal property. The taxpayers also asserted that Wisconsin sales tax law specifically included prewritten computer software regardless of delivery method, within the definition of tangible personal property. Finally, the taxpayers argued their Wisconsin activities were de minimis. The Commission rejected these arguments, finding first that state law applied to determine the characterization of software for purposes of determining whether P.L. 86-272 applies. "Before one can conclude what limits federal law places on the power of the state, one must determine what the state power is. And the determination of the state power must be derived from the review of the state statutes, administrative code and relevant caselaw." Under state income tax law, the Commission determined that taxpayers' sales of licenses involved intangible personal property; the sales tax code did not govern the matter. As such, P.L. 86-272 was not applicable to the case. Further, the Commission determined that the taxpayers' activities were not limited to solicitation and there was nothing in P.L. 86-272 that stated "other" non-solicitation activities (such as the taxpayer's customer support services) could be de minimis. The Commission concluded that because the taxpayers licensed computer software to Wisconsin schools, for use in Wisconsin classrooms, the taxpayers were "doing business in Wisconsin" and had "business transacted in Wisconsin" sufficient to subject them to tax. Please contact [Brad Wilhelmson](#) with questions on *Kuta Software LLC v. Wisconsin Department of Revenue*.

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