Cite as 4 WTD 327 (1987)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of)	D E T E R M I N A T I O N
)	No. 87-359
. . .)	Registration No. . . .

[1] **RULE 155:** RETAIL SALE -- "CANNED" SOFTWARE -- MODIFICATION OF -- CUSTOM SOFTWARE DISTINGUISHED. Payments for the license to use standard, prewritten software are subject to retail sales tax. "Canned" software does not become "custom" software, as that term is used in Rule 155, if the software is adapted to meet a customer's needs and/or because a customer spends a substantial fee to have the software installed.

[2] **RULE 155:** RETAIL SALE -- "CANNED" SOFTWARE -- PAYMENT FOR REVISION AND MAINTENANCE OF. Where payment for license to use "canned" software include maintenance and additions or improvements of or to the standard software functions, the total payment is subject to retail sales tax.

TAXPAYER REPRESENTED BY: . . .
. . .

DATE OF HEARING: July 14, 1987

NATURE OF ACTION:

The taxpayer protests the assessment of use tax and/or deferred sales tax on computer software.

FACTS AND ISSUES:

Frankel, A.L.J. -- The taxpayer's records were examined for the period October 1, 1982 through June 30, 1986. The audit disclosed taxes and interest owing in the amount of $ . . . . Assessment No. . . . in that amount was issued on November 18, 1986. The taxpayer paid the major portion of the assessment, but disputes the assessment relating to the use tax on computer software (. . .).

At issue is the assessment of retail sales/use tax on monthly license and service fees paid by the taxpayer for a television traffic and accounting minicomputer system. The system is comprised of hardware and a nontransferable "license" to use software. The purchase agreement states the following purchase terms:

Customer hereby agrees to purchase [seller]'s Television Traffic and Accounting minicomputer system (the "System"), comprised of the Hardware and a nonexclusive, non-transferable license to utilize the Software. Customer shall pay a basic purchase price of $59,913.00 for the Hardware and an additional monthly Software license and service fee of $2,000.00 for the first thirty-six (36) months of this Agreement. Additionally , Customer shall pay an initial Software installation charge of $12,000.00 upon execution of this Agreement, for installation of the Software on Exhibit B and $5,000 for installation of the Software on Exhibit C, if utilized. . . .

> "Software" is defined as:
>
> > The electronic data processing systems [seller] developed for television stations to perform traffic and accounting functions and any improvements, additions or modifications thereof during the life of this agreement compatible with the Hardware, as specified on Exhibits B and C to this Agreement.

Tax was assessed because the auditor found the software that was purchased was standard, prewritten software which had been developed for television stations. The auditor relied on WAC 458-20-155 and assessed use tax after August 7, 1985 on the total monthly software license and service fees.

The taxpayer argues that because it was required to expend $12,000 for adaptation and installation of the software, the software was converted to a "custom program." The taxpayer contends that the expenditure of $12,000 is not an "incidental modification" envisioned by the language in Rule 155. The

taxpayer contends that because the software was adapted at considerable expense to meet its specific needs, the license and service fee is for a service and not subject to the sales or use tax.

In the alternative, the taxpayer contends the monthly fee should be apportioned to reflect an amount for services and an amount for the license to use the software. The taxpayer argues that only the portion for the license to use the software should be subject to retail sales tax.

DISCUSSION:

[1] Excise Tax Bulletin 515.04.155 issued in 1979 distinguished standard, prewritten, canned software programs and custom produced, one-of-a-kind programs developed for the express, exclusive needs of a particular user. Rule 155 contains the same distinction. The Department's position has been, and is, that "canned," off-the-shelf software programs constitute tangible personal property.

Prior to the adoption of revised Rule 155 in 1985, however, transfers of computer software under license to use agreements were treated as professional services not subject to sales or use tax. The Department distinguished a license to use from a lease or sale because a license to use did not convey unconditional possession or use to the customer.

The Department reconsidered its position and revised Rule 155 effective August 7, 1985. The rule states all licenses to use standard, pre-written software are sales of tangible personal property. The taxpayer is not contending that the assessment is invalid because it is on payments for a license to use software. Rather, the taxpayer contends the assessment is invalid because payments are not for the use of "standard" software. We disagree.

The software at issue was pre-written software developed for television stations. The software was not written to satisfy the particular needs of the taxpayer. Sales of canned software programs are subject to sales/use tax, notwithstanding some modifications to the program to suit a customer's needs.

In this case, the purchase agreement required the taxpayer to pay a "software installation charge." The fact that the installation charge might not be considered "incidental" does

not mean that the software program itself became a "custom" program.

Prewritten, off-the-shelf, or canned programs are generally those that include prepackaged bookkeeping or payroll programs, word processing programs, and video game cartridges. Custom programs are those developed from scratch or those uniquely designed and custom tailored to meet the customer's specific requirements. A canned program does not become custom because it is adapted to suit a customer's needs. For example, a payroll program might be adapted to add dates, names, or additional items to suit a customer's needs. That alone would not make the prewritten program "custom."

[2] Because we find that the licensing of the computer product is a sale or lease of a product and subject to the retail sales tax, we next consider the taxpayer's argument that part of the monthly fee is for "service" and should not be subject to retail sales tax.

The purchase agreement provided for the maintenance and improvement of the software:

> In addition to the Software, [seller] shall furnish, at no additional charge to Customer, all normal service, maintenance and additions or improvements of or to its standard traffic and accounting software functions, except as otherwise provided herein. Changes in the form of new releases and revisions must be accepted by Customer. Such service and maintenance of the Software by [seller] shall be subject to Customer's making the entire System available to [seller] for service and maintenance upon reasonable notice. [Seller] shall not be responsible for any malfunction or failure of the System unless the System is made available for preventive maintenance, service, correction or improvement during normal working hours. (Emphasis added.)

Any portion of the payment that is to add or improve the standard program in the form of new releases and revisions is not customized but is also in the nature of "canned" or "off-the-shelf" software. Such charges would also be subject to retail sales tax. Also, even if stated separately, charges for service and maintenance contracts are retail sales subject to retail sales tax. WAC 458-20-107. We find, therefore,

that the assessment of retail sales tax on the total payment is valid.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 9th day of December 1987.