

STATE OF COLORADO

DEPARTMENT OF REVENUE
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PLR-13-003

August 7, 2013

XXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: Private Letter Ruling

Dear XXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXXXXXXXXXXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24-35-103.5. This letter is the Department's private letter ruling.

Issues

Are the sale of the Company's computer software and computer software maintenance contracts subject to sales tax?

Conclusion

The sale of Company's computer software is subject to tax, even if the license agreement is not contained in a "tear open" format, if the license at issue in the transaction is not subject to negotiation. Licenses for XXXXXXXXX products are not negotiable because the customers have only the option of an online "click" agreement and, thus, are subject to tax. Licenses for XXXXXXXXXX and XXXXXXXXX software are subject to negotiation and therefore not subject to tax. Company's computer software maintenance contracts are subject to sales tax if the original software was subject to tax and the upgrades are delivered in a tangible medium.

Background

Company is a global provider of product lifecycle management (PLM) software. Company describes its software as follows:

1. Most licenses are perpetual licenses; however, some are term licenses where purchaser buys what is similar to a subscription for a period of a month or a year.
2. License agreements for XXXXXXXXXX products are an online "click" agreement where the licensee clicks to accept the terms and conditions of license and is nonnegotiable.

Conversely, XXXXXXXX and XXXXXXXX products have a license agreement that is signed by the licensee and is negotiable.

3. The software is prepackaged for repeated sale or license
4. The software is non-transferable and non-assignable without permission
5. The software is delivered to the customer in a tangible medium (unless the customer makes the election to acquire all materials via electronic download).

Company describes its software maintenance as follows:

1. Computer software maintenance is optional for the customer (i.e., the software will continue to function without being under a current maintenance contract).
2. The maintenance contract entitles the customer to hotline support and any updates/upgrades that become available during the maintenance period (typically twelve months).
3. The updates are delivered to the customer in a tangible medium (unless the customer makes the election to acquire all materials via electronic download).

Discussion

Software

Computer software, as defined in §39-26-102(15)(c)(I), C.R.S., that is sold on or after July 1, 2012.¹ is subject to Colorado sales or use tax if it meets the following criteria:

The software is prepackaged for repeated sale or license;
The use of the software is governed by a tear-open nonnegotiable license agreement;
The software is delivered to the customer in a tangible medium. Software is not delivered to the customer in a tangible medium if it is provided through an application service provider, delivered by electronic software delivery, or transferred by load and leave software delivery.

The Department has not independently verified Company's factual representations. These representations are presumed to be complete and accurate for purposes of this ruling. Based on these representations, Company's PLM software is normally subject to sales and use tax because they meet the above listed criteria. However, Company's PLM software is not subject to Colorado sales and use taxes if it is delivered electronically to the customer.

The only criteria for which there seems to be some doubt relates to the "tear-open

¹ Sale of standardized software that occurs between March 1, 2010 to June 30, 2012 are taxable. Such software is, for that time period, considered tangible personal property, regardless of how the standardized software is acquired by the purchaser or downloaded to the purchaser's computer.

"Standardized software" means:

Computer software, including prewritten upgrades that are not designated or developed to the specifications of a specific purchaser.

Computer software designed and developed to the specifications of a specific purchaser but then sold to another purchaser.

Software that is modified or enhanced even if such modification or enhancement is designed and developed to the specification of a purchaser.

Department FYI Tax Publication Sales 89, "Computer Software."

nonnegotiable license agreement.”² A license qualifies as a “tear-open” license even though the retailer offers the license online. “Tear-open” license agreements are those most commonly found when a customer purchases a CD of a software program from a store. Once the plastic packaging is torn off the CD case, the buyer can find the license agreement. These license agreements are generally not negotiable. However, it is not essential that the buyer has to actually tear something open in order to meet this criterion.³ For example, we believe this provision applies to licenses presented on the Internet when the buyer only has the option to click “I Agree” in order to purchase the software program.

Company states that some of its software licenses are subject to negotiation. Assuming there is a realistic opportunity for the purchaser to negotiate substantive terms of the license, Company’s sale of such software is not subject to sales or use tax, even if the buyer did not negotiate the terms of the license when it purchased the software. Company identified XXXXXXXX and XXXXXXXX as software products whose licenses are subject to negotiation.

Software Maintenance Agreements

Software maintenance agreements are not considered “standardized software,” but rather, are generally considered a service provided to a customer. Because maintenance agreements are generally viewed as a service, they are not subject to sales and use tax. However, mandatory maintenance agreements entered into from March 1, 2010 through June 30, 2012 that are inseparable from sale of “standardized software” and included in the purchase price of the “standardized software” are subject to sales tax.⁴ Maintenance agreements that include upgrades are taxable if the original computer software is taxable, unless the upgrades represent only a small portion of the seller’s cost of maintenance (e.g., less than 25% of the cost of the maintenance agreement). A maintenance agreement seller may elect to charge sales tax on the maintenance agreement to avoid having taxable and

² In general, software that is subject to Colorado sales and use tax is software whose programming is substantially complete, at least from the seller’s perspective, when delivered to the customer. This is not to say that the functions performed by the software or the programming itself cannot be subject to change if performed by the customer. For example, purchaser of Microsoft’s email software can make certain selections to alter how email is handled. Moreover, third party programmers may have the ability to modify and supplement the software’s programming to create an enhanced product.

This original software is subject to tax because the seller has no obligation to perform further programming. Conversely, the sale of modular software programs are subject to sales tax even if the software must undergo further programming in order to become fully functional if the software is offered for repeated sale “as is” by the seller, the seller does not perform any substantial programming of the software prior to the sale, the software license is non-negotiable, and the software is delivered other than by an ASP provider, electronically, or as a load and leave transaction. On the other hand, software that requires substantial programming by the seller to meet the needs of a customer is not “pre-packaged,” even though the software module represents the “core” of the software programming and is repeatedly resold to customers if the seller is obligated to the buyer to perform programming of the software as part of the sale of the software.

³ This conclusion is reinforced by the statutory definition of “prepackaged” software, in which the legislature notes that such software is “typically” sold in a shrink-wrapped box.

⁴ Department FYI Tax Publication Sales 70, “Warranties and Maintenance Agreements.” You can view this and other FYI Publications at www.colorado.gov/revenue/tax > Tax Library > FYI Publications > Sales.

nontaxable maintenance components.⁵

Company represents that its maintenance contracts are optional, provides upgrades and delivers the upgrades in a tangible medium, unless a customer elects to receive the upgrades via electronic download. Company must collect sales tax on charges for maintenance contracts when the original software was subject to sales or use tax, except if Company delivers the upgrade electronically. Company should not collect sales tax on maintenance contracts where the original software was not subject to sales or use tax.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. Please note that the Department administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home rule cities and counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

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Email: neil.tillquist@state.co.us

⁵ Department FYI Tax Publication Sales 89, "Computer Software."