BOARD OF TAX APPEALS
STATE OF LOUISIANA

CERVEY, LLC; FORMERLY KNOWN AS NEW – TECH COMPUTER SYSTEMS LLC **B.T.A. DOCKET NO. 12272D**

Petitioner

versus

SECRETARY OF DEPARTMENT OF REVENUE, STATE OF LOUISIANA

Respondent

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JUDGMENT ON TAXPAYER'S MOTION FOR SUMMARY JUDGMENT WITH REASONS

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On August 10, 2022, this matter came before the Board for a hearing on the *Motion for Summary Judgment* filed by Cervey, LLC; Formerly Known as New – Tech Computer Systems LLC ("Taxpayer") on August 10, 2022. Presiding at the hearing were Francis J. "Jay" Lobrano, Chairman, Vice-Chairman Cade R. Cole, and Judge Lisa Woodruff-White (Ret.). Present before the Board were Miranda Scroggins, attorney for the Secretary of the Department of Revenue, State of Louisiana ("Department"), and Cheryl M. Kornick, attorney for the Taxpayer. At the conclusion of the hearing, the Board took the matter under advisement. The Board now issues Judgment in accordance with the attached written reasons:

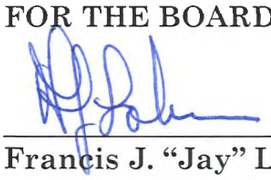
IT IS ORDERED, ADJUDGED AND DECREED that the Taxpayer's *Motion for Summary Judgment* be and is hereby GRANTED.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that for the tax periods ending June 30, 2016 and June 30, 2017 (the "Tax Periods") Taxpayer was in the business of manufacturing for purposes of La. R.S. 47:606(A)(3)(b).

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that there be Judgment in favor of the Taxpayer and against the Department and that the Assessment be and is hereby invalidated, canceled, and set aside.

JUDGMENT RENDERED AND SIGNED at Baton Rouge, Louisiana, this 8th day of September, 2022.

FOR THE BOARD:



Francis J. "Jay" Lobrano, Chairman
Louisiana Board of Tax Appeals

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REASONS FOR JUDGMENT ON TAXPAYER'S MOTION FOR SUMMARY JUDGMENT

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Facts

On January 30, 2020, Taxpayer filed the instant Petition seeking a redetermination of an assessment of Corporation Income and Franchise Tax ("CIFT") for the tax periods ending June 30, 2016 and June 30, 2017 (the "Tax Periods"). The Taxpayer asserts, as a matter of undisputed fact, that during the Tax Periods it "created software by having employees write sets of instructions, physically manifested on a disc or computer chip through the arrangement of electrons in binary form, that tell electronic hardware, *e.g.* computers, what to do."[1]

[1] Affidavit of Trent Jackson p.2, Paragraph 5.

Taxpayer introduced the Affidavits attached to its Motion and its Responses to the Department's interrogatories attached to its supplemental memorandum.[2] The Taxpayer's responses to interrogatories provide some more details about the Taxpayer's software, specifically in Taxpayer's Answer to Interrogatory No. 5.

Taxpayer is in the business of creating different software platforms, primarily for use in the medical industry. Currently, Taxpayer has three main sectors. First, it provides long-term care software, which consists of a full electronic health record within a long-term care facility. Second, it provides software to manage inventory in the setting of a hospital pharmacy, in conjunction with the government's 340B drug pricing program. This software has the ability to manage the operational and financial functions required of the federally mandated program. It also has other products such as "track and trace" – *i.e.*, to track the pedigree of a drug and determine where it came from.[3] Third, it provides software for a pharmacy benefit manager, where the information received at a pharmacy can be run and claims can be processed.

When Taxpayer develops a new software product or tool, the development is much like the development of any software. Taxpayer has subscriptions to certain data provided by 3rd party vendors (such as, for example, prescription drug or medication data) that may be used in such development. Taxpayer's products are developed on computers, using computer memory, hard drive, keyboard, etc. Data may be input to help develop the software. But the software itself is primarily the product of a developer's use of those tools to create and design a new product.

Taxpayer's software is provided to its customers largely through the internet. Taxpayer's customers often have a subscription service that allows them to access Taxpayer's products over the internet. Taxpayer also addresses customer issues when using its software products, and Taxpayer will from time to time provide updates or

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[2] Filed more than thirty days prior to the hearing.

[3] "Patient Assistance" is a software that helps patients acquire discounts through manufacturer discount programs.

changes to its software product. The foregoing facts are undisputed and controverted by the Department.

When the Taxpayer filed CIFT Returns for the Tax Periods, it computed the apportionment of its taxable capital using the formula applicable to manufacturers found at La. R.S. 47:606(A)(3)(b). The Department's position is that the Taxpayer has failed to demonstrate that the software that it creates is Tangible Personal Property ("TPP"), and alternatively failed to demonstrate that it manufactures TPP by the use of raw materials. The Department's primary contention with respect to whether Taxpayer's software is TPP is that the Taxpayer failed to show that the software was "canned" rather than "custom computer software." The Department relies on La. R.S. 47:301(16)(h)(iv) as legal authority for this assertion. That provision states that solely for the purposes of sales and use tax imposed by the state of Louisiana, custom computer software is excluded from the definition of TPP.

Discussion

Software was held to be TPP by the Louisiana Supreme Court in *South Central Bell Telephone Co. v. Barthelemy*, 94-0499 (La. 10/17/94), 643 So.2d 1240.[4] In reaching its conclusion, the Court expressly rejected the canned vs. custom distinction that had been embraced by some legislatures in other states and the Department. Instead, the Court adhered to general civilian principles governing property law. As the Court put it: "whether the software is custom or canned, the nature of the software is the same." *Id.* at 1249. The Court arrived at its holding exclusively by discerning the tangible or intangible nature of software, nearly disregarding the venerable technique of analyzing whether the true object of the transaction was for the provision of services or the transfer of property.[5]

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[4] Moreover, the Court declined to adopt the distinction between "canned" and "custom" software. *Bell*, 643 So.2d at 1250, 94-0499 at 20. The legislature presumably was aware of this and intended to change the law when it enacted La. R.S. 47:301(16)(h)(iv). See 2002 1st Ex. Sess. Act 7 (HB 30).

[5] The Court recognized that "canned programs are classified as taxable on the theory that the buyer acquires an end product; whereas, custom programs are classified as non-taxable services on the theory that the buyer acquires professional services." *Id.*

The facts presented to the Court in *Bell* were recited, in relevant part, as follows:

> In its narrowest scope, software is synonymous with program, which, in turn, is defined as "a complete set of instructions that tells a computer how to do something." Thus, another definition of software is "a set of instructions" or "a body of information."
>
> When stored on magnetic tape, disc, or computer chip, this software, or set of instructions, is physically manifested in machine readable form by arranging electrons, by use of an electric current, to create either a magnetized or unmagnetized space. The computer reads the pattern of magnetized and unmagnetized spaces with a read/write head as "on" and "off", or to put it another way, "0" and "1". This machine readable language or code is the physical manifestation of the information in binary form.

The Court confronted the challenge presented by the general civilian criteria for classifying corporeal property, acknowledging that an arrangement of electrons could not be seen by the naked eye, measured by a yardstick, or weighed on a scale. Nevertheless, the Court observed that software could be read by a machine, that a computer carrying out the instructions of a program resulted in physical changes that a human could perceive, that software took up physical space on a tape, disc, or hard drive. Moreover the Court held that software was information inescapably intertwined with corporeal, perceptible object upon which it was recorded.

The dispute in *Bell* concerned local use tax. However, the Court's holding cannot logically be limited to one type of tax. The Court reached its conclusion by analyzing the fundamental nature of software under property law principles of general applicability. The statutory exception for state sales tax does not apply to this case. The canned versus custom distinction is not a material issue outside of the scope of that statute. There was no need for the Taxpayer to establish that it produced "canned" software as an element of its Motion for Summary Judgment. The material question here is whether the nature of the Taxpayer's software is fundamentally different than the software in *Bell*.

Software has changed dramatically since 1994. That much is indisputable. However, the facts surrounding the evolution of software are not part of the summary judgment evidence before the Board in this case. There is no expert testimony

concerning the intricacies of the Taxpayer's products. The record in this case does not present an ideal platform for the Board to launch into a discussion of whether *Bell* is still relevant in the current year.

Bell held that software by its nature was TPP. The import of that pronouncement necessarily extends to all software unless a particular item is shown to be of a distinct nature, *i.e.* that it does not possess the same physical traits. The Department argues that the Taxpayer's software is distinguishable from the software in *Bell* because it is accessed over the internet. This is not persuasive. A component of the software in *Bell* was delivered via phone line, an analogous precursor to to the modern internet. Moreover, the Court stated expressly that "the form of *delivery* of the software – magnetic tape or electronic transfer via a modem – is of no relevance." *Id.* at 1246. The point that the Court made was that the method of delivery is not important. Furthermore, the Department has not developed a factual record that allows the Board to draw a distinction between the modern internet and the "electronic transfer via a modem" described in *Bell*.

The Department also argues that the Taxpayer's software does not become inseparable from a physical object like a disc. This is a closer question. The Taxpayer's software is accessed by customers over the internet. It is not clear whether the software is delivered to the customers and stored on their computers. However, even if the Board were to infer that the software is not provided to the Taxpayer's own customers nor comes to rest by being stored on their computers, this would not mean that the Taxpayer's software is not TPP. The software would still be stored in, and physically exist on, the Taxpayer's servers. Moreover, the storage of software on a disk was not the sole criteria on which the decision in *Bell* rested. Software is physically perceptible in other ways than storage on physical media. For example, the operation that the software instructs a computer to perform has perceptible results. The software is "machine-readable" *i.e.* its instructions can be read by a computer. And software causes a computer to display an interface that a human user

can perceive. The uses to which customers can put Taxpayer's software show the manner in which it causes a computer to perform physically perceptible operations.

Finally, the Department argues that production of software inherently cannot meet the definition of manufacturing. The Department looks to the sales tax definition of Manufacturing in La. R.S. 47:301(3)(h)(cc). That provision states in relevant part:

> "Manufacturing" means putting raw materials through a series of steps that brings about a change in their composition or physical nature in order to make a new and different item of tangible personal property that will be sold to another. Manufacturing begins at the point at which raw materials reach the first machine or piece of equipment involved in changing the form of the material and ends at the point at which manufacturing has altered the material to its completed form.

The thrust of the Department's argument on this point is that the Taxpayer does not transform raw material TPP into a finished product that is also TPP for resale. This argument relies in part on the premise that the finished product, software, is not TPP. The Board does not agree with that premise for the reasons explained above. However, that conclusion does not necessarily lead to the conclusion that the Taxpayer is engaged in the business of manufacturing. Manufacturing requires the transformation of a raw material with machines or equipment. Machinery and equipment is specifically defined to include: "Computers and software that are an integral part of the machinery and equipment used directly in the manufacturing process." La. R.S. 47:301(3)(h)(aa)(I)(aaa). The missing element in this case is the raw material.

Taxpayer's Affidavit states that it created software by having employees write sets of instructions that were physically manifested on a media through the arrangement of electrons in binary form that tell electronic hardware, *e.g.* computers, what to do. Viewing the information contained set of instructions as a raw material presents a problem, as the information contained in the instructions is not TPP. A more logical approach, however, is to view the baseline arrangement of electrons, before the Taxpayer arranged them into software as the raw material. In re-

arranging electrons from something like a blank file into a useful form, like a program, the Taxpayer transformed a raw material into finished TPP for sale. Accordingly, the Board concludes, based on the limited but uncontroverted facts before it in this case, that this Taxpayer was engaged in the manufacture of software.

For the foregoing reasons, the Board will grant the Taxpayer's Motion for Summary Judgment. For purposes of CIFT and the apportionment formula provided for in La. R.S. 47:606(A)(3)(b), *Bell* controls and holds that software is TPP. The exception for custom software enacted in La. R.S. 47:301(16)(h)(iv), by its own terms, applies solely for purposes of the sales and use tax imposed by the state of Louisiana and not to CIFT. Although software and technology have undoubtedly changed a great deal since *Bell* was decided, the competent summary judgment evidence presented in this case does not supply a basis for the Board to declare that *Bell*'s holding is no longer valid for the software at issue in this case. Finally, based on the uncontroverted facts presented in this case, this Taxpayer is engaged in the manufacture of TPP. Accordingly, the Taxpayer was in the business of manufacturing during the Tax Periods and properly calculated its Louisiana correctly by utilizing the single sales factor apportionment formula. The Assessment appealed from must be invalidated and Judgment will be entered accordingly.

Baton Rouge, Louisiana, this 9th day of September, 2022.

FOR THE BOARD:

Francis J. "Jay" Lobrano, Chairman
Louisiana Board of Tax Appeals