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Credits and Incentives

Best Practices to Monetize your Incentives Package

While the many economic development and other incentives programs available can be extremely lucrative for companies that dedicate the resources to seek out, plan, and negotiate appropriate incentive packages, many companies do not fully realize the anticipated benefits because of weaknesses in their compliance, tracking, and/or monitoring procedures. This article identifies many of the areas in which these breakdowns often occur and explains how they can be avoided. The authors also offer a number of practical tips and practices that can be implemented by companies to help maximize the value their incentives efforts.

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Sales Tax

The Massachusetts "Tech-Tax" Fiasco: It's History, Impact and Valuable Lessons Learned

This past summer, the Massachusetts legislature enacted a broad expansion of the sales tax base to include computer system design and software modification services. This highly complex tax legislation, which took many by surprise and became effective only seven days after its enactment, soon became the subject of widespread criticism for a variety of reasons. Not only was it viewed as a discriminatory tax that focused on a vibrant sector of the Massachusetts economy, but the legislation was enacted without a public hearing, which would have given affected taxpayers an opportunity to raise questions before its enactment. Additionally, some Massachusetts legislators acknowledged that they voted for the legislation without a full understanding of its impact. It was not surprising, then, that the legislation was repealed less than two months after its effective date. This article highlights the legislation's history, explains the repeal provision and abatement process, and asks what policy and other lessons were learned from what has been dubbed the "Tech-Tax" fiasco.

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The Massachusetts "Tech-Tax" Fiasco: It's History, Impact and Valuable Lessons Learned

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History of the Massachusetts "Technology Tax"

On July 24, 2013, Massachusetts enacted H.B. 3535, *An Act Relative to Transportation Finance*¹ (the "Act"), which included several significant tax provisions, such as the adoption of market-based sourcing for receipts from sales of other than tangible personal property for income tax purposes and an increase in cigarette and gasoline taxes. But perhaps the most significant tax provision in H.B. 3535 was the expansion of the sales tax base to computer system design and software modification services,² a provision which became effective on July 31, 2013, just seven days after the legislation's enactment.³

This provision was highly criticized by the Commonwealth's business and technology community, many of whom only became aware of its inclusion after it had been enacted and who had little time to digest the new provision's application to their services or to implement procedures to insure compliance with the new law.

Anticipating the complexity the new law would present, the Massachusetts Department of Revenue ("the Department") immediately issued the first of two Technical

¹ An Act Relative to Transportation Finance, St. 2013, c. 46.

² Under the now-repealed law, Massachusetts General Laws, c. 64H, § 1, the definition of "services" was amended by adding to the list of taxable services "computer system design services and the modification, integration, enhancement, installation or configuration of standardized software." As discussed in this article, this amendment was repealed on September 27, 2013, through the enactment of H. 3662, *An Act Repealing the Computer and Software Services Taxes*.

³ An Act Relative to Transportation Finance, St. 2013, c. 46 §§ 48, 49, 89.

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Information Releases⁴ the day after the Act was enacted.⁵ Because it quickly became clear that the Department would need to issue additional guidance as taxpayers' questions and comments began to pour in, a second Technical Information Release⁶ was issued just a few weeks later.

However, despite the comprehensive guidance provided in these two Technical Information Releases, questions and concerns from affected taxpayers continued to be presented, which led to the Department also producing a Frequently Asked Questions (FAQ) document detailing the numerous questions presented by the business and taxpayer community and the Department's responses.

Although a "technology" tax provision was introduced early on as part of the Governor's initial budget bill,⁷ and legislative discussion continued once it became a part of the Transportation Finance Bill,⁸ its final enactment took many Massachusetts taxpayers by surprise. It wasn't long before the Massachusetts business, technology, and taxpayer advocacy community went into high gear to see the controversial law repealed. Within days of the new law's enactment, the Massachusetts Taxpayers Foundation⁹ and the Massachusetts High Technology Council¹⁰ had joined forces and filed a petition with the

Massachusetts Attorney General's office.¹¹ Obtaining the requisite number of signatures would have allowed a November 2014 ballot vote to decide the law's fate.

But the business and technology community, not content to wait for the November 2014 election results, continued to pressure lawmakers to repeal the tax immediately. The argument to repeal the tax was based not only on its vagueness and complexity, but on the view that it would stifle Massachusetts' thriving technology sector. This argument was supported by a report issued by the Massachusetts Taxpayers Foundation on September 9th, which showed that, as a result of the enactment of the "technology tax," Massachusetts would have the most burdensome tax on computer and software services in the entire nation.¹² Estimates also projected that the tax provision would generate significantly more than the \$161 million in tax revenue it was originally slated to generate.¹³ This revelation, along with the fact that Massachusetts' tax collections were \$139 million above budget for July

profit, public organization whose mission includes strengthening the New England technology economy by facilitating collaboration and rapid access to innovative technologies and advocating for competitive public policies and practices to sustain Massachusetts as a globally preeminent economy in which to live and work, and to create, operate, and expand high tech businesses.

⁴ Massachusetts Technical Information Releases (TIRs) inform taxpayers and tax practitioners of the Department's response to changes in federal or state tax laws or to court decisions interpreting those laws. A TIR states the official position of the Department, has the status of precedent in the disposition of cases unless revoked or modified, and may be relied upon by taxpayers in situations where the facts, circumstances and issues presented are substantially similar to those in the TIR.

⁵ Mass. Dept. of Rev., Technical Information Release (TIR) 13-10: Sales and Use Tax on Computer and Software Services Law Changes Effective July 31, 2013, issued 7/25/13.

⁶ Mass. Dept. of Rev., Working Draft Technical Information Release (TIR) 13-XX: Further Guidance Regarding the Scope of Sales and Use Tax on Computer and Software Services, issued 8/20/13.

⁷ H1, An Act Making Appropriations For Fiscal Year 2014

⁸ H.B. 3535, An Act Relative to Transportation Finance

⁹ The Massachusetts Taxpayers Foundation is a non-partisan, public policy organization that focuses on Massachusetts state and local fiscal, tax and economic policies. The organization's mission includes providing accurate, unbiased research with balanced, thoughtful recommendations that strengthen the state's finances and economy in order to foster the long-term well-being of the Commonwealth.

¹⁰ The Massachusetts High Technology Council is a non-

¹¹ An Act To Repeal The 2013 Sales Tax on Computer And Software Technology Service, Petition No. 13-21, Filed 8/7/13. The petition can be viewed at: <http://www.mass.gov/ago/docs/government/2013-petitions/13-21.pdf>

¹² Massachusetts Taxpayer's Foundation News Release, MTF Analysis: New Computer and Software Services Tax Most Burdensome in the Nation, 9/9/13. The Foundation's press release can be viewed at: <http://www.masstaxpayers.org/sites/masstaxpayers.org/files/MA%20Most%20Burdensome%20Tax%20on%20Computer%20and%20Software%20Services%20of%2050%20States.pdf>. The 50-state analysis can be downloaded from the Foundation's home webpage at: <http://www.masstaxpayers.org/>

¹³ In its Bulletin, "The Folly of Taxing Our Innovation Economy," issued on August 16, 2013, the Massachusetts Taxpayers Foundation noted that the impact of the "technology tax" would have been \$500 million—not the \$161 million that the Department estimated. The Bulletin stated that the Department's \$161 million estimate was based on assumptions that did not capture the full burden of the tax. For instance, it only took into account sales tax revenues that would have been raised from purchases by Massachusetts-based companies from other Massachusetts-based companies, and therefore the estimate incorrectly omitted the use tax revenues that would have resulted from purchases by Massachusetts-based companies from out-of-state businesses. The Bulletin can be viewed at: <http://www.masstaxpayers.org/sites/masstaxpayers.org/files/MTF%20-%20The%20Folly%20of%20Taxing%20Our%20Innovation%20Economy.pdf>

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and August, suggested that the "technology tax" revenues would not be needed, and further supported the view that retaining the provision could stifle the Commonwealth's recovering economy.

That same day, September 9th, two Massachusetts legislators introduced a proposal to repeal the tax.¹⁴ By mid-September, Governor Patrick had expressed his intent to see the controversial provision repealed. Shortly thereafter, Massachusetts House Speaker Robert DeLeo and Senate President Therese Murray confirmed, via a joint press conference, that they would work to see the "tech tax" repealed.¹⁵

By September 25th, H. 3662, *An Act Repealing the Computer and Software Services Taxes*, had been reported favorably by the Massachusetts House Ways and Means Committee. From there, the repeal bill moved swiftly through the legislative process with the House approving it the same day by an overwhelming majority vote of 156 to 1. The following day, September 26th, the Senate passed the bill by a unanimous majority vote of 56 to 0. Despite Governor Patrick's concern that the legislation did not provide a replacement for the lost tax revenue that would result from a repeal of the "tech-tax," the Governor signed the repeal legislation into law the very next day, September 27th.¹⁶

Effects of the Repeal on Vendors that Took Actions to Comply with the Repealed Provision

Because the tax on computer system design and software modification services was in effect for almost two full months prior to its repeal,¹⁷ some taxpayers may have complied with the requirement to charge sales

tax on the services subject to tax under the law. The now repealed law applied the Massachusetts 6.25% sales/use tax to computer system design and software modification services performed on or after July 31, 2013. In the Department's first Technical Information Release, taxpayers were instructed to report sales and use tax related to the taxable services provided or used between July 31st through August 31, 2013, on their Massachusetts sales and use tax return due on September 20, 2013.

However, when it appeared that a repeal of the "tech-tax" was likely, the Department, on September 16, 2013, issued a third Technical Information Release, TIR 13-14, in which it announced an extension of the first due date for the filing and remittance of sales and use taxes due on computer system design and software modification services.¹⁸ TIR 13-14 granted an additional one month extension, or until October 20, 2013, for the filing and remittance of sales and use taxes on computer system design and software modification services that covered the period from July 31, 2013 through September 30, 2013, and it noted that "the Department anticipated issuing further guidance regarding (a) the requirement of vendor refunds to customers of any tax collected from customers and (b) applications for abatement on any tax remitted to DOR by vendors pursuant to the repealed provisions."

And indeed, shortly after enactment of the repeal, the Department issued yet one more Technical Information Release, TIR 13-17,¹⁹ in which it described the procedures that vendors should follow under each of the following scenarios: (1) where the vendor collected tax but did not remit it, (2) where the vendor filed a return and remitted taxes that had been collected, and (3) where the vendor filed a return but did not remit taxes collected. Regarding vendors that had collected but not remitted tax, TIR 13-17 instructs that these vendors must make reasonable efforts to return the tax to the retail customers from whom

¹⁴ HD 3864, *An Act to Repeal the 2013 Sales Tax on Computer And Software Technology Services*, was introduced by Representative Bradley Jones, and Senator Bruce Tarr on September 9, 2013.

¹⁵ See "DeLeo, Murray join Patrick to support tech tax repeal," *BostonGlobe.com*, September 13, 2013; and "Senate President Therese Murray and House Speaker Robert DeLeo support repeal of new Massachusetts tech tax," *MassLive.com* - Politics, September 12, 2013.

¹⁶ *An Act Repealing the Computer and Software Services Tax*, St. 2013, c. 95.

¹⁷ The sales tax on computer system design and software modification services went into effect on July 31, 2013, and was repealed, retroactively, on September 27, 2013.

¹⁸ Mass. Dept. of Rev., Technical Information Release 13-14: *Extension of Due Date for First Reporting of Sales and Use Tax on Computer and Software Services*, issued 9/16/13. In TIR 13-14, the Department noted that the Commissioner was exercising her authority to grant the extension in light of the public statements of support for repeal of these new tax provisions by the Governor, the Senate President, and the Speaker of the House, and to minimize administrative burden on vendors during a period when the Legislature is likely to be considering repeal of these new tax provisions.

¹⁹ Mass. Dept. of Rev., Technical Information Release 13-17: *Repeal of the Computer and Software Services Tax*, issued September 30, 2013.

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the tax was collected. Regarding vendors that filed returns and remitted tax, TIR 13-17 provides that these vendors must electronically file abatement applications no later than December 31, 2013.²⁰ And finally, regarding vendors that filed returns but did not remit tax, TIR 13-17 provides that these vendors should (1) make reasonable efforts to return the tax to the retail customers from whom the tax was collected, and (2) electronically file abatement applications no later than December 31, 2013.²¹ Taxpayers in the second and third categories should carefully review the detailed instructions included in TIR 13-17 for accomplishing both of these tasks by the abatement filing deadline. Complying with these instructions is especially important for vendors that filed returns but did not remit taxes collected, as these taxpayers could be subject to billing and collection if they filed a return showing tax due but fail to file an abatement.

TIR 13-17 also notes that the rules regarding the taxation of the transfer of standardized or prewritten software remain unchanged, as these transfers were taxable prior to the enactment of the computer/software services tax and continue to be taxable after repeal.²²

²⁰ Regarding abatement filed by vendors that filed returns and remitted tax, TIR 13-17 notes that "other than the shortened statute of limitations provided in St. 2013, c. 95, for filing the abatement application, all other provisions of G.L. c. 62C, § 37 and 830 CMR 62C.37.1, governing abatement applications will apply, including the need to provide supporting documentation *if requested by the Department*. Such substantiating documentation may include sample invoices that would show that an abatement request relates solely to software and computer services transactions, as opposed to sales of standardized or prewritten software licenses or other taxable transactions. Further, no actual refund will be made until the vendor establishes that the tax has been repaid or credited to the retail customer. See 830 CMR 62C.37.1(6)(b)."

²¹ Regarding abatements filed by vendors that filed returns but did not remit taxes collected, TIR 13-17 notes that "other than the shortened statute of limitations provided in St. 2013, c. 95, for filing the abatement application, all other provisions of G.L. c. 62C, § 37 and 830 CMR 62C.37.1, governing abatement applications will apply, including the need to provide supporting documentation *if requested by the Department*. If a taxpayer has filed a return showing tax due and fails to file for an abatement, billing and collection activity may result."

²² 64H.1.3, Computer Industry Services and Products Regulation. The Department may have emphasized that transfers of pre-written software remain taxable even after the repeal because several questions presented to the Department addressed in the FAQ dealt with either the definition of "standardized" software or the taxability of transfers of standardized or prewritten software. Additionally, in a February 2013 Working Draft Directive, 13-XX, *Criteria for Determining Whether a*

Policy and Other Lessons Learned

In summary, on July 31, 2013, Massachusetts enacted legislation which expanded the sales tax base to computer system design and software modification services, making it one of the few states in the country with such a tax. Because the tax provision was effective just seven days after the legislation was enacted, vendors of computer system design and software modification services were required to quickly assess the new law's impact on their services and on their sales tax registration, collection and remittance requirements.

And although the Department attempted to quickly address the application of the new law, as well as offer sourcing and transition guidance through a first, and then a second, Technical Information Release, taxpayers were still significantly confused as to the new tax provision's impact on their computer and software services. This was evident from the numerous and vast questions presented to the Department, the responses to which were compiled into a lengthy FAQ.

Almost as soon as the "tech-tax" was enacted, a coalition spearheaded by the Massachusetts Taxpayers Foundation and the Massachusetts High Technology Council filed a petition that would put the fate of the "tech-tax" into the hands of Massachusetts voters. But a November 2014 ballot was too far off for the Massachusetts technology community, who had banded together and continued to push for a more immediate repeal. Less than two months after the law's effective date, it was retroactively repealed despite the fact that the legislature failed to provide an alternative source of tax revenue to support the Governor's transportation funding bill.²³

Transaction is a Taxable Sale of Pre-written Software or a Non-taxable Service, the Department acknowledged that the Directive was a response to the large volume of requests for guidance on the taxability of transfers of pre-written software. This further demonstrates that Massachusetts taxpayer are uncertain regarding the taxability of pre-written software transfers.

²³ When the time came to vote on the repeal, all but one member of the Massachusetts legislature voted to repeal. The one dissenting vote came from Representative Angelo Scaccia, a veteran legislator who has served in the Massachusetts House since 1980. When questioned on his dissenting vote, Representative Scaccia noted that he wondered what had changed about the state's budget needs — and specifically, the alleged transportation crisis—and why one industry could swiftly pressure the governor and Legislature into repealing a tax it didn't like. See Joan Vennoch, "What about the lost tech tax income?," *The Boston Globe*, October 20, 2013 (available at <http://www.bostonglobe.com/opinion/2013/10/20/angelo-scaccia-lonely-vote-against-tech-tax-repeal-not-swayed-crocodile-tears-massachusetts-business/z0H1zaTafyBHVcjCjDO/story.html>).

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Because the Massachusetts tax on computer design services and software modification services is no longer in effect, this article does not address the application of the repealed law's provisions.²⁴ However, those who followed this development and reviewed the Department's numerous Technical Information Releases, FAQ and other guidance, are well aware that the provision was both vague and complex – requiring taxpayers to quickly figure out its impact and/or reach out to the Department for specific guidance.

One might wonder how a tax on technology was even enacted in a “technology-centric” state such as Massachusetts. Was this yet another example²⁵ of a state reaching to the most viable source of potential tax revenues without regard to the overall economic impact on the state? And although the business, technology and taxpayer advocacy community cheered the repeal, one might also wonder how the Governor had so quickly gone from declaring a “transportation funding crisis” to approving a repeal with no alternative tax revenue source being offered.²⁶

²⁴ TIR 13-17 notes that the following public statements of the Department are revoked to the extent they related to the now-repealed tax: TIR 13-10, *Sales and Use Tax on Computer and Software Services Law Changes Effective July 31, 2013*; Working Draft TIR 13-XX, *Further Guidance Regarding the Scope of Sales and Use Tax on Computer and Software Services* (never issued in final form and no longer available online); TIR 13-14, *Extension of Due Date for First Reporting of Sales and Use Tax on Computer and Software Services*; and the FAQs. However, TIR 13-17 also notes that the sourcing rules in TIR 13-10, Section III. C. remain applicable to sales of taxable standardized or prewritten software in situations where no Multiple Points of Use (“MPU”) exemption certificate is provided by the buyer.

²⁵ In 2007, Maryland's Governor O'Malley signed The Tax Reform Act of 2007 (S.B. 2) into law. Amongst its provisions, the Maryland legislation expanded the sales tax base to a variety of computer and software related services which met the Maryland legislation's definition of a taxable “computer service.” Like the Massachusetts “tech-tax” repeal effort, the Maryland business and technology community formed a grass-roots effort which resulted in the Maryland “tech-tax” being repealed prior to its July 1, 2008 effective date. (Maryland S.B. 46, Computer Services Sales Tax Repeal and Other Tax Adjustments, signed into law April 8, 2008). See also Joseph Henchman, “Momentum Builds to Repeal Maryland Computer Services Tax,” (March 14, 2008), available at <http://taxfoundation.org/blog/momentum-builds-repeal-maryland-computer-services-tax>.

²⁶ On September 23, 2013, The Massachusetts Budget and Policy Center, a non-partisan research and analysis group focused on Massachusetts' budget and tax policies, published a Budget Brief which examines a number of possible tax revenue

One lesson for states that choose to take this approach is that other states whose tax climate and policies may be more beneficial will be quick to open their doors to companies in the “taxed” state.²⁷ This is indeed what occurred in this scenario. While many Massachusetts technology providers decried the “tech-tax” and threatened to move to New Hampshire (Massachusetts' “no sales tax” neighbor state to the north), even faraway states were quick to take notice. Shortly after the “tech-tax” was enacted, several news stories surfaced reporting that Florida Governor Rick Scott had mailed letters to 100 business leaders in Massachusetts urging them to “book a one-way ticket to Florida,” noting Florida's low unemployment rate and rapidly improving economy.²⁸ The lesson here for State legislators is that states are aggressively competing against each other – and legislators should carefully consider the overall impact of legislation they enact.

Another “issue” that came to light after the enactment of

options in light of the then potential “tech-tax” repeal. These include revenue sources that would result from reforming or eliminating special business tax breaks, reducing opportunities for tax avoidance, and re-examining other major tax credits of the past two decades. Specific examples cited in the article include eliminating the single-sales factor used in the computation of the Massachusetts corporate excise (income) tax by Massachusetts manufacturers and mutual fund companies, reducing the Massachusetts film credit, and eliminating off-shore tax haven loopholes. See Noah Berger and Kurt Wise, “After the Tech Tax Repeal: Remembering the Big Picture,” which can be viewed at: http://www.massbudget.org/report_window.php?loc=after_tech_tax.html

²⁷ On October 9, 2013, the Tax Foundation, a Washington D.C. based non-partisan tax research group, issued its 2014 State Business Tax Climate Index, which details the results of the Foundation's assessment of the overall business tax climate of the fifty states based on over 100 variables in individual income tax, corporate income tax, sales tax, unemployment insurance tax, and property tax. In its report, the Foundation notes that “even in our global economy, states' stiffest and most direct competition often comes from other states.” The report, citing Department of Labor statistics, also notes that “most mass job relocations are from one U.S. state to another, rather than to a foreign location.” The Foundation's 2014 State Business Tax Climate report can be viewed at: <http://taxfoundation.org/sites/taxfoundation.org/files/docs/2014%20State%20Business%20Tax%20Climate%20Index.pdf>

²⁸ See Michael Levenson, “Fla. governor's bid to lure business raises ire in Mass.,” The Boston Globe, August 9, 2013 (available at: <http://www.bostonglobe.com/metro/2013/08/08/fla-governor-bid-lure-business-raises-ire-mass/rFqAOM3xLGp-guXnPkVuSWP/story.html>)

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the "tech-tax" was the revelation that some state legislators voted for the tax provision without truly understanding it.²⁹ The reality is that tax laws are complex! And all too often, legislators must vote on tax proposals without a thorough understanding of them. As technologies and business models continue to evolve, how tax laws will be applied in practice will only continue to be more challenging. For this reason, taxpayers and their tax advisors are reminded of the importance of staying abreast of legislative developments and their potential impact.

In conclusion, the Massachusetts "tech-tax" was simply a bad idea – a law that was vague, yet complex, with far reaching economic implications. Good tax policy suggests that the object or persons being taxed should have some connection to desired outcome or purpose (e.g., cigarette taxes and the cessation of smoking, gasoline taxes and the decrease in carbon monoxide emissions). This was a tax on "technology" that was intended to fund the Commonwealth's current and future "transportation" needs – roads, bridges, buses and subway trains. In the end, the policy connection simply wasn't there!

²⁹ Another criticism of the legislation was that it was enacted without a public hearing and based on incorrect information. According to Michael Widmer, President of the Massachusetts Taxpayers Foundation, "the passage of the bill was based on an incorrect number presented to legislators that 35 states shared similar taxes. Without a public hearing, those voting on the tax as part of the transportation bill did not have complete information." See Sarah Kuranda, "New Massachusetts Software Tax Highest in the Nation," CRN, August 14, 2013 (available at: <http://www.crn.com/news/applications-os/240159911/new-massachusetts-software-services-tax-highest-in-nation.htm>)