Cite as Det. No. 95-252, 16 WTD 56 (1995)

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. 95-252
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

RULE 155: "CANNED" SOFTWARE -- DATABASE -- MODIFICATION. Charges for modifications to standard, prewritten software are retail sales. However, applications written from "scratch" to run with database programs constitute separate custom programs rather than modifications if the original program was not altered.

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

NATURE OF ACTION:

A computer service provider protests the reclassification of data base development and installation from service to retail.[1]

FACTS:

Pree, A.L.J. -- The taxpayer provides computer services. The taxpayer creates unique applications for customers using database software.

The taxpayer was audited for the period from January 1, 1991 through September 30, 1994. The Audit Division reclassified some of the taxpayer's charges from service to retail and assessed retail sales tax. The taxpayer appealed.

ISSUES:

Two activities are at issue which the taxpayer identifies as "Database Services" and "Installation Services". In Database development, the taxpayer designs new fields or applications to meet the customer's special needs. These applications are programs written by the taxpayer from "scratch" designed to run with copyrighted, prewritten programs generally referred to as database software.

The taxpayer identifies the fields with names and gives them certain properties (text numerical, calculation, date, time picture summary, and restrictions of data input). The taxpayer creates data

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

entry screens. He designs report and query screens for printing. He automates complex data gathering tasks. While the taxpayer designs these applications to run with the database program; the copyrighted, prewritten program itself is not altered or modified.

The taxpayer performed installation services by installing or loading the programs on the customer's hardware. Customers, rather than the taxpayer, actually entered data.

DISCUSSION:

RCW 82.08.020 imposes retail sales tax on retail sales in Washington. Retail sales are defined in RCW 82.04.050. That definition includes the charge made for tangible personal property as well as services rendered in respect to the installing, repairing, altering, or improving of tangible personal property of or for consumers. The statute does not address charges regarding software. WAC 458-20-155 (Rule 155) is the Department's duly promulgated excise tax regulation regarding computer issues.

Rule 155 provides that liability for sales tax or use tax depends upon whether the subject of the sale is a product or a service. Sales of software in connection with custom programs written to meet a particular customer's specific needs are classified as a service and are not subject to retail sales tax or use tax. The programs are considered to be the tangible evidence of a professional service rendered to a client.

On the other hand, Rule 155 states:

. . . the sale, lease, or licensing of the computer program is a sale or lease of a product, even though produced through a computer system or process, it is taxable as a retail sale. Standard, prewritten software programs do not constitute professional services rendered to meet the particular needs of specific customers, but rather, are essentially sales of articles of tangible personal property. Articles of this type are no different from a usual inventory of tangible personal property held for sale or lease and, irrespective of any incidental modifications to the program medium or its environment (e.g., adaptation to computer room configuration) to meet a particular customer's needs, the sale or lease of such standard software is a sale at retail subject to retail sales tax or use tax.

. . .

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 Audit Division concluded that the applications made by the taxpayer were modifications to standard, prewritten software. The database programs were standard, prewritten programs. Therefore, the Audit Division concluded that retail sales tax applied to any charges for the applications.

However, the taxpayer indicates that original database programs were not altered or modified. Rather, the taxpayer created new databases composed of elements called fields. The taxpayer created the fields from "scratch" giving them names and properties for a particular client.

If the taxpayer is correct in stating that the original database program was not modified, we agree that in the end the customer will have two computer programs. One program will be the original "canned" database program. The second will be a custom program. The fact that the second will not run without the presence of the first program, does not make the second program a "canned" program or a modification of the first program. This is a little different than a program running with the Disk Operating System (DOS). An application program generally cannot run without the presence of the computer's operating system. Merely adding programs does not alter the system's programs.

Det. No. 89-43A, 8 WTD 5 (1989) (copy attached) was an executive level reconsideration by the Department of Det. No. 89-43, 7 WTD 130 (1989) involving modifications to a standard, prewritten or "canned" program. The final determination found that charges for additional programming "written from scratch" and designed to run in conjunction with a canned program were not subject to sales or use tax. Those activities were professional services. If we can separate the charges for the canned program from the charges for creating the applications from "scratch", we can trace them to specific activities taxable under separate classifications.[2]

[2] Proving whether the new application is separate from the original, standard database program is a factual question. One method may involve checking the original file creation date with the original vendor's program file creation date. The execution file should show when the database program was last modified. If

Rule 155 does not address charges for installing or loading software. RCW 82.04.050 includes installing tangible personal property in the definition of retail sale. The Audit Division reasons that the taxpayer's installation charge was for installing a standard, prewritten program. Under the same reasoning, installing custom programs would fall under the service rather than the retail classification.

Rule 155 defines the two types of programs:

The term "custom program" means software which is developed and produced by a provider exclusively for a specific user, and which is of an original, one-of-a-kind nature.

The term "standard, prewritten program," sometimes referred to as "canned" or "off-the-shelf" software, means software which is not originally developed and produced for the user.

Charges for installing or loading custom programs are classified as a service, not subject to retail sales or use tax. Charges for loading standard prewritten programs are subject to retail sales tax.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part subject to verification. To the extent that the taxpayer verifies to the Audit Division that its database service charges were for unique applications rather than modifications to the underlying software, the assessment will be revised. Similarly, to the extent that the taxpayer verifies that its installation charges were for custom programs or services other than installing standard, prewritten programs relief will be granted.

The taxpayer has thirty (30) days from the date of this determination to make such information available to the Audit Division. If supporting records are provided, the taxpayer will be issued a revised assessment with a new due date.

DATED this 29th day of December, 1995.

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it matches the original vendor's creation date, the program was not modified by the taxpayer.