MULTISTATE TAX COMMISSION

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To: MTC Executive Committee
From: Roxanne Bland, Counsel
Date: March 26, 2010
Subject: Applicability of Sales and/or Use Tax to Computer Software (1988)

In November 2008, the Uniformity Committee undertook a review of the Commission's sales and use/transactional tax uniformity regulations to assess their continued relevancy as well as whether they present any conflict with the Streamlined Sales and Use Tax Agreement (SSUTA). The Uniformity Committee recommends that the Applicability of Sales and/or Use Tax to Computer Software (1988) should be repealed because it is outdated and there is not a pressing need for a revised model at this time.

The Uniformity Recommendation is Outdated

The recommendation proposes a uniform guideline to govern state transactional taxation of computer software. The purpose of the guideline was to reflect the policy applicable to the transaction taxes of computer software (including license and leasing agreements) for states that adopted that regulation to eliminate inconsistent taxation of computer software as a tangible or intangible. The guideline provides definitions of "computer", "computer software", "custom software" and "canned software", the latter definition containing examples of canned software such as Bank Street, Crossfire, etc.

The Uniformity Committee believes the guideline is outdated. Most of the software programs listed are obsolete. Moreover, the issue of whether computer software is tangible or intangible for transaction tax purposes has long been settled in the states.

The Uniformity Committee chose to repeal the recommendation because making revisions to the recommendation is not a pressing issue in the states. While the recommendation's definitions and those contained in SSUTA are similar in concept, states have the SSUTA definitions to follow, and do not see the need to create an alternative proposed uniform rule that might conflict with SSUTA.

To date, one state, TX, has adopted this recommendation. At the Uniformity Committee's July 2009 meeting, the TX representative to the Uniformity Committee indicated her state did not object to its repeal.

Applicability of Sales and/or Use Tax to Sales of Computer Software

Adopted July 14, 1988

Policy Statement

This guideline sets forth the policy of each state which adopts its as to the manner in which that state applies its sales/use tax to computer software. Such states are designated herein as signatory states.

Objective

It is the purpose of this guideline to further the cause of uniformity and predictability in the manner in which states treat computer software for purposes of sales and use taxation.

The Problem

Many states subject sales of tangible personal property to sales and use tax but exempt from such taxes sales of intangible personal property and sales of services. Distinguishing between the two types of transactions, i.e. taxable and non-taxable, is often difficult. This is particularly true with respect to computer software; and the states have sometimes reached differing conclusions on the basis of the same facts.

Goal

This guideline seeks to establish a uniform standard by which the signatory states will distinguish between canned and custom sales of computer software. It is relevant for only those states which differentiate between the two for the purpose of distinguishing between taxable and non-taxable sales of computer software.

Definitions

Computer, as used here, means a programmable machine or device (including word processing equipment and testing equipment) having information processing capabilities and usually consisting of a central processing unit, internal memory and input and output peripherals. The term includes a programmable microprocessor and/or any other integrated circuit embedded in manufactured machinery or equipment.

Computer software, as used here, means and includes programming, i.e., a set of statements or instructions which, when incorporated into a machine-usable data processing storage or communication medium or device (such as printed material, cards, disks, tapes or modems), is capable of causing a computer to indicate, perform or achieve a particular function, task or result.

Custom software, as used here, means and includes programming which results when a user purchases the services of a person to create software which is specialized to meet the user's particular needs. The term includes those services that are represented by separately stated and identified charges for those modifications to an existing pre-written program which are made to the special order of the customer, even though the sale, lease or license to use the existing program remains taxable. The signatory states treat the sale of custom software as a sale of services on the basis: 1) that the user has purchased not tangible personal property but services; and 2) that the resulting software is simply the means by which those services are delivered to the user.

Canned software, as used here, means and includes programming that has general applicability and/or has not been prepared at the special request of the purchaser to meet his particular needs. It is sometimes known and/or described as "pre-written programming." Evidence of general applicability is to be found in the selling, licensing and/or leasing of the identical program more than once. A program may qualify as custom software for the original purchaser/lessee/licensee but became canned software with respect to all others. The signatory states treat the sale of canned software as either a taxable sale of, lease of or license to use tangible personal property. Examples of prominent canned programs are: Bank Street, Crossfire, D-Base III, DOS, Electric Desk, Fun Pack, Kings's Quest, Lisa, Lotus 1-2-3, MacEdge, MacPaint, MacPhone, MacVegas, MacWrite, MegaMerge, Soft Maker II, Solomon II, Ventura, Word Perfect, Word Proof, Wordstar, and Writing Assistant (IBM).

Licensing/Leasing Agreements

Whether a software licensing or leasing agreement is subject to tax depends, in some states, upon whether the software itself is custom or canned software.