

STATE OF COLORADO

DEPARTMENT OF REVENUE
State Capitol Annex
1375 Sherman Street, Room 409
Denver, Colorado 80261
Phone (303) 866-3091
FAX (303) 866-2400



John W. Hickenlooper
Governor

Barbara J. Brohl
Executive Director

GIL-13-007

May 14, 2013

XXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: Maintenance Agreements

Dear XXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXX ("Company") a request for guidance to determine whether a maintenance agreement is subject to tax under the rules governing software transactions from March 1, 2010 to June 30, 2012.

The Colorado Department of Revenue ("Department") issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues and is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department regulation 24-35-103.5 at www.colorado.gov/revenue/tax > Tax Library > Rulings.

The Department initially treats your request as one of a general information letter. If you would like the Department to issue a private letter ruling on the issues you raise, you can resubmit a request and fee in compliance with regulation 24-35-103.5. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not a determination of the tax consequence of any particular action or inaction.

Issue

Is the maintenance agreement subject to tax under the rules governing software transactions from March 1, 2010 to June 30, 2012?

Background

Company provides guidance to customers regarding Colorado State, state-administered cities and counties, special districts and home rule cities' sales and use tax issues. Company's client, which is not located in Colorado, uses an Information Technology (IT) service company which performs various services for client, including selling and setting up new computers for client, installing canned software like Microsoft products, and shipping computers directly to Company's client. The IT services company bills hourly for general IT services, such as resolving problems with personal computers, printers, email, etc.

Additionally, the IT service company charges an optional monthly server support fee that includes searching for and remotely installing relevant free Microsoft product patches and software upgrades. The IT service company represents that it does not sell the patches or other general Microsoft product upgrades. The patches and upgrades are provided by the software manufacturer free of charge and are typically received by users through the software company's automatic upgrades feature. The monthly server support fee covers server software issues and not hardware issues. If any software upgrades are new products, such as switching from Microsoft's Windows 7 to Windows 8 or installing new versions of antivirus, the IT service company separately charges clients for such items. Company states that in circumstances where their client purchases new products, the client remits use tax on purchased upgrades.

Discussion

Colorado levies sales tax on the sale or use of tangible personal property, but not on the sale of services.¹ There are, however, important exceptions to the non-taxability of services. For example, charges for services are subject to sales tax if the charges are not separately stated on the customer's invoice and the invoice includes the sale of taxable goods.² Services that are inseparable from the sale of taxable tangible personal property are also included in the sales tax calculation, even if the service charge is separately stated on the customer's invoice.³

Beginning July 1, 2012, electronically transmitted computer software is not subject to sales or use tax.⁴ However, the question at issue here is whether the maintenance agreement is subject to tax under the rules governing software transactions occurring between March 1, 2010 to June 30, 2012. From March 1, 2010 to June 30, 2012, standardized software was subject to tax, regardless of how the standardized software was acquired by the purchaser or downloaded to the purchaser's computer. Under these rules, standardized software means computer software, including prewritten upgrades that is not designated or

¹ §§39-26-104(1)(a), and 202, C.R.S.

² Hellerstein, *State Taxation* (WG&L), ¶ 17.12 (The Separate Statement Rule); Department Private Letter Ruling 2009-004; Department Private Letter Ruling 2010-001; Department Private Letter Ruling 2010-004.

³ *A.D. Stores v Department of Revenue*, 19 P.3rd 680 (Colo. 2001).

⁴ §39-26-102(), C.R.S.

developed to the specifications of a specific purchaser.⁵ Because Microsoft patches and software fall within the definition of standardized software, the question arises whether the transaction is considered the sale of a service, even though some tangible personal property is transferred to the buyer, or the sale of tangible personal property.

In *Leanin' Tree v City of Boulder*, 72 P.3rd 361 (Colo. 2003), the Colorado Supreme Court reviewed a number of tests used in Colorado and other states in such an inquiry. The Court ultimately adopted a case-by-case approach which looks to the "totality of the circumstances" and whether the transaction is commonly viewed as a sale of services or sale of goods. ("Varied as these analyses may be, they largely share in common some attempt to identify characteristics of the transaction at issue that make it either more analogous to what is reasonably and commonly understood to be a sale of goods, or more analogous to what is generally understood to be the purchase of a service or intangible right."⁶). Factors which the Court considered included in the determination of this question were whether the "true object, dominant purpose, or essence" of the transaction is, in fact, corporeal tangible property or an intangible right or service.⁷

Although we do not determine this issue in general information letters, there are at least two facts that suggest company's monthly server support fee is a non-taxable service. First, the charge is assessed regardless of whether tangible personal property (patches and upgrades) is transferred to the client. Second, the free patches and upgrades appear to be passed through without any specific mark-up. This also suggests that the charge is not a sale of the product.⁸

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule 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.

⁵ FYI Publication Sales 89, "Computer Software." To view this publication, please visit www.colorado.gov/revenue/tax > Tax Library > FYI Publication > Sales > Sales 89.

⁶ *Leanin' Tree*, supra.

⁷ *Id.* at 365.; see also Steven P. Young & Robert D. Walker, *Current Developments: Colorado*, 14 J. Multistate Tax 28, 4 1-45 (2004); Andrew W. Swain, *The Taxability of Computer Software in Colorado*, 32 Colo. Law. 91, 96 (Dec. 2003).

⁸ Department General Information Letter 09-001. To view this letter, please visit www.colorado.gov/revenue/tax > Tax Library > Rulings > Rulings by Number > GIL-09-001.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter 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 letter.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Tele: (303)866-5627
Email: ntillquist@spike.dor.state.co.us