

Cite as Det. No. 23-0004, 45 WTD 013 (2026)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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>
Tax Ruling of)	
)	No. 23-0004
)	
...)	Registration No. . . .
)	

[1] RCW 82.04.050(8)(b): RETAIL SALE – SERVICES PROVIDED EXCLUSIVELY IN CONNECTION WITH DIGITAL AUTOMATED SERVICES. Customization services provided exclusively in connection with the implementation of digital automated services are included in the retail sale of digital automated services.

[2] RCW 82.08.010(1)(a)(i): RETAIL SALE – COST REIMBURSEMENTS – TRAVEL, LODGING, AND FOOD. Cost reimbursements for travel, lodging, and food expenses incurred as part of a contract to implement digital automated services are taxed in the same manner as the associated digital automated services and are, therefore, subject to retail sales tax.

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.

Sattelberg, T.R.O. – A software services provider protests the Department’s tax ruling dated September 21, 2022. The software provider argues that the Department’s Taxpayer Information and Education (TI&E) section erroneously concluded that its time and materials transactions, as well as its time and expense transactions, were subject to retail sales tax. We deny the petition.¹

ISSUES

1. Whether a software services provider’s time and materials transactions are subject to retail sales tax as services provided exclusively in connection with a digital automated service under RCW 82.04.050(8)(b) and RCW 82.08.020(1)(b), or whether they are not subject to retail sales tax as the customization of prewritten computer software under RCW 82.04.050(6)(b)(ii) and WAC 458-20-15502(7)(a).
2. Whether a software services provider’s cost reimbursements for travel, lodging, and food are subject to retail sales tax under RCW 82.08.020.

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

FINDINGS OF FACT

... (Taxpayer) offers software-as-a-service to state and local governments in the United States and across the globe. Taxpayer's main offering, [Platform], allows governments to interact with the public in many different ways, including licensing, permitting, environmental health, and fire prevention. Taxpayer bills its [Platform] subscribers monthly or yearly.

In 2016, Taxpayer launched [Software], a payment processing software that integrates with Taxpayer's [Platform]. [Software] allows governments to accept payment for numerous services, including utility bills, licenses, code violations, and permits. Through [Software], citizens can make multiple payments and view them in real time payments, and make them from any internet-connected device. [Software] is Payment Card Industry compliant, and offers payment data security through encryption and by meeting other Payment Card Industry standards. Governments can subscribe to [Platform] and [Software] independently of each other, or subscribe to both.²

In order for a government to adopt Taxpayer's [Platform] or [Software], Taxpayer will create a project plan and work through the software implementation process. Taxpayer's generic Statement of Work provides these four general implementation steps:

Stage Title	Stage Overview	Activities and Artifacts
Stage 1: Define	The Define stage sets the framework for how the project will be managed throughout the project life cycle.	<ul style="list-style-type: none"> • Project Schedule • Project Management Plan • Project Kickoff • Solution Provisioning
Stage 2: Refine	The Refine stage begins the knowledge transfer of the Agency's [Platform] solution and promotes adoption of the new system. This stage completes the Agency-specific tailoring of the configuration.	<ul style="list-style-type: none"> • Core Team Training • Tailoring Sessions • Review and Verification testing • Conference Room Checkpoints • Integration Designs • Data Conversion Kickoff
Stage 3: Develop	The Develop stage builds upon the tailored solution from the Refine Stage adding automation, custom reports and integrations, and running the data conversion efforts. The result of this stage is a fully built solution ready for deployment.	<ul style="list-style-type: none"> • Business Automation Configuration • Custom Report development • Integration development • Data Conversion mock runs • Review and Verification testing • Conference Room Checkpoints
Stage 4: Deploy	After all development work has been completed, the system is ready for User Acceptance Testing and End User Training. The final data conversion and	<ul style="list-style-type: none"> • Training Plan • Test Plan and Test Cases • User Acceptance Testing • End User Training • Final extract for production

² Taxpayer has since sold [Software].

	cutover activities support Go-Live.	<ul style="list-style-type: none"> • Final conversion load into Production • Go Live Support and Transition to [Taxpayer] Customer Support
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Taxpayer customizes either [Platform] or [Software], or both, to suit the specific needs of the governmental entity, as governmental functions can vary from jurisdiction to jurisdiction.

On February 22, 2022, Taxpayer wrote to TI&E requesting a tax ruling regarding the taxability of:

[1.] Web Payment Transactions. These type of invoices were for a transaction fee that [Taxpayer] received when someone uses the product. For example, Our Customer (City A) has a customer go online and make a payment, [Taxpayer] would get a fee for that transaction, be it \$1 or less each time it was used.

[2.] Time and Material Transactions. These type of invoices are issued for Professional Service work that is being done on a specific project. For example, a customer may purchase [Professional Service] hours to help with the migration, back end assistance for implementing the product or however they elect to use it. Each grouping of hours is specific to the customized environment they purchased. There wouldn't be a same environment for multiple customers. City A and City B would need different levels of assistance because their data and software environment would be different. The scope of the project would be different as well.

[3.] Time and Expense Transactions. These types of invoices are for our Customer reimbursing [Taxpayer] for specific agreed upon charges. For example, airfare, rental car, hotel and food. These expenses would have been for what we had staff that was sent onsite to work with our customer. There isn't a profit made on these expenses, it is just for reimbursement that our employee incurred.

On September 21, 2022, TI&E issued Taxpayer a tax ruling that each of the three types of transactions were retail sales subject to retail sales tax and retailing B&O tax. The tax ruling opened by stating that the [Platform] is a digital automated service, which are taxed as retail sales. TI&E noted that even though Taxpayer had not requested a tax ruling about its [Platform], the taxability of the [Platform] was central to the taxability of the other items raised.

The tax ruling stated that Taxpayer's web payment transactions were retail sales because Taxpayer's [Software] was a stand-alone digital automated service. The tax ruling stated that Taxpayer's time and material transactions were provided exclusively in connection with the [Platform], a digital automated service, so they were taxed like the [Platform]. Finally, the tax ruling stated that Taxpayer's time and expense transactions were also considered retail sales because they were cost reimbursements associated with the [Platform], a digital automated service.

The tax ruling included the following additional information:

- In addition to the subscription fee, [Taxpayer] charged subscribers an additional fee for each transaction processed through [Software]. This per-transaction fee corresponds to the “web payment processing” fees described in [Taxpayer] ruling request. [Taxpayer] has not requested a ruling as to the taxability of the separately charged [Software] subscription fees.
- [Taxpayer] reports that it relied on a third-party company to provide the payment processing capability for [Software]. [Taxpayer] has not provided documentation outlining its relationship with the third-party payment processor.

TI&E tax ruling dated September 21, 2022, at 2.

Taxpayer timely sought partial review of the September 21, 2022, tax ruling. Taxpayer did not dispute the web payment transactions portion of the tax ruling, but did dispute the other two sections. Taxpayer argues that time and materials transactions are the customization of prewritten computer software, which is not taxed as a retail sale. Taxpayer also argues that it should not be charging its customers retail sales tax for its time and expense transactions, or cost reimbursements, as it has already paid retail sales tax at the time of purchase of its travel and lodging.

In support of its petition, Taxpayer submitted materials previously provided to TI&E: a Statement of Work template, excerpted above; several invoices to different Washington government customers that show that it was not collecting retail sales tax; and a couple hotel receipts for employee stays in Washington.

ANALYSIS

Washington imposes retail sales tax and retailing B&O tax on each retail sale in this state. RCW 82.08.020; RCW 82.04.250. Persons who charge for services defined as retail sales are required to collect and remit retail sales tax and pay retailing B&O tax. *See* RCW 82.08.020; RCW 82.08.050; RCW 82.04.250. If a seller fails to collect the retail sales tax, whether such failure is the result of the seller’s own acts or the result of acts or conditions beyond the seller’s control, the seller is, nevertheless, personally liable to the state for the amount of the tax. RCW 82.08.050(1) and (3).

1. Time and Materials Transactions

RCW 82.04.050(8) defines the term “retail sale” to include:

- (a) . . . [S]ales to consumers of . . . digital automated services . . .
- (b) *A retail sale of . . . digital automated services under the subsection (8) includes any services provided by the seller exclusively in connection with the . . . digital automated services, whether or not a separate charge is made for such services.*

(Emphasis added.)

“Digital automated services” is defined as “any service transferred electronically that uses one or more software applications.” RCW 82.04.192(3)(a). “Transferred electronically” means “obtained by the purchaser by means other than tangible storage media.” RCW 82.04.192(8). As Taxpayer’s [Platform] and [Software] are both obtained by their customer governments by means other than tangible media, they are “transferred electronically.”

“Computer software” is defined as “a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task.” RCW 82.04.215(2). As Taxpayer’s [Platform] and [Software] are both sets of coded instructions designed to cause a computer or automatic data processing equipment to perform a task, they are computer software. Since Taxpayer’s [Platform] and [Software] are both computer “software” that is “transferred electronically,” both applications are considered digital automated services.

Taxpayer has not disputed TI&E’s tax ruling stating that Taxpayer’s [Software] is a digital automated service, nor has Taxpayer contested the tax ruling’s conclusion that its [Platform] is also a digital automated service. As both of these services are digital automated services, any services provided “exclusively in connection with” them are also considered retail sales under RCW 82.04.050(8)(b).

Taxpayer states that its time and materials transactions happen as a result of its projects to implement its [Platform] or [Software] digital automated services for its government customers. The invoices Taxpayer provided do not show otherwise. A customer would not incur time and materials transactions were it not implementing [Platform] or [Software], and Taxpayer does not appear to sell these services separately from such an implementation. Thus, as far as we are aware, these services are provided exclusively in connection with Taxpayer’s digital automated services. As such, they too are considered retail sales under RCW 82.04.050(8)(b).

Taxpayer argues that its time and materials transactions should be carved out of digital automated services as the customization of prewritten computer software. [RCW 82.04.050(6)(b)(ii) excludes from the definition of “retail sale” the sale of or charges made for “the customization of prewritten computer software.”] “Customization of prewritten computer software” means “any alteration, modification, or development of applications using or incorporating prewritten computer software for a specific person.” RCW 82.04.215(4). “Customization of prewritten computer software” includes “individualized configuration of software to work with other software and computer hardware but does not include routine installation.” *Id.* [However, remote access prewritten software is only excluded from the definition of digital automated services if it is “provided on a standalone basis.” WAC 458-20-15503(303)(h). *See* RCW 82.04.192(3)(b)(viii). Remote access prewritten software “that is used in connection with a service that is transferred electronically would generally be included in the definition of a digital automated service.” *Id.* Taxpayer acknowledges that both its [Platform] and [Software] are digital automated services.]

We examined a similar issue in Det. No. 18-0109, 38 WTD 189 (2019). In 38 WTD 189, an electronic medical records provider offered a suite of services in connection with its electronic medical records platform. 38 WTD at 191. The services the taxpayer provided in addition to the electronic medical records platform included data hosting [and] help desk services . . . *Id.* at 190-92. While [help desk services and “mere” data and software storage] are generally considered non-

retail services, 38 WTD 189 held that the taxpayer’s main electronic medical records platform was a digital automated service, and that the other services were provided exclusively in connection with it. *Id.* at 195-96. [See RCW 82.04.192(3)(b)(xv).]

While we do not dispute that Taxpayer engages in the customization of its [Platform] and [Software] digital automated services for its customers, this customization is not provided outside of projects to implement those digital automated services. As in 38 WTD 189, the services Taxpayer argues should be carved out of digital automated services instead fall within [the retail sale of] digital automated services as services provided exclusively in connection with a digital automated service under RCW 82.04.050(8)(b). Accordingly, TI&E correctly concluded these transactions were subject to retail sales tax, and we deny Taxpayer’s petition on this issue.

2. Cost Reimbursements

RCW 82.08.010 defines “sales price” to mean:

[T]he total amount of consideration, except separately stated trade-in property of like kind, including cash, credit, property, and services, for which tangible personal property, extended warranties, digital goods, digital codes, digital automated services, or other services or anything else defined as a “retail sale” under RCW 82.04.050 are sold, leased, or rented, valued in money, whether received in money or otherwise.

RCW 82.08.010(1)(a)(i) (emphasis added).

The Department has this general information available regarding the taxability of cost reimbursements:

Are cost reimbursements taxable?

Generally, yes. The amounts that you bill your customers (to cover business costs) are subject to tax.

...

Example 2

Build Co. is a construction company in Kent. The company will perform the construction on the above project in Spokane for Liddle Company. Under the agreement, Larry from Build Co. is reimbursed for fuel to get his equipment to and from the construction site, meals and lodging while in Spokane.

The gross income from Build Co.’s services is generally taxable under the Retailing classification of the B&O tax. The contractor must also collect and remit Retail Sales tax on the gross charges. The gross income from this project includes the amount that Liddle Company reimburses Larry to cover his fuel, meals and lodging.

Department's Tax Topic regarding Cost Reimbursements.³

Taxpayer's time and expense transactions are incurred during the implementation of one or both of its digital automated services, but these transactions are not for "services" like with Taxpayer's time and materials transactions. Instead, these transactions are for the reimbursement of employee costs for travel, lodging, and food that Taxpayer incurs during a digital automated service implementation. Since the cost reimbursements are part of Taxpayer's gross income, their taxation follows that of the underlying sale, as indicated in the tax guidance above.

Here, Taxpayer's cost reimbursements are taxed in the same manner as their digital automated services as they are included in the sales price under RCW 82.08.010(1)(a)(i), which are subject to retail sales tax under RCW 82.08.020.⁴ Accordingly, TI&E correctly concluded these transactions were also subject to retail sales tax, and we deny Taxpayer's petition on this issue.

DECISION AND DISPOSITION

[Taxpayer's petition is denied.]

Dated this 5th day of January 2023.

³ <https://dor.wa.gov/forms-publications/publications-subject/tax-topics/cost-reimbursements> (last visited December 19, 2022)

⁴ Reimbursed costs for travel and lodging are not eligible for a tax paid at source deduction as Taxpayer does not resell them.