

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

In the Matter of the Petition) D E T E R M I N A T I O N
For Correction of Assessment of)
) No. 89-43

)
 . . .) Registration No. . . .
) . . . /Audit No. . . .
)

- [1] **RULE 155:** RETAIL SALES TAX -- USE TAX -- SOFTWARE -- CANNED OR CUSTOM -- LIMITED AVAILABILITY. Payments to an out-of-state software provider are subject to sales or use tax for a standard, pre-written program. A program not written for the specific purchaser constitutes a canned program regardless of its limited availability in Washington.
- [2] **RULE 155:** RETAIL SALES TAX -- USE TAX -- SOFTWARE -- PROGRAM MODIFICATION -- ALTERATIONS TO CANNED PROGRAM. Payments to an independent, programmer to modify a taxpayer's canned program for the taxpayer's specific use are subject to sales or use tax.
- [3] **RULE 155:** RETAIL SALES TAX -- USE TAX -- COMPUTER TRAINING --EMPLOYEES -- CANNED PROGRAM. Payments to a vendor of canned computer programs for the training of employees to use those programs are not subject to sales or use tax when separately negotiated and severable from purchase of the canned program.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: January 3, 1989

NATURE OF ACTION

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

FACTS AND ISSUES

Pree, A.L.J. -- [C] , the taxpayer, is a Washington Corporation which manufactures and distributes heating and ventilating supplies. In April 1987 [C] purchased computer software [S] for its . . . Computer at a cost of \$50,000. The software was purchased from [X] to assist the sales and purchasing functions of the taxpayer and was used to prepare the general ledger. The taxpayer was unable to find a program to suit its needs in Washington and finally purchased the [S] program in another state. The program was used by approximately 300 other businesses at that time. No sales or use tax was paid at the time of purchase.

[C] separately negotiated with [X] to train [C] 's employees regarding the use of [S] . [X] agreed to provide a[n] [X] employee to train [C] employees at the rate of \$700. per day plus expenses. This was not a special rate, nor was it limited to (or required for) [X] customers who purchased [S] . The training cost [C] \$19,190.65. No sales or use tax was paid for the training.

After using the software, the taxpayer found the program inadequate for all its needs and cumbersome. The taxpayer hired a local programmer, [L], to modify [S] . [L] was not related to [X]. [L] altered the [S] program, improving the cash sales program, pricing matrix, and making other modifications to adapt the program to the taxpayer's needs and make it more efficient. The services were performed at the taxpayer's place of business as well as at [L] in Washington with those changes transmitted over the phone. The [L] modifications cost the taxpayer \$28,131.68 for which no sales or use tax was paid.

When the taxpayer was audited for the period from January 1, 1984 through March 31, 1988, the auditor assessed retail sales tax on the software purchase, its modification, and the training, as well as other adjustments which the taxpayer did not dispute. The taxpayer petitioned for correction of assessment, arguing that the computer software, training, and modification were services not subject to sales tax.

DISCUSSION:

[1] RCW 82.12.020 imposes use tax on the privilege of using within this state articles of tangible personal property purchased at retail. WAC 458-20-155 (Rule 155) provides:

"The use tax applies upon the full value of computer systems, hardware, equipment, standard, prewritten software, and materials which are used by consumers in this state and upon which the retail sales tax has not been paid. The person liable for the tax is the user."

The rule distinguishes between custom programs written to meet a particular customer's specific needs which are considered to be a service not subject to retail sales tax or use tax, and standard prewritten programs which are considered to be tangible personal property subject to retail sales tax or use tax.

In a prior determination, Det. 87-359, 4 WTD 327 (1987), the administrative law judge stated:

"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.'"

After purchasing its computer, the taxpayer was unable to find a suitable software program for its sales and purchasing functions in Washington and eventually purchased the [S] program from [X]. The [S] program was not designed specifically for the taxpayer and was used by approximately 300 other companies when purchased by the taxpayer.

Since the program was not designed specifically for the taxpayer, but in fact was used by other taxpayers, it was a prewritten, off-the-shelf, canned program. The \$50,000. cost is subject to retail sales tax or use tax.

The taxpayer contends that since the tangible personal property (magnetic tape or disc) in the transaction is

insignificant in cost relative to the professional services (information) transmitted on it, the transaction should be exempt from sales tax as a service rather than taxable as tangible personal property. The taxpayer compares taxation of computer software as tangible personal property to the taxation of professional services of attorneys and accountants as tangible personal property if transmitted to clients on paper.

When using that analogy, the taxpayer overlooks that attorneys and accountants are performing services for particular clients similar to a "custom" program. If they produce forms or write books for public sale and use, retail sales or use tax is imposed similar to the treatment of "canned" computer programs.

In this determination, however, we are not dealing with analogies, but a rule which says standard, prewritten, software programs are articles of tangible personal property subject to retail sales tax or use tax. RCW 82.32.300 provides in part as follows:

"The administration of this and chapters 82.04 through 82.28 RCW of this title is vested in the department of revenue which shall prescribe forms and rules of procedure for the determination of the taxable status of any person, for the making of returns and for the ascertainment, assessment and collection of taxes and penalties imposed thereunder.

The department of revenue shall make and publish rules and regulations, not inconsistent therewith, necessary to enforce their provisions, which shall have the same force and effect as if specifically included therein, unless declared invalid by the judgment of a court of record not appealed from."

The rule has not been declared invalid, and therefore, has the force and effect of law. The software purchased by the taxpayer is subject to retail sales or use tax.

[2] RCW 82.08.020 imposes tax on retail sales. RCW 82.04.050(2) defines retail sales as:

"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,. . ."

Regarding alteration or modification charges for computer software, Rule 155 states:

"The retail sales tax also applies to all charges to users for the repair, maintenance, alteration, or modification of hardware, equipment, and/or standard, prewritten software or materials."

The taxpayer hired a programmer, independent of the software vendor from whom the "canned" program was purchased. The programmer was requested to modify the [S] program to run more efficiently in performing special functions for the taxpayer. Although the programming was only done for the taxpayer, it consisted of adding to and altering existing software rather than creating a new, custom program.

Rule 155 specifically states that the retail sales tax applies to the alteration or modification of standard, prewritten software. The rule does not differentiate between alteration or modification done by the vendor or an independent programmer. If the program is "canned", any modification to it is subject to retail sales tax under the rule. Therefore, the \$28,131.68 paid to [L] to modify the [S] program is subject to retail sales tax.

[3] Retail sales tax and use tax are imposed on the sale or use of tangible personal property. WAC 458-20-138 states that the retail sales tax does not apply to the amount charged or received for the rendition of personal services to others. Unlike modifications or alterations to "canned" computer software, Rule 155 does not address or mention training costs.

The taxpayer paid the software vendor, [X], \$19,190.65 to train its employees to use the software. [X] agreed to send one of its employees to the taxpayer to provide the training at the rate of \$700. per day plus expenses. The taxpayer was not required to have [X] provide the training as part of the purchase, nor did the taxpayer receive a special rate on the training because of the software purchase or discount on the software because of the training. Since the agreement was to provide training, a service, and retail sales tax or use tax is only imposed on tangible personal property, no sales or use tax is due on the cost of training.

DECISION AND DISPOSITION:

The taxpayer's petition is denied regarding issue [1] for the purchase of software and issue [2] for the modification of the software and the assessment of retail sales or use tax on the amounts of \$50,000. and \$28,131.68 respectively. The taxpayer's petition regarding issue [3], the assessment of sales tax on training costs of \$19,190.65 is granted. This matter will be referred to the Audit Division which will issue an amended assessment in accordance with this Determination.

DATED this 20th day of January 1989.