



RULE-MAKING ORDER

CR-103 (June 2004)
(Implements RCW 34.05.360)

Agency: Department of Revenue

- Permanent Rule**
- Emergency Rule**

Effective date of rule:

Permanent Rules

- 31 days after filing.
- Other (specify) _____ (If less than 31 days after filing, a specific finding under RCW 34.05.380(3) is required and should be stated below)

Effective date of rule:

Emergency Rules

- Immediately upon filing.
- Later (specify) _____

Any other findings required by other provisions of law as precondition to adoption or effectiveness of rule?

- Yes
 - No
- If Yes, explain:

Purpose: The Department is adopting this rule, WAC 458-20-15501, to update and further explain beyond WAC 458-20-155 the application of the business and occupation (B&O), retail sales, and use taxes as they apply to persons providing information or computer services, and persons who manufacture, develop, process, or sell information, software, or computer programs. This rule also recognizes that RCW 82.12.020(1)(b) now excludes software provided free of charge from the use tax.

Citation of existing rules affected by this order:

Repealed:

Amended:

Suspended:

Statutory authority for adoption: RCW 82.32.300 and 82.01.060(2)

Other authority :

PERMANENT RULE ONLY (Including Expedited Rule Making)

Adopted under notice filed as WSR 08-15-173 on July 23, 2008.

Describe any changes other than editing from proposed to adopted version: **See attachment.**

If a preliminary cost-benefit analysis was prepared under RCW 34.05.328, a final cost-benefit analysis is available by contacting: **An analysis was not prepared.**

EMERGENCY RULE ONLY

Under RCW 34.05.350 the agency for good cause finds:

- That immediate adoption, amendment, or repeal of a rule is necessary for the preservation of the public health, safety, or general welfare, and that observing the time requirements of notice and opportunity to comment upon adoption of a permanent rule would be contrary to the public interest.
- That state or federal law or federal rule or a federal deadline for state receipt of federal funds requires immediate adoption of a rule.

Reasons for this finding:

Date adopted: December 16, 2008

NAME (TYPE OR PRINT)

Alan R. Lynn

SIGNATURE

TITLE Rules Coordinator

CODE REVISER USE ONLY

OFFICE OF THE CODE REVISER
STATE OF WASHINGTON
FILED

DATE: December 16, 2008
TIME: 10:05 AM

WSR 09-01-088

**Note: If any category is left blank, it will be calculated as zero.
No descriptive text.**

**Count by whole WAC sections only, from the WAC number through the history note.
A section may be counted in more than one category.**

The number of sections adopted in order to comply with:

Federal statute:	New	_____	Amended	_____	Repealed	_____
Federal rules or standards:	New	_____	Amended	_____	Repealed	_____
Recently enacted state statutes:	New	_____	Amended	_____	Repealed	_____

The number of sections adopted at the request of a nongovernmental entity:

New	_____	Amended	_____	Repealed	_____
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The number of sections adopted in the agency's own initiative:

New	<u>1</u>	Amended	_____	Repealed	_____
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The number of sections adopted in order to clarify, streamline, or reform agency procedures:

New	_____	Amended	_____	Repealed	_____
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The number of sections adopted using:

Negotiated rule making:	New	_____	Amended	_____	Repealed	_____
Pilot rule making:	New	_____	Amended	_____	Repealed	_____
Other alternative rule making:	New	<u>1</u>	Amended	_____	Repealed	_____

Attachment for CR103 of WAC 458-20-15501

Describe any changes other than editing from proposed to adopted version

A number of minor edits were made to Rule 15501. These edits are designed primarily to clarify existing language of Rule 15501 as adopted. For example, all of the hypothetical examples originally had "Customer X, Y, or Z." All of the references to hypothetical customers were changed to actual random names such as Steve, Julie, Jack, Amelia, etc.

Additionally, minor edits were made to correct some grammatical and spelling errors. Edits were also made in an attempt to uniformly use client, customer, or buyer in the different examples and subsections. However, these three terms are still meant to be used interchangeably within this rule.

Changes, other than mere edit changes, are addressed below. Language added to proposed Rule 15501 is underlined, while language removed from proposed Rule 15501 is indicated by a strikethrough of the text.

1. WAC 458-20-15501(101)(d) & (e)(i)

- (d) **Retail sale of computer systems.** Gross proceeds of sales of computer systems to consumers are subject to B&O tax under the retailing classification. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law. If the seller is required to collect Washington sales tax (such as in the case of the seller having nexus in Washington), but ~~did~~ does not collect Washington sales tax, the buyer is responsible for remitting retail sales tax (commonly referred to as deferred sales tax), unless the sale is specifically exempt by law. If the seller is not required to collect Washington sales tax, then the buyer is responsible for remitting use tax, unless the transaction is specifically exempt by law. Separately stated charges for custom software ~~involved~~ sold with the ~~associated~~ computer ~~software~~ system are subject to service B&O tax. See subsection (302) of this section. This edit clarifies that the interaction between nexus, retail sales tax, and use tax are consistent with current Department practice.
- (e) (i) Separately stated charges for custom programming ~~involved~~ sold with the ~~associated~~ computer ~~software~~ system are not subject to manufacturing B&O tax, but are subject to service B&O tax. See subsection (302). This subsection was updated to reflect the changes made to subsection (d) of the same subsection (101).

2. WAC 458-20-15501(102)(d) – This subsection was deleted.

3. WAC 458-20-155(102)(e) – This subsection become subsection (d). Also, we clarified that the possession of the computer system was taken by the purchaser before the software was purchased and installed. ~~(de)~~ Same facts as ~~(dc)~~ of this subsection, except that AFG sells and installs the prewritten computer software after ~~JoeZ~~ purchases and takes possession of the computer system. AFG is subject to retailing B&O tax and must collect retail sales tax from Joe on the sale of the computer system and the prewritten computer software. Also, AFG is subject to manufacturing B&O tax on the value of the computer system. AFG is entitled to claim a multiple activities tax credit. AFG is not subject to manufacturing B&O tax on the value of the prewritten computer software, because the installation of the software by AFG is not a part of AFG's manufacturing activity.

4. WAC 458-20-15501(301)(d)(ii) – The first sentence was rewritten to provide a clearer explanation of the exemption for internally used software. (ii) **Use of prewritten computer software by software developer.** ~~Use of prewritten computer software by a software developer is not subject to use tax because the software developer is not an end user~~ The internal use of prewritten computer software by the developer of that software is not subject to use tax because the software developer is not an end user of its own internally developed software. For example, VV Software, Inc., an in-state software developer, creates accounting software generally used by small businesses. VV plans to sell its newly created software to other companies. VV also plans to make a copy of this software and use it for its accounting operation. The copy of software used by VV for its accounting operation is not subject to use tax.

5. WAC 458-20-15501(302)(e) – The following changes were made in the last two sentences of this subsection that reads: Additionally, income received for ~~customer~~ client access and use of the software is subject to service and other activities B&O tax. PFC is hosting its own software for ~~customer~~ client access and use. See subsection (401)(g) of this section for treatment of gross income received for providing remote access to software applications such as an ASP provides. The second sentence was updated to match changes to subsection 401(g).
6. WAC 458-20-15501(303)(a)(ii)(A), (B), (C), and (D) - The following examples were edited to better reflect the principles of subsection (303).
- WAC 458-20-15501(303)(a)(ii) – (ii) **Examples.** The examples presume sellers have nexus with Washington.
 - WAC 458-20-15501(303)(a)(ii)(A) - (A) UM Computers, Inc., is a software developer that develops engineering software. UM sells the prewritten computer software at wholesale to OX Computers, Inc., in shrink-wrapped packages. UM delivers the software to OX. OX then resells the software to customers in the same shrink-wrapped packages. Sales of prewritten computer software by UM are subject to wholesaling B&O tax. Sales by OX to consumers are retail sales subject to retailing B&O tax and retail sales tax.
 - WAC 458-20-15501(303)(a)(ii)(B) - (B) GB Computers, Inc., is a software developer that develops engineering software. GB grants ~~an intangible right to~~ SE Computers, Inc., ~~the right to~~ ~~for~~ ~~reproducing~~ and ~~distributing~~ copies of the prewritten computer software for sale. GB retains all of its ownership rights to the software and delivers one copy of the software to SE to reproduce. Royalties Amounts received from GB granting ~~an intangible~~ the right to reproduce and distribute prewritten computer software to SE are subject to royalties B&O tax. Sales by SE to consumers are retail sales subject to retailing B&O tax and retail sales tax.
 - WAC 458-20-15501(303)(a)(ii)(C) - (C) DH Computers, Inc., is a software developer that develops engineering software. DH ~~sells~~ grants the right to sell its engineering prewritten computer software at wholesale to WK Computers, Inc. ~~DH does not allow WK to reproduce copies of the prewritten computer software for sale to end users.~~ DH delivers the software electronically to WK. WK then ~~resells the same~~ software to its customers, who download the software from WK. Sales of prewritten computer software by Income to DH are is subject to wholesaling royalties B&O tax. Sales of prewritten computer software by WK to its customers are retail sales subject to retail sales tax.
 - WAC 458-20-15501(303)(a)(ii)(D) - (D) AJ Soft, Inc., is a software developer of architectural drafting software. AJ Soft enters into an agreement with DJ Sales, Inc. to sell AJ Soft's drafting software. DJ Sales must pay a fee for each copy DJ Sales sells through its website. AJ Soft does not allow DJ Sales to reproduce the drafting software. Customers download the software, but are unaware the software is downloaded directly from AJ Soft. AJ Soft is making a wholesale sale of software to DJ Sales subject to wholesaling B&O tax. DJ sales is making a retail sale to its Washington customers subject to retail sales tax.

Edits to all the examples addressing the retail sales by OX, SE, WK and DJ add the tax treatment for the retailer. The other changes to example (B) clarify what rights are being granted so that the example is not so conclusory. The Department edited the facts to clarify example (C), resulting in a different conclusion, to make the example clearer. Example (D) was then added to provide a clear example with the original conclusion from example (C).

7. WAC 458-20-15501(304)(a) –The first change to this subsection was to uniformly use the word “customer” throughout. The second was to take out the word “used” from the description of when retail sales tax applies to avoid confusion with use tax applications. The third was to add third parties to possible providers of hosted software and reference to the new subsection (401)(g). (a) **Retail sales of a site license.** Gross proceeds of sales of a site license to a consumer are subject to B&O tax under the retailing classification, whether or not ownership or title passes to the ~~buyer~~ consumer, and regardless of any express or implied restrictions upon the ~~buyer~~ consumer. Delivery occurs when and where ~~when any copy of the~~ prewritten computer software ~~to be used by the buyer created under~~ subject to the site license is received by the consumer, whether it is through tangible storage media or any electronic means, regardless of the method of delivery. See WAC 458-20-145 (sourcing) for more information on sourcing prewritten computer software. See also

WAC 458-20-197 (When tax liability arises) and WAC 458-20-199 (Accounting methods) for details regarding reporting procedures and revenue recognition of retail sales of a site license. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the ~~buyer~~ consumer in determining when and where the sale takes place. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.

If the prewritten software is hosted by the licensor or a third party for remote access by the licensee (e.g., an Application Service Provider (ASP)), then see ~~Part IV,~~ subsection (401)(g) of this section.

8. WAC 458-20-15501(304)(c) – The following edits were made: (c) **Use of a site license partly in this state and partly outside this state.** Where the use of a site license is partly in this state and partly outside this state, the part of the site license used by the person in this state is subject to use tax, provided Washington state sales tax was not previously paid. For example, a person purchases and takes delivery of a site license in California. Pursuant to the multiple site license agreement, this person is licensed to use one thousand copies of prewritten computer software, of which four hundred copies will be used in Washington. Use tax is due on the four hundred copies of prewritten computer software used in this state. If the prewritten software purchased by the licensee is delivered in Washington, then the entire charge for the site license is subject to retail sales tax if purchased from a seller responsible for collecting Washington's sales tax. ~~If the original prewritten computer software for which the site license was purchased and delivered in Washington, then the entire charge of the site license is subject to retail sales tax.~~ This edit clarifies that retail sales tax is only applicable to the charge for all site licenses when delivery occurs in Washington, otherwise, use tax applies to those site licenses used in Washington.
9. WAC 458-20-15501(304)(e)(i) – This subsection was edited to clarify the location of the taxpayer in the example. (i) DEF Computers, Inc., is located in Washington and sells in this state at retail a multiple site license of its prewritten computer software to P's Design, Inc.
10. WAC 458-20-15501(306)(b) – This subsection was changed to clarify the fact that two distinct sales occurred. (b) **Example.** Same facts as (a) of this subsection, except that ZZ ~~sells~~ makes two separate sales at retail of two types of prewritten computer software to ~~Customer~~ Jack. One is server software, and the other is client software (which is different from client access licenses). ZZ delivers the server software to Jack in Washington where Jack's server is located. ZZ delivers the client software to Jack outside Washington where all of Jack's personal computers are located. Only the sale of server software to Jack is subject to retailing B&O tax, and ZZ must collect retail sales tax from Jack for the same sale.
11. WAC 458-20-15501(307)(a)(vi)(A) – Reference to sales agreements was added to this example to better match the example to the explanation in this subsection. (A) Tee, Inc., is in need of financial modeling software that can tie into most of its existing computer systems. Because of its unique business, however, Tee needs the industry-wide computer software offered by PQR Computers, Inc., that is modified to meet the needs of Tee. Both Tee and PQR are in-state corporations, and the software is delivered in this state. PQR provides a separately stated charge to Tee for customization of prewritten computer software performed in this state that is supported by the terms of the sales agreement. PQR is subject to retailing B&O tax, and it must collect retail sales tax from Tee for the sale of prewritten computer software in Washington. PQR, in addition, is subject to service and other activities B&O tax for the customization of prewritten computer software in Washington.
12. WAC 458-20-15501(401)(a)(ii)(C) – This example was simplified by removing the reference to “on-line access.” (C) WW Travel, Inc., bills its customers a monthly fee for having ~~on-line~~ access to a travel reservation system that includes a charge for dedicated telephone lines. WW is subject to service and other activities B&O tax for providing information services, rather than a telecommunications service. The provider of dedicated telephone lines to WW must collect retail sales tax from WW on the sale of telecommunications service. WW is the consumer of telecommunications service.

13. WAC 458-20-15501(401)(g) – The title of this subsection was changed to reflect that access to software can be provided by other processes other than application service providers (ASP), such as Software as a Service (SaaS). (g) **Sales of remote access to applications prewritten software, provided by i.e. application service providers (ASPs) or Software as a Service (SAAS).** Gross income received for providing remote access to applications on the ASP's host's servers are subject to service and other activities B&O tax, when the service is performed in Washington. Sellers of remote access to applications (e.g., ASPs) may be able to apportion income if they perform activities in multiple states (i.e., servers used in multiple states to host the software). See WAC 458-20-194 (apportionment).

"ASP" means a provider that generally offers customers with electronic access to applications on the ASP's server. ASP generally does not provide computer software for customers to download. ASP, however, may provide downloadable codes in order for customers to access its applications on its server that are only incidental to the services provided to customers.

14. WAC 458-20-15501(401)(h)(i) – Reference to the B&O rate in RCW 82.04.280 for newspapers as defined in RCW 82.04.214 was added to this subsection. (i) **Sales of on-line advertising services.** Gross income received for on-line advertising services are subject to service and other activities B&O tax. See RCW 82.04.280 and RCW 82.04.214 for tax treatment of the electronic form of a printed newspaper.