

Cite as Det. No. 98-049R, 19 WTD 316 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>F I N A L</u>
Assessment of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 98- 049R
)	
...)	Registration No. . . .
)	FY. . . /Audit No. . . .
)	Appeal of Det. No. 98-049

RULE 112, RULE 155; RCW 82.04.040, RCW 82.04.450: MANUFACTURING B&O – VALUE OF CANNED SOFTWARE – LEASED – LICENSED -- OUT-OF-STATE. A company that produces canned software in Washington, which leases or licenses the software to out-of-state users is subject to manufacturing B&O tax measured by the gross proceeds of sales, the total realized in lease or license fees from its customers for the software.

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 software company protests the measure of manufacturing B&O tax.¹

FACTS:

M. Pree, A.L.J. -- . . . [Taxpayer] provides computer software to businesses The software allows the [businesses] to communicate. By sharing research, strategies, and . . . offers, the taxpayer's customers can efficiently manage their [business]. Customers' . . . could access each other's data through a server located at the taxpayer's Washington headquarters. The database remains at the customers' locations.

The Department of Revenue (Department) reviewed the taxpayer's books and records for the period January 1, 1992 through September 30, 1995. The Department's Audit Division issued Assessment No. . . . on November 13, 1996. The assessment was revised by a post assessment

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

adjustment, . . . issued October 8, 1997 showing a total tax and interest due and assessed at that time of On March 31, 1998 we issued Determination No. 98-049 remanding the assessment to the Audit Division. The taxpayer requests reconsideration of that determination with additional clarification of how to value and apportion its receipts.

In Determination No. 98-049 we determined that the taxpayer's customers paid the taxpayer for licenses to use its software.² Normally, these receipts would be taxable under the retail business and occupation (B&O) tax classification. The taxpayer developed and produced the software in Washington. It delivered the software to its customers, most of whom were located outside of Washington. In the case of software produced in Washington, but delivered outside the state, the taxpayer's manufacturing activity was subject to B&O tax. While the Audit Division and the taxpayer do not dispute imposing the manufacturing B&O tax, they recognize a potential issue regarding how that tax is measured under these circumstances. This determination will address the taxpayer's measure of manufacturing B&O tax.

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ISSUE:

What is the measure of manufacturing B&O tax imposed upon the activity of producing software in Washington, which the manufacturer licenses for use outside the state?

DISCUSSION:

Washington imposes B&O tax upon the value of products manufactured in Washington regardless of the fact that deliveries may be made to points outside the state. RCW 82.04.240. Regarding the production of computer software, WAC 458-20-155 (Rule 155) provides in part:

Persons who produce computer systems, hardware, equipment, standard, prewritten software, and materials in this state and who sell, lease, license, or otherwise transfer such things to buyers outside this state and deliver such things outside this state are not subject to either retailing or wholesaling business tax. Such persons are subject to the Manufacturing classification of business and occupation tax. See WAC 458-20-136. The measure of tax is the full value of the product manufactured. See WAC 458- 20-112.

WAC 458-20-112 (Rule 112) and RCW 82.04.450 direct us to value products from the gross proceeds derived from the sales of the products. Sales include renting or leasing products or any contract under which the purchaser obtains possession, but title is retained by the vendor. RCW 82.04.040. We recognize that the taxpayer does not sell title to the software.

² The taxpayer provided the server, a communication link in Washington. Unlike an internet web site, the taxpayer did not maintain the database. Customers, most of whom were located outside of Washington, maintained the data. We found that under the terms of the taxpayer's contracts, the customers paid the receipts in question for the licensing rights to use the taxpayer's unique software.

The Department recognizes the intangible value intrinsic in software programs. *See* Det. No. 90-342, 10 WTD 123 (1990); and Det. No. 92-340, 11 WTD 547 (1992). Receipts from sales best measure the value. In Det. No. 98-049, this taxpayer argued it produced canned software rather than custom software because the taxpayer did not realize its costs on a sale to a single customer. We agreed with the taxpayer. We reasoned the value of products (software) produced and sold by a for-profit business should not exceed the taxpayer's costs. When the proceeds from a single sale were insufficient to justify the single sale, we agreed the taxpayer contemplated additional sales. The additional sales or proceeds from licensing reflect the software's value.

According to the usual definition, a lease is a contract whereby one party gives to another the right to the use and possession of property for a specified time and, ordinarily, for fixed payments. The right to continued possession under a lease is conditioned upon the payment of rentals and performance of other covenants. Det. No. 88-258, 6 WTD 141 (1988). A lease is not a single transaction, but a series of transactions. *Gandy v. State*, 57 Wn. (2d) 690, 695, 359 P. (2d) 302 (1961). In this case, the taxpayer leases or licenses its customers to use the software while the taxpayer retains title. The gross proceeds the taxpayer derives from these licenses constitute the value of the software and should be used as the taxpayer's measure of manufacturing B&O tax.

DECISION AND DISPOSITION:

The file is remanded to the Audit Division to issue a post audit adjustment consistent with this determination and Det. No. 98-049.

Dated this 18th day of May 1999.