

STATE OF WISCONSIN
TAX APPEALS COMMISSION

KUTA SOFTWARE LLC,

DOCKET NOS. 21-W-080
AND 21-W-081

MICHAEL KUTA,

DOCKET NO. 21-I-082

Petitioners,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

RULING AND ORDER

KENNETH ADLER, COMMISSIONER:

The appeal consists of three separate cases and two separate Petitioners. The Petitioners, Michael Kuta and Kuta Software, LLC, appear by their Attorney Robert B. Teuber and the law firm von Briesen & Roper, S.C. The Respondent, the Wisconsin Department of Revenue (the Department), appears by Attorney Mark S. Zimmer. This case comes before the Commission for decision on competing Motions for Summary Judgment.

The issue for determination in these cases concerns the licensing of computer software by an out of state entity into the state of Wisconsin. The legal questions are whether the individual Michael Kuta is required to pay individual income tax and the business Kuta Software, LLC is required to pay withholding tax for such licensing.

Based upon the facts and analysis detailed below, the Commission concludes

the licensing of computer software is subject to individual income tax and a corporate pass-through withholding tax.

STIPULATED FACTS

1. Petitioner Michael Kuta (Michael Kuta) is a resident of the District of Columbia and is the sole owner of Petitioner Kuta Software, LLC (LLC), a limited liability company organized and existing under the laws of the state of Maryland. Kuta and the LLC are collectively referred to as "Petitioners." (Stipulation of Facts (Stip.) ¶ 1.)

2. The appeal covers the Audit Period of calendar years 2012 through 2018, inclusive. During the years 2012 through 2015, the LLC was treated as a disregarded entity for tax purposes and reported its operations on Michael Kuta's federal Form 1040, Schedule C. Effective January 1, 2016, the LLC filed an election to be taxed as a Subchapter S corporation under the Internal Revenue Code and began reporting operations on a federal Form I 120-S, U.S. Income Tax Return for an S Corporation. (Stip. ¶ 2.)

3. The LLC developed educational software to assist schools and teachers when teaching math to their students. Teachers use the software to generate worksheets for lessons, homework assignments, quizzes, and tests. The software can be used to generate worksheets covering the topics of pre-algebra, algebra 1, algebra 2, geometry, precalculus, and calculus. Once the topic is chosen, the teacher chooses the mathematical properties and can generate a virtually unlimited number of mathematical questions with those properties. The software allows the teacher to:

- a. Toggle questions between free-response and multiple choice.
- b. Scramble the order of the questions or the choices.
- c. Regenerate all of the questions in an assignment.
- d. Create different versions of the same worksheet.
- e. Control the spacing of questions in a worksheet.
- f. Modify the answer format.
- g. Include diagrams.
- h. Customize and modify instructions or questions.
- i. Create their own questions.
- j. Display 1-4 questions on the screen in a presentation-style format.
- k. Merge assignments together.
- l. Proportionally increase or decrease the number of questions in an assignment.

(Stip. ¶ 3.)

4. During the Audit Period 2012 through 2018, Petitioners sold licenses to use the educational software to Wisconsin customers (including both private and public schools). (Stip. ¶ 4.) Petitioners only sold licenses to use the software; no copyright rights in the software were sold to third parties. (*ibid.*)

5. Purchases of the licenses to use Petitioners' software were made (a) online through Petitioners' website, (b) by phone or (c) by a customer's submission of an order form or purchase order sent to Maryland by email, fax, or mail. (Stip. ¶ 5.)

6. The software was available via (a) online download or (b) mail delivery (from Maryland) of a compact disk containing the software. (Stip. ¶ 4.)

7. Petitioners' customers purchased the software subject to either a (1) single-user license or a (2) site-license. Single-user licenses offer a lifetime license which does not expire. Site-licenses have a standard term of three years; however, terms of different duration can be chosen. Site-licenses expire at the end of the license term and can be renewed at any time prior to expiration or within 90 days of expiration. (Stip. ¶ 6.)

8. During the years 2012 through 2018, Petitioners used four substantially similar versions of each of the single-user and site-licenses. Exhibits A-H are copies of each of the four single-user and four site-licenses in use during this period. The differing versions of the licenses are labeled with their electronic file names as follows:

Exhibit A- Single 1.45 (4-12-2011)

Exhibit B - Single 1.50 (3-15-2012)

Exhibit C - Single 2.00 (7-23-2014)

Exhibit D - Single 2.18 (12-27-2017)

Exhibit E - Single 1.45 (4-12-2011)

Exhibit F - Site 1.50 (3-15-2012)

Exhibit G - Site 2.00 (7-23-2014)

Exhibit H - Site 2.18 (12-27-2017)

(Stip. ¶ 7.)

9. Exhibit A is the form of single-user license used by Petitioners from

April 12, 2011, through March 14, 2012. This license contains the following language:

1) LICENSE. The SOFTWARE PRODUCT is licensed, not sold to you, and may be used only by you for such uses as described herein. Subject to the terms and conditions herein, KUTA SOFTWARE grants you a limited, non-transferable, non-exclusive license to install, activate and use the SOFTWARE PRODUCT."

...

"You shall use the SOFTWARE PRODUCT ... solely for classroom or tutoring instruction and presentation."

...

"You agree that your use of the SOFTWARE PRODUCT shall comply with all applicable laws."

...

4) INTELLECTUAL PROPERTY. As the licensee of the SOFTWARE PRODUCT, you own the physical media on which the SOFTWARE PRODUCT is originally fixed or recorded, however KUTA SOFTWARE retains the title and ownership of the SOFTWARE PRODUCT, including, but not limited to, the worldwide copyright therein. This license is not a sale or transfer of the original software or any rights thereto . . .

You acknowledge and agree that the SOFTWARE PRODUCT ... and any copies thereof are the exclusive property of KUTA SOFTWARE, and that the SOFTWARE PRODUCT is licensed to you only for the term of this LICENSE and strictly under the terms hereof. All right, title and interest in and to any and all copyrights, trademarks, and trade secrets in and pertaining to the SOFTWARE PRODUCT are owned or licensed by KUTA SOFTWARE."

...

Sec. 8: "This LICENSE may not be assigned by you except upon the written consent of KUTA SOFTWARE."

10. Similar language appears in the single-user licenses Exhibits B through D, covering the remainder of the Audit Period.

11. Exhibit E is the form of site-license used by Petitioners from April 12,

2011, through March 14, 2012. This license contains the following language:

2) LICENSE. The SOFTWARE PRODUCT is licensed, not sold, to LICENSEE, and may be used only by LICENSEE and authorized USERS. Subject to the terms and conditions herein, KUTA SOFTWARE grants LICENSEE a limited, non-transferable, non-exclusive license to install and use the SOFTWARE PRODUCT."

...

"LICENSEE may:

...

(v) allow each USER to install and use the SOFTWARE PACKAGE on a single home-based computer for use solely in the course of such USER's employment by LICENSEE..."

...

"LICENSEE shall not:

...

(ii) use or authorize the use of the SOFTWARE PACKAGE for any purpose other than for classroom instruction and presentation..."

...

5) INTELLECTUAL PROPERTY. As the licensee of the SOFTWARE PRODUCT, LICENSEE owns the physical media on which the SOFTWARE PRODUCT is originally fixed or recorded, however KUTA SOFTWARE retains the title and ownership of the SOFTWARE PRODUCT, including, but not limited to, the worldwide copyright therein. This LICENSE is not a sale or transfer of the original software or any rights thereto.

LICENSEE acknowledges and agrees that the SOFTWARE PRODUCT ... and any copies thereof are the exclusive property of KUTA SOFTWARE, and that the SOFTWARE PRODUCT is licensed to LICENSEE only for the term of this LICENSE and strictly under the terms hereof. All right, title and interest in and to any and all copyrights, trademarks, and trade secrets in and pertaining to the SOFTWARE PRODUCT are owned or licensed by KUTA SOFTWARE."

...

10) MISCELLANEOUS: . . . This LICENSE may not be assigned by the LICENSEE except upon the written consent of KUTA SOFTWARE."

12. Similar language appears in the later site-licenses, Exhibits F through H, covering the balance of the Audit Period.

13. In addition, the form of the site-license Exhibit F, in use by Petitioners from March 15, 2012, through July 22, 2014, contains the following language:

2) LICENSE . . .

Installation and Authorized Use.

...

Licensee may:

...

- Allow Users to use the Software Product on classroom laptop computers at locations other than the Site..."

...

Licensee's Obligations.

Licensee shall:

...

- Ensure the Software Product is used solely for instruction and presentation purposes ..."

14. Contractual language similar to the foregoing appears in the later site-licenses, Exhibits G and H, covering the period beginning July 23, 2014, through the end of the Audit Period.

15. During the years 2012 through 2018 Petitioners had no physical presence in any state other than the state of Maryland, did not have any persons, property, or equipment in the state of Wisconsin and did not have any salespersons or representatives that visited the state of Wisconsin. (Stip. ¶¶ 8, 10-12.) The Petitioners' only activity related to Wisconsin was the solicitation of orders which 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 of Petitioners' software for use in Wisconsin schools. (Stip. ¶ 8.)

16. Petitioners did not engage in direct marketing, make telephone solicitations, or promote their software at conferences or trade shows. Petitioners only advertise online. (Stip. ¶ 9.)

17. Petitioners do not own or lease any real estate or tangible personal property in Wisconsin. (Stip. ¶ 10.)

18. Petitioners do not have any employees or representatives in Wisconsin or engaging in any activities in Wisconsin. (Stip. ¶ 11.)

19. Petitioners do not maintain any business locations in Wisconsin or operate mobile stores in Wisconsin. (Stip. ¶ 12.)

20. Petitioners do not perform any services in Wisconsin, although Petitioners provide customer support from Maryland and have an email address, phone number, and fax number that Wisconsin customers may use to obtain support. Petitioners provided a limited warranty for their software as set forth in Exhibits A through H, inclusive. (Stip. ¶ 13.)

21. During the years 2012 through 2018, Petitioners' total sales to all customers and total sales to Wisconsin customers equaled:

	Total Sales to all Customers	Total Sales to Wisconsin
2012	1,389,131.00	17,210.50
2013	1,891,768.00	25,896.00
2104	1,936,347.00	21,366.10

2015	2,032,215.00	18,927.00
2016	2,614,827.00	32,018.00
2017	2,649,579.00	29,310.00
2018	2,519,969.00	20,121.00

(Stip. ¶ 14.)

JURISDICTIONAL FACTS

22. For the tax years 2012 through 2015, the Department issued four separate Notices of Estimated Tax Amount Due – Individual Income Tax against Petitioner Kuta on May 18, 2020, asserting Wisconsin individual income tax, interest, penalties, and fees due. (Stip. ¶ 19, Ex. K.)

23. For the tax years 2016 and 2017, the Department issued two separate Notices of Amount Due – Pass-Through Withholding against Petitioner LLC on July 10, 2020, asserting Wisconsin pass-through withholding tax, interest, penalties, and fees due. (Stip. ¶ 21, Ex. M.)

24. For the tax year 2018, the Department issued a Notice of Amount Due – Pass-Through Withholding against Petitioner LLC on May 13, 2020, asserting Wisconsin pass-through withholding tax, interest, penalty, and fees due. (Stip. ¶ 17, Ex. I.) (Collectively, all of the foregoing Notices constitute the “Assessments.”)

25. Petitioners timely petitioned for redetermination of each of the Assessments. (Stip. ¶¶ 18, 20, and 22; Exs. J, L, and N.) The Department denied in full each of the petitions for redetermination by three separate Notices of Action all dated

December 18, 2020. (Stip. ¶ 23, Ex. O.) This appeal followed, and the cases involving the Petitioners were consolidated by Order of the Commission. (Stip. ¶ 26.)

STANDARD OF REVIEW

A motion for summary judgment will be granted if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Wis. Stat. § 802.08(2). All parties filed Motions for Summary Judgment and filed a Joint Stipulation of Facts, supported by related documents. Summary judgment is thus appropriate.

ISSUE

The issue for determination concerns the sale of licenses for the use of computer software by an out of state entity into the State of Wisconsin. The questions are whether or not the individual Michael Kuta is required to pay individual income tax and whether or not the business Kuta Software, LLC is required to pay pass-through withholding tax on the income generated by these transactions. Foundational to the determination of tax liability is the question of whether or not the sale of licenses for the use of computer software in Wisconsin constitutes the sale of tangible or intangible personal property. This involves both (1) the sale of license to use the copyrighted computer software and (2) the copyrighted computer software for which the license to use is sold.

RELEVANT STATE STATUTES

INCOME AND FRANCHISE TAX

Chapter 71 of the Wisconsin Statutes governs Income and Franchise Taxes for State and Local Revenues. Subchapter 1 addresses Taxation of Individuals and Fiduciaries and provides as follows:

Wis. Stat. § 71.01 Definitions. In this chapter in regard to natural persons and fiduciaries, . . . :

...

(5p) "Intangible property" includes stocks, bonds, financial instruments, patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.

Wis. Stat. § 71.02(1). Imposition of tax. (1) For the purpose of raising revenue for the state and the counties, cities, villages and towns, there shall be assessed, levied, collected and paid a tax on all net incomes of individuals and fiduciaries, . . . by every nonresident natural person and trust of this state, upon such income as is derived from property located or business transacted within the state including, but not limited by enumeration, . . . income derived from a limited liability company member's distributive share of limited liability company income. . . . A single-owner entity that is disregarded as a separate entity under section 7701 of the Internal Revenue Code is disregarded as a separate entity under this chapter, and its owner is subject to the tax on the entity's income.

"Gross receipts from the use of computer software" is found later in

Subchapter 1 at Wis. Stat. § 71.04(7)(df) as follows:

Wis. Stat. § 71.04. Situs of income; allocation and apportionment.

...

(4) Nonresident allocation and apportionment formula.

Nonresident individuals . . . engaged in business within the state shall be taxed only on such income as is derived from business transacted . . . within the state.

(7) Sales factor. For purposes of sub. (4):

...

(df) 1. Gross receipts from the use of computer software are in this state if the purchaser or licensee uses the computer software at a location in this state.

TAXATION OF CORPORATIONS

Subchapter IV of Chapter 71 addresses Taxation of Corporations and provides as follows:

Wis. Stat. § 71.22. Definitions. In this chapter, in regard to corporations . . . :

(1r) "Doing business in this state" includes, except as prohibited under P.L. 86-272, . . . regularly selling products or services of any kind or nature to customers in this state that receive the product or service in this state; regularly soliciting business from potential customers in this state; regularly performing services outside this state for which the benefits are received in this state; regularly engaging in transactions with customers in this state that involve intangible property. . . . A taxpayer doing business in this state for any part of the taxable year is considered to be doing business in this state for the entire taxable year.

...

(3h) "Intangible property" includes stocks, bonds, financial instruments, patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.

71.25 Situs of income; allocation and apportionment. For purposes of determining the situs of income under this section and s. 71.255 (5) (a) 1. and 2.:

...

(5) Corporations engaged in business both within and without the state. (a) Apportionment income. . . .

corporations engaged in business both within and without this state are subject to apportionment.

...

(9) Sales factor. For purposes of sub. (5) . . . :

(df) 1. Gross receipts from the use of computer software are in this state if the purchaser or licensee uses the computer software at a location in this state.

ADMINISTRATIVE PROVISIONS APPLICABLE TO ALL ENTITIES

Finally, Subchapter XII of Chapter 71 provides as follows:

Wis. Stat. § 71.738. Definitions. In this chapter: . . .

(3d) "Pass-through entity" means a partnership, a limited liability company, a tax-option corporation, an estate, or a trust that is treated as a pass-through entity for federal income tax purposes.

Wis. Stat. § 71.775. Withholding from non-resident members of pass-through entities.

...

(2) WITHHOLDING TAX IMPOSED. (a) For the privilege of doing business in this state or deriving income from property located in this state, a pass-through entity that has Wisconsin income for the taxable year that is allocable to a nonresident partner, member, shareholder, or beneficiary shall pay a withholding tax.

...

FEDERAL LIMITATIONS ON STATE TAXATION

15 U.S.C. § 381¹, also known as P.L. 86-272, provides as follows:

(a) Minimum standards. No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

¹ Although codified at 15 U.S.C. § 381, this federal statute is almost always referred to by its public law designation, P.L. 86-272.

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

RELEVANT ADMINISTRATIVE CODE

Wisconsin references the Federal limitation codified as P.L. 86-272 in the administrative code at Wis. Admin. Code § Tax 2.82 (3):

(3) FEDERAL LIMITATIONS ON TAXATION OF FOREIGN CORPORATIONS.

(a) *Federal constitutional provisions.* 1. Article I, Section 8 of the U.S. Constitution grants congress the power to regulate commerce with foreign nations and among the several states. States are prohibited from levying a tax which imposes a burden on interstate or foreign commerce. However, this does not mean states may not impose any tax on interstate commerce. A state tax on net income from interstate commerce which is fairly attributable to the state is constitutional.

...

(b) *Federal Public Law 86-272.* 1. Under Public Law 86-272, a state may not impose its franchise or income tax on a business selling tangible personal property, if the only activity of that business is the solicitation of orders by its salesperson or representative which orders are sent outside the state for approval or rejection, and are filled by delivery from a point outside the state. The activity must be limited to solicitation. If there is any activity which exceeds solicitation, the immunity from taxation under P.L. 86-272 is lost.

2. This law, enacted by congress in 1959, does not extend to: a. Those businesses which sell services, real estate or intangibles in more than one state

...

ANALYSIS

In matters before the Commission, the Petitioner carries the burden to prove that the Department's determination is incorrect. "Assessments made by the Department are presumed to be correct, and the burden is upon the Petitioner to prove by clear and satisfactory evidence in what respects the Department erred in its determination." *Puissant v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 202-401 (WTAC 1984).

This consolidated case presents two distinct taxpayers and two different Wisconsin taxes, although the underlying facts and legal principles are the same. The issues to be resolved are whether sales² of licenses to use computer software in the state of Wisconsin involve sales of tangible or intangible property, and whether or not the resulting income is subject to the assessment of income and pass-through withholding taxes.

Income Tax on Michael Kuta for Years 2012 - 2015

Wisconsin imposes an income tax on nonresident natural persons "upon such income as is derived from property located or business transacted within the state including . . . income derived from a limited liability company member's distributive share of limited liability company income. . . ." Wis. Stat. § 71.02(1). The statute further provides that "[a] single-owner entity that is disregarded as a separate entity under

² While the transactions under review are classified by both parties as "sales" of licenses to use computer software, the Department explains it is not seeking to recover taxes under the sales tax provisions of Chapter 77 but is instead seeking to recover taxes under the income tax provisions of Chapter 71. The Petitioner does not contest this.

section 7701 of the Internal Revenue Code is disregarded as a separate entity under this chapter, and its owner is subject to tax on the entity's income." Wis. Stat. § 71.02(1).

Michael Kuta is a nonresident natural person subject to individual income tax on his income from business transacted within the state through the licensing of computer software to schools in the state of Wisconsin. He is also the single member of Kuta Software, LLC. A single member of an LLC is treated as a "disregarded entity" for tax purposes. 26 C.F.R. § 301.7701-2(a). During the years 2012 through 2015, Kuta Software, LLC operated as a disregarded entity under the law, and thus Michael Kuta was subject to individual income tax on the Wisconsin income he derived from the LLC. Therefore, if Kuta Software, LLC had sales into Wisconsin which triggered taxable income in 2012 through 2015, Wis. Stat. § 71.02(1) imposed the obligation for the tax directly on Petitioner Michael Kuta as the sole owner of the LLC. Wis. Stat. § 71.02(1).

Pass-Through Withholding Tax on Kuta Software, LLC for years 2016 - 2018

Pursuant to federal law, a single member LLC may elect to be taxed as a corporation rather than as a disregarded entity. 26 C.F.R. § 301.7701-3(a). LLCs electing to be taxed as a corporation may also elect to be taxed as an "S corporation" subject to subchapter S of the Internal Revenue Code. 26 U.S.C. § 1361-1363. Subchapter S corporations are treated as "pass-through" entities which are generally not subject to income taxes. Rather, such entities compute and report income on a filed tax return, and the income is then passed-through to the owners where the income is taxed. In Wisconsin, S corporations are referred to as "tax option corporations" and are generally treated in the same manner as S corporations are treated under federal law. Wis. Stat. § 71.34(2).

Owners of a tax-option corporation are required to include their proportionate share of the corporation's income in their adjusted gross income on their personal tax returns. To administer the collection of tax owed by nonresident owners of pass-through entities, Wis. Stat. § 71.775(2) imposes the obligation on pass-through entities doing business in Wisconsin to withhold tax on the entity's income that is allocable to the nonresident owner. Wis. Stat. § 71.775(2)

Effective January 1, 2016, Kuta Software, LLC made an election to be taxed as an S corporation/tax option corporation and was treated as a pass-through entity in the years 2016 through 2018. As Michael Kuta is the nonresident owner of Kuta Software, LLC, the imposition language of Wis. Stat. § 71.775(2) must be reviewed to determine whether Kuta Software, LLC met the definition of "doing business in this state" in the years 2016 through 2018, thus requiring it to withhold tax on any income allocable to Michael Kuta in the years 2016 through 2018.

This is a case of statutory interpretation. Statutory interpretation "begins with the language of the statute. If the meaning of the statute is plain, we ordinarily stop the inquiry." *State ex rel. Kalal v. Circuit Court for Dane County*, 2004 WI 58, 271 Wis. 2d 633, 681 N.W.2d 110. When interpreting a statute, we assume the legislature's intent is expressed in the statutory language. *Id.*

"Intangible property" is defined in Wis. Stat. § 71.01(5p) and Wis. Stat. § 71.22(3h)³ as including "stocks, bonds, financial instruments, patents, patent applications,

³ The language is identical in both statutory sections.

trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.” The Department asserts the licensing of computer software is the sale of the right *to use* that computer software. And that the “right to use software granted by a license is a license of intellectual property rights, such as intellectual property rights in software, through a license.” *Wisconsin Dept. of Revenue v. Microsoft Corp*, 2019 WI App 62 ¶ 24, 389 Wis. 2d 350, 936 N.W. 2d 160. The Department argues this meets the definition of “intangible” found in Wis. Stat. § 71.01(5p) and Wis. Stat. § 71.22(3h). The Department explains the Petitioners sold licenses granting the Licensee the right to use Petitioner’s software.⁴ They did not sell the copyrights and they did not sell the software itself.⁵ The Department notes all the licenses at issue clearly state Kuta Software, LLC owns the copyrights, trademarks and trade secrets, and the Licensee is only granted the right to use and install the computer software.⁶ The parties agree on this point, as evidenced by Stipulation of Fact 4:

During the Audit Period 2012 through 2018, Petitioners sold licenses to use the educational software to Wisconsin customers (including both private and public schools). Petitioners only sold licenses to use the software; no copyright rights in the software were sold to third parties. [underline added]

⁴ Single User License used by Petitioners from April 12, 2011 through March 14, 2012 states “1) LICENSE. The SOFTWARE PRODUCT is licensed, not sold to you . . . KUTA SOFTWARE grants you a limited, non-transferable, non-exclusive license to install, activate and use the SOFTWARE PRODUCT.” See Exhibit A.

⁵ Single User License used by Petitioners from April 12, 2011 through March 14, 2012 states “4) INTELLECTUAL PROPERTY. As the licensee of the SOFTWARE PRODUCT, you own the physical media on which the SOFTWARE PRODUCT is originally fixed or recorded, however KUTA SOFTWARE retains the title and ownership of the SOFTWARE PRODUCT, including, but not limited to, the worldwide copyright therein. This license is not a sale or transfer of the original software or any rights therein.”

⁶ The Petitioners agree with this, stating “[c]omputer software may be protected by a copyright.” See Petitioner’s Reply Brief, page 8.

The Department asserts the right to use is intangible and notes the common dictionary meaning of “intangible” is “incapable of being perceived by the senses.” *The American Heritage Dictionary of the English Language*, 937 (3rd ed. 1996). Therefore, the Department argues the licensing of the Petitioners’ software is a license of an intangible right.

The Petitioners admit that the intangible items listed in Wis. Stat. § 71.01(5p) and Wis. Stat. § 71.22(3h) all “refer to some sort of representation of a right held in relation to another item . . . a copyright may demonstrate the right to a literary work.” The Petitioners continue by stating “[e]ach of the specified intangibles found in Wis. Stat. § 71.01(5p) and Wis. Stat. § 71.22(3h) exists only in relation to describing a right or interest held in something else. This is entirely different than the Petitioner’s software sales.” *Id.*

However, Kuta Software, LLC was not selling *software* – it was selling *the right to use* the software. Again, this is confirmed by the language in Petitioners’ contracts.

The Department also asserts the computer software itself is intangible. Although Wis. Stat. § 71.01(5p) and Wis. Stat. § 71.22 (3h) do not include “computer software” within the definition of intangible property, the Department asserts the Legislature intended computer software to be considered intangible property for purposes of the assessment of individual and pass-through withholding taxes. The Department points to the allocation and apportionment provisions found at Wis. Stat. § 71.04(7) and Wis. Stat. § 71.25(9) and argues the placement of sections (df) within both statutory sections clearly indicates the Legislature intended computer software to be considered intangible property. The reason provided is that sections (a), (b) and (c) of

both Wis. Stat. § 71.04(7) and Wis. Stat. §71.25(9) all address sales of tangible personal property. The Department argues if the Legislature intended computer software to be considered tangible personal property, it would have so noted under these sections devoted to tangible personal property. In addition, the Legislature placed computer software in section (df) of both statutes, where the surrounding sections (dh), (dj) and (dk) address gross receipts from, or sales of, intangible personal property. We note that sections of statutes relating to the same subject matter must be construed in *pari materia*.⁷ *Gottfried, Inc. v. Dep't. of Revenue*, 145 Wis. 2d 715, 429 N.W. 2d 508.

Based upon the above, the Department also argues Kuta Software, LLC's licensing of intangible rights for use in Wisconsin schools establishes nexus with Wisconsin. For individual income tax purposes, Wis. Stat. § 71.02 governing Michael Kuta's personal liability for tax in years 2012 through 2015, imposes individual income tax on "every nonresident natural person and trust of the state, on such income as is derived from property located or business transacted within the state." Wisconsin statute § 71.047 governs the situs of gross receipts from the use of computer software based on the location where the purchaser uses the computer software. Since Petitioners' software was licensed for use in Wisconsin schools, the sales of those software licenses to Wisconsin schools constituted business transacted in Wisconsin thus establishing nexus for individual income tax purposes.

⁷ "On the same subject, relating to the same matter." *Blacks Law Dictionary* (7th ed. 1999)

For corporate taxation purposes, Wis. Stat. § 71.22(1r) defines “doing business in the state” as including “regularly selling products or services of any kind or nature the customer is in this state that received the product or service in this state,” and Wis. Admin. Code § Tax 2.82 (9m) governing nexus provides that “[l]icensing of intangible rights for use in Wisconsin” is sufficient activity in the state to confer jurisdiction to tax a business. The Department also references the Commission’s decision in *MacKinney Systems, Inc v. Wisconsin Dept. of Revenue*, Wis. Tax Rptr. (CCH) ¶402-504 (WTAC 2022), which relied on Wis. Stat. § 71.22(1r). The case concerned an out of state taxpayer licensing prewritten computer software to Wisconsin customers, and remotely providing technical support, new releases, enhancements and fixes to the software – a set of circumstances substantially similar to those at issue here. The Commission found the taxpayer liable for Wisconsin pass-through withholding tax pursuant to Wis. Stat. § 71.22 (1r), noting “the Petitioner’s customers in this state receive the product and any associated services in this state. This falls squarely under the definition of ‘doing business in this state.’” *Id.* The Department notes the Petitioners in this case license their software for use continuously via three-year renewable term or on a permanent basis and this continuous licensing meets the definition of “regularly” found at Wis. Admin. Code § 2.82 (2)(bm) thus creating nexus to warrant assessing pass-through withholding taxes on the corporate entity.

Finally, the Department asserts that as the sale of software licenses are sales of intangible property rights, Public Law 86-272, which is limited to solicitation of sales

of tangible personal property, does not prohibit Wisconsin from taxing the Wisconsin income from those sales.⁸

The Petitioners contend that the determination whether Michael Kuta is individually subject to income tax under Wis. Stat. § 71.02(1) in years 2012 through 2015 and whether Kuta Software, LLC is subject to pass-through withholding tax under Wis. Stat. § 71.775(2) in years 2016 through 2018 is answered by determining whether the sale of computer software licenses constituted sales of tangible personal property under Public Law 86-272. The Petitioners argue the sales of their software licenses were sales of tangible personal property, and therefore Public Law 86-272 prohibits the imposition of income tax on Michael Kuta, and Kuta Software, LLC is not subject to pass-through withholding tax because it is not “doing business” in Wisconsin.

Without looking to Wisconsin law first, and by initially asserting the sale of computer software licenses constituted sales of tangible personal property under Public Law 86-272, the Petitioners argue “[t]he Respondent’s brief considers only the definitions of tangible and intangible under the Wisconsin statutes, Wisconsin case law or the case law of other states.” Petitioners’ November 8, 2022 Reply Brief, page 4. The Petitioners continue by stating “this is not a question of interpreting how state law definitions apply to state taxation but a question of how federal law limits the power of the state.

⁸ The Department also asserts that if the Commission were to consider applying Public Law 86-272 to the facts in these cases, then that statute should be found unconstitutional. However, as the Commission does not have the authority to decide the constitutionality of any law, particularly a federal law, that argument will not be addressed further.

Answering the question requires the application of federal law and federal definitions.”

Id.

The Petitioners then turn to Public Law 86-272 and assert it applies as Petitioners’ sales of licenses to use computer software constitute sales of tangible personal property. The Petitioners use Public Law 86-272 as a stepping stone – arguing this allows them to first turn to federal law to define “tangible” and “intangible” without considering Wisconsin law. The Petitioners then immediately jump to analyzing United States Treasury Regulation § 1.861-18 and three cases from various jurisdictions which considered the definition of tangible property under federal law.

Although Petitioners argue that federal law should govern the interpretation of these appeals, they also turn to Chapter 77, Sales and Use Tax, and assert the definition of “tangible personal property” found at Wis. Stat. § 77.51(20) should be applied to this income and pass-through withholding case. That section provides, in relevant part, as follows:

“Tangible personal property” means personal property that can be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses, and includes . . . prewritten computer software, regardless of how it is delivered to the purchaser.

Finally, the Petitioners argue that the provisions of Wis. Stat. § 71.775(2) do not apply as they do not meet the definition of “doing business” in Wisconsin because their activities are *de minimus*. However, the parties agreed in the Stipulations of Fact that “Petitioners provide customer support from Maryland, and have an email address,

phone number and fax number that Wisconsin residents may use to obtain support.”

Stipulation of Fact ¶ 13.⁹

For the reasons set forth below, the Commission does not find Petitioners’ argument that the issue in this case involves a licensing of tangible property rights to be persuasive or that they should not be subject to income or pass-through withholding tax.

First, the Petitioners assert “this is not a question of interpreting how state law definitions apply to state taxation but a question of how federal law limits the power of the state. Answering the question requires the application of federal law and federal definitions.” Petitioners’ Reply Brief, page 4. However, Petitioners have put the proverbial cart before the horse. 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.

Second, the Petitioners assert “because the Petitioners’ case involves the application of federal Public Law 86-272, determinations of state law do not govern whether Petitioners’ computer software sales were sales of tangible property.” Petitioners’ Reply Brief, page 9. However, as detailed above, state law does govern, and it explains that Kuta Software, LLC’s sale of licenses for the use of computer software involves intangible personal property; therefore, this case cannot involve the application of Public Law 86-272.

⁹ Compare this with Stipulated Fact ¶ 8 where the parties agree “[t]he Petitioner’s only activity related to Wisconsin was the solicitation of orders . . . the delivery of software . . . and the licensing of software”, Stipulated Fact ¶ 13 acknowledges the additional activity of customer support.

Third, Public Law 82-272 clearly states it only applies if solicitation is the only activity. The Petitioners acknowledge they do more than simply solicit business as they also provide customer support.¹⁰ However, the Petitioners then assert that these other contacts with the state are *de minimus*. There is no definition in Public Law 82-272 that explains whether other contacts can be diminished. The law simply states “the activity must be limited to solicitation.” As the Petitioners clearly do not pass this initial introductory paragraph, continuing to review the subsequent provisions of the public law is inappropriate.

Finally, when the Petitioners do look to Wisconsin law, they look to the law governing sales taxes under Chapter 77. However, the issue in this case involves income and pass-through withholding taxes under Chapter 71, not sales taxes under Chapter 77.

The Petitioners license computer software to Wisconsin schools, for use in Wisconsin classrooms. From the sale of those licenses, Petitioners derived Wisconsin income. The sale of those licenses constitutes "doing business in Wisconsin" and "business transacted in Wisconsin" sufficient to subject Petitioner Michael Kuta to Wisconsin individual income tax and Petitioner Kuta Software, LLC to Wisconsin pass-through withholding tax.

CONCLUSIONS OF LAW

1. The sale of licenses for the use of computer software constitutes the sale of intangible personal property pursuant to Wis. Stat. §§ 71.01(5p) and 71.22(3h).

¹⁰ Stipulation ¶ 13

2. The Petitioners' gross receipts from sales of the rights to copy, install, and use computer software under copyright license agreements are "gross receipts from the use of computer software" as that language is used in Wis. Stat. §§ 71.04(7)(df) and 71.25(9)(df).

3. For individual income tax purposes, the sale of licenses for the use of computer software, which are not considered tangible personal property, constitutes "business transacted in Wisconsin," subjecting Petitioner Michael Kuta to tax pursuant to Wis. Stat. § 71.02(1).

4. For pass-through withholding tax purposes, the sale of licenses for the use of computer software, which are not considered tangible personal property, constitutes "doing business in Wisconsin," subjecting Kuta Software, LLC to tax pursuant to Wis. Stat. § 71.22(1r).

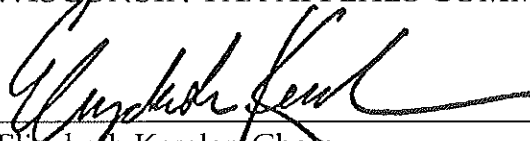
5. Public Law § 82-272 is not applicable to the facts of this appeal as the elements are not met as (1) the sale of licenses for the use of computer software are not the sale of tangible personal property and (2) the sale of licenses to use computer software are not the only activities of the business.

ORDER

That the Petitioners' Motions for Summary Judgment are denied, and the Respondent's Motions for Summary Judgment are granted.

Dated at Madison, Wisconsin, this 28th day of July , 2023.

WISCONSIN TAX APPEALS COMMISSION



Elizabeth Kessler, Chair



Jessica Roulette, Commissioner



Kenneth Adler, Commissioner

ATTACHMENT: NOTICE OF APPEAL INFORMATION