

TIR 05-15: Transfers of Prewritten Computer Software

Sales and Use Tax

I. Introduction:

This Technical Information Release announces statutory changes contained in recent legislation, St. 2005, c. 163, §§ 27, 29, 34, 59, 61, concerning sales of standardized computer software (“prewritten software”). As the result of this change, prewritten software sold to a customer in Massachusetts or purchased for use in Massachusetts shall be deemed a transfer of tangible personal property subject to the sales or use tax regardless of the method of delivery, including transfers by electronic means such as the Internet or “load and leave.” This change is effective April 1, 2006. Prior to this statutory change, sales or use tax was imposed on sales of prewritten software^[1] delivered in tangible form such as a disk, but not on prewritten software delivered electronically or by “load and leave.” See 830 CMR 64H.1.3, DD 01-3 and LR 00-14.

The legislation also provides that the development and sale of prewritten software shall be considered a manufacturing activity for purposes of certain corporate excise provisions, regardless of the method of the delivery of the software. This may result in the applicability of single sales factor apportionment and to eligibility for potential local property tax benefits, investment tax credits, and certain sales tax exemptions. These changes are effective for taxable years beginning on or after January 1, 2006.

This TIR revokes and replaces any prior public written statements to the extent they are inconsistent.

II. Statutory Changes:

The recent legislation amends the definition of “tangible personal property” in the sales tax statute, G.L. c. 64H, § 1, to add the following: “A transfer of standardized computer software, including but not limited to electronic, telephonic, or similar transfer, shall also be considered a transfer of tangible personal property. The commissioner may, by regulation, provide rules for apportioning tax in those instances in which software is transferred for use in more than one state.”

The legislation also amends provisions in the corporate excise statute at G.L. c. 63, §§ 38C and 42B to provide that for purposes of those sections and G.L. c. 63, § 38, “the development and sale of standardized computer software shall be considered a manufacturing activity, without regard to the manner of delivery of the software to the customer.”

III. New Sales/Use Tax Treatment:

All transfers of prewritten software on and after April 1, 2006, including but not limited to electronic, telephonic, or similar transfers, downloaded software from the Internet or transfers by “load and leave” are considered transfers of tangible personal property. Sales or use tax will apply when such software is transferred for a consideration to a retail purchaser in Massachusetts or for use in Massachusetts.

On and after April 1, 2006, taxable transfers of software include, but are not limited to, the following:

1. Licenses and leases of prewritten software.
2. Granting the right to use prewritten software installed on a remote server.
3. Upgrades to prewritten software, including upgrades delivered pursuant to maintenance contracts ^[2], regardless of whether the software was taxable when initially transferred to the retail customer.
4. License upgrades for prewritten software. See LR 93-2.

Transfers of custom software will generally continue to be treated as nontaxable personal service transactions. See 830 CMR 64H.1.3. There is no change in the treatment of database or similar electronic information services available to multiple subscribers or data processing, which remain non-taxable services. See TIR 05-8.

Generally, business taxpayers that download or otherwise acquire prewritten software for use in Massachusetts from an unregistered out-of-state retailer for a consideration are required to file and pay the use tax due on Form ST-9, Sales/Use Tax Return or ST-10, Business Use Tax Return. Under some circumstances, a business purchaser may give a Multiple Points of Use Certificate to the vendor. See Section IV.

Individuals acquiring prewritten software for nonbusiness use from an unregistered out-of-state retailer for a consideration must pay applicable use tax due by filing Form ST-11, Individual Use Tax Return. An individual's use tax may also be paid with the Form 1 Massachusetts Resident Income Tax return. See Form 1 instructions and TIR 03-1.

Manufacturers of prewritten software that is delivered electronically may also now qualify for sales tax exemptions under G.L. c. 64H, § 6 (r) and (s) for machinery, materials, tools and fuel, provided that the other requirements of those provisions are met. See *generally* LR 03-11.

IV. Multiple Points of Use – Exemption Certificate:

Business and commercial purchasers of prewritten computer software that will be concurrently available for use in multiple tax jurisdictions must present to the vendor an exemption certificate, Form ST-12, to elect Multiple Points of Use (MPU) treatment.^[3] Upon receipt of the MPU Exemption Certificate, the vendor is relieved of all obligation to collect, pay, or remit the applicable tax and the purchaser shall be obligated to report and remit the applicable sales or use tax on its sales/use tax return.

A purchaser delivering the MPU Exemption Certificate may use any reasonable, but consistent and uniform, method of apportionment that is supported by the purchaser's business records, as they exist at the time a return is filed. Generally, a "reasonable" method must reflect the location of use of the software by the purchaser and not the location of the servers where the software is installed. The purchaser must maintain records and documentation for review by the Department of Revenue's Audit Division in accordance with 830 CMR 62C.22.1, the Records Retention Regulation.

Examples of situations where use of an MPU is appropriate include, but are not limited to the following:

Example 1: Software is installed on a server located in another state but concurrently available for use by purchaser's employees in Massachusetts as well as other states. The purchaser gives the seller a properly completed MPU form. Part of the sales price of the software will be apportioned to Massachusetts for sales/use tax purposes.

Example 2: Software is installed on a server located in Massachusetts but concurrently available for use by purchaser's employees in other states as well as Massachusetts. The purchaser gives the seller a properly completed MPU form. Part of the sales price will be apportioned to those other states for sales/use tax purposes.

Example 3: A business in Massachusetts purchases an enterprise license that allows the purchaser to make copies of software (either from a master disk or downloaded copy) and those copies will be concurrently available for use at the purchaser's business locations in various jurisdictions. The purchaser gives the seller a properly completed MPU form. For sales/use tax purposes, part of the sales price will be apportioned to the other states where the purchaser is using copies of the software.

A Multiple Points of Use Certificate may not be used for computer software received in person by a business purchaser at a business location of the seller, such as a retail store. A Multiple Points of Use Certificate also may not be used for software that is loaded on computer hardware prior to sale; in that situation the sales tax sourcing rules for computer hardware determine the taxability of the transaction, regardless of whether the price for the hardware and software are separately stated.

In accordance with the authority in St. 2005, c. 163, § 34, the Department will promulgate regulations on Multiple Points of Use Certificates and apportionment of sales or use tax to other jurisdictions.

V. Treatment of Corporations as Engaged in Manufacturing Activity:

St. 2005, c. 163, §§ 27, 29 also amend G.L. c. 63, §§ 38C, 42B to provide that for purposes of those provisions and G.L. c. 63, § 38, the development and sale of standardized computer software shall be considered a manufacturing activity, without regard to the manner of delivery of the software to the customer. These changes are effective for taxable years beginning on or after January 1, 2006.

A corporation classified as a manufacturing corporation may use certain tax benefits outlined in 830 CMR 58.2.1(4). In addition, a corporation engaged in manufacturing but not having been so classified may qualify for certain tax benefits described in 830 CMR 58.2.1(5). A corporation engaged in manufacturing activity may also be subject to single sales factor income apportionment for the corporate excise as provided by G.L. c. 63, § 38(I). Previously, corporations engaged in the development and sales of prewritten software could only be treated as engaged in manufacturing to the extent that software was delivered in a tangible medium.

[1] Prewritten software was called “canned software” in some of the Department’s prior public written statements.

[2] With respect to maintenance contracts sold before April 1, 2006, software vendors are required to collect tax on invoices after April 1, 2006. For example, if a multiple year contract that began in June, 2005 has payments due in June, 2006 and June, 2007, the vendor must collect applicable tax on the payments due in June, 2006 and 2007.

[3] The holder of a Direct Payment Certificate is not required to give its vendor an MPU certificate to apportion sales/use tax as provided in this section, providing the purchase is otherwise eligible under the Direct Payment Certificate. See 830 CMR 64H.3.1.