

Cite as Det. No. 98-012, 17 WTD 247 (1998)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 98-012
)	
...)	Registration No. ...
)	FY. ... /Audit No. ...
)	

[1] WAC 458-20-155; RCW 82.04.440: RETAIL SALES TAX -- COMPUTER TRAINING -- DATA RETRIEVAL -- INFORMATION SERVICES. Charges for data retrieval, conversion, and transfer are not subject to retail sales tax if they are separately negotiated and severable from contracts for the purchase of canned software and its installation, in the same manner as training charges.

[2] RCW 82.04.050: RETAIL SALES TAX -- INSTALLATION CHARGES -- SERVICES IN RESPECT TO INSTALLATION. Installation planning, travel for installing software, preparing systems for installing software, and similar services are subject to retail sales tax, as services rendered in respect to the installation of software.

Headnotes are provided as a convenience for the reader and are not in any way part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Software company protests the assessment of retail sales tax on set up, data processing, and planning activities associated with installation services.¹

FACTS:

Mahan, A.L.J. -- The taxpayer is primarily involved in the development, sale, and installation of software for the seafood processing industry. Its main product is a package of accounting and inventory software. It also provides custom programming, training, consulting, and data processing services. Consultation commonly involves issues concerning communication and

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

data transmittal to and from remote locations, data capture and reconciliation, and the formatting of accounting data. It also sells annual upgrade and maintenance contracts.

For some of its long-term clients, the taxpayer will invoice them for any software purchases and will provide services on an hourly basis, without the use of a written contract. When it has a written contract, the taxpayer typically provides an estimated cost breakdown between “software” and “services”. Included in the cost breakdown for software is the software purchase and annual maintenance and support costs. Included in the service component are such items as “installation planning”, “software installation”, “Custom integration”, and “training”. The taxpayer did not charge retail sales tax on any of the costs it classified as service.

Most service work is billed on an hourly basis. The descriptions on the invoices do not directly correspond to cost details in the written contracts. For example, the invoices will have line items similar to the following: “PROGRAMMING Set up, installation, and training of GL and FT.” For each of its invoices the taxpayer keeps a Billing Worksheet that gives further detail for each line item on the invoice. The worksheet provides a breakdown of the time spent on specific tasks. In addition to detail items involving training, the worksheets included such items as “installation on-site”, “programming data conversion”, “travel” “retrieve data”, “data transfer” “set up of FP, GL systems”, “set up menus for data transfer”, and similar entries.

The Department of Revenue (Department) audited the taxpayer’s books and records for the January 1, 1991 through December 31, 1994 period. Under Schedule 5 of the assessment, the Department reclassified income identified under the invoices under the general description of “programming” as a retail sale. The Department reasoned the charges for software installation, planning installation, or any other items included in sale of canned software was part of the retail sale. Although the taxpayer agreed that installation was part of the retail sale, it did not agree that other charges were part of the installation and it should be able to separate out those charges. The Department reasoned:

The backup for [an] invoice may have 5 hours of data conversion, 5 hours of installation/setup planning, 5 hours of software installation, and 10 hours of configuration to existing hardware. You feel that the data conversion and planning should be broken out and treated as a service. We believe that all of these items are part of the same job, i.e., “setup xx system: or work order “Wyyyy” and that if some of the job is retail, all of the job is retail. You feel that the workorder is purely a somewhat arbitrary internal number you assign that doesn’t necessarily mean the various tasks (on the workorder) are linked. We feel that to break up an invoice beyond its line items is bifurcation which, as stated above, is not favored. One exception to this treatment was made regarding training. Training is an exception to the rule regarding the bifurcation of contracts. Where training could be segregated, on the invoice backup, it was allowed.

The taxpayer appealed and contends that services sold on an hourly basis that are not part of the installation or sale of the software should not be subject to retail sales tax. In support it cites Det. No. 89-43, 7 WTD 130-1 (1989).

ISSUES:

1. Can the taxpayer separate out charges for services other than training when it provides a detailed backup for training, installation, and other services?
2. If the taxpayer can separate out service charges from retail charges, to what extent can computer installation services be broken down and billed as separate service charges?

DISCUSSION:

1. Bifurcation

Charges for the sale of canned software are subject to retail sales tax. WAC 458-20-155 (Rule 155). In contrast, personal or professional services are not considered retail sales and, therefore, are not subject to sales or use tax. See RCW 82.04. 040, .050; WAC 458-20-138 (Rule 138); WAC 458-20-224 (Rule 224). Thus, payments to a vendor of canned software for training are not subject to sales or use tax when separately negotiated and severable from the purchase of the canned program. Det. No. 89-43, 7 WTD 130-1 (1989), aff'd, Det. No. 89-43A, 8 WTD 5 (1989). Rule 155 also provides that information services are taxable under the service and other business activities classification. See Det. No. 90-5, 9 WTD 51 (1990). Taxpayer argues that its charges for data conversion and other information services, like training, involve professional services and should not be subject to retail sales tax.

In order for such professional services to be excluded from sales tax, the charges for those services must be separately negotiated and severable from the charges for installation services and other charges subject to retail sales tax. In Det. No. 89-43A, which related to modifications to a canned program as well as custom programming, we stated:

It is important to note here that the work at issue was not performed pursuant to a single contract for a single, lump sum billing. Rather, the work constituted a combination of activities classifiable as either retailing or service activities. Taxpayer now claims to have documented the various activities. Accordingly, subject to confirmation of the claimed segregation of activities and charges, the taxpayer is entitled to the appropriate tax classification for each. See RCW 82.04.440.

The Department does not generally allow a single contract to be segregated unless there is a reasonable basis on which to do so. As we stated in Det. No. 89-433A, 11 WTD 313 (1992):

We do believe that bifurcation of a contract for taxation will be the unusual case. In most cases income from a performance contract will be taxed according to the primary nature of the activity. For example, income from processing for hire is taxed at the processing for hire rate even though some storage or other services are also involved.

In that case, segregation was allowed because the taxpayer's contract, which was negotiated before the work was performed, provided a reasonable basis for determining the value of the

various activities performed. See also Det. No. 92-183ER, 13 WTD 96 (1993)(the Department looks to the primary activity in order to identify the proper tax classification for work completed under that contract.); Det. No. 90-35A, 9 WTD 289 (1990)("the Department does not favor bifurcation"); Det. No. 91-163, 11 WTD 203 (1991)("We must determine the predominant nature of the contract to determine the business and occupation tax classification of the receipts received under its terms. We must also determine if it is a separate service, severable from the contract."). The burden of segregating taxable income from exempt income rests upon the taxpayer. See Tidewater Terminal Co. v. State, 60 Wn.2d 155, 372 P.2d 674 (1962) Generally, if a taxpayer engages in activities that are within the purview of two or more tax classifications, it will be taxable under each applicable classification. See RCW 82.04.440.

In this case, the charges for data retrieval, conversion, and transfer would not be subject to retail sales tax if they were separately negotiated and severable from the purchase of the canned software and its installation. Such charges are billed and separately identified in the same manner as the training charges. The Department has already concluded that, when such charges could be segregated on the invoice backup, they were treated as a service. Similarly, where the data and information service charges can be segregated on the invoice backup, they should be treated as a service.

2. Installation Charges.

The taxpayer contends that services not directly related to the actual installation of the software, e.g., installation planning, should not be subject to retail sales tax. However, services rendered in respect to the installation are part of a retail sale. In this regard, RCW 82.04.050 provides that a retail sale includes:

The term "sale at retail" or "retail sale" shall include the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following:

(a) The installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers, . . .

(Emphasis added.)

Accordingly, the charges subject to retail sales tax are more than the charges for the actual installation of the software. Installation planning, travel for installing the software, preparing systems for installing software, and the like would also be subject to retail sales tax as services rendered in respect to the installation of the software.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. To the extent the data processing and information service charges can be segregated on the invoice backup, they should be treated in the same manner as the training charges. Charges rendered in respect to the installation of the

software remain subject to retail sales tax. The case is remanded to the Audit Division for adjustment in accordance with this determination.

Dated this 26th day of February, 1998.