

WAC 458-20-15502 Taxation of computer software. (1) **What is computer software?** RCW 82.04.215 provides that "computer software" is a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task. All software is classified as either prewritten or custom. "Computer software" includes only those sets of coded instructions intended for use by an end user and specifically excludes retained rights in software and master copies of software. Computer software does not include data.

(a) **How is computer software delivered?** Computer software may be delivered either by intangible means such as electronically downloaded or by tangible means such as tangible storage media.

(b) **What is automatic data processing equipment?** "Automatic data processing equipment" includes computers used for data processing purposes and their peripheral equipment.

(c) **What are retained rights?** "Retained rights" means any and all rights, including intellectual property rights such as those rights arising from copyrights, patents, and trade secret laws, that are owned or are held under contract or license by a software developer, author, inventor, publisher, licensor, sublicensor, or distributor. RCW 82.04.215.

(d) **What are master copies of software?** "Master copies" of software means copies of software from which a software developer, author, inventor, publisher, licensor, sublicensor, or distributor makes copies for sale or license. RCW 82.04.215.

(i) **Development of a master copy of software.** Development of a master copy of software by a software developer, or a third party hired by the software developer, that is used to produce copies of software for sale or commercial or industrial use, is not a manufacturing activity. A third-party charge for development of a master copy of software is a charge for custom software development and is subject to service and other activities B&O tax.

(ii) **Use of prewritten computer software by software developer.** The internal use of prewritten computer software by the developer of that software is not subject to use tax because the software developer is not an end user of its own internally developed software. For example, VV Software, Inc., an in-state software developer, creates accounting software generally used by small businesses. VV plans to sell its newly created software to other companies. VV also plans to make a copy of this software and use it for its accounting operation. The copy of software used by VV for its accounting operation is not subject to use tax.

(2) **What is custom software?** "Custom software" is computer software created for a single person. RCW 82.04.215. The use of library files in software development does not preclude the developed software from being characterized as custom software, as long as the software is created for a single person. The nature of custom software does not change when ownership is transferred to a person with no rights retained by the transferor.

For purposes of this section, "library files" are a collection of precompiled and frequently used routines that a software developer can use in developing the software. The purchase or use of such "library files" may be subject to retail sales or use tax as the sale of pre-written software.

(a) **Creation of custom software.** Gross income received for creating custom software is subject to service and other activities B&O tax.

(b) **Duplication of custom software.** Duplication of custom software for the same person, or by the same person for the person's own use, does not change the character of the custom software. RCW 82.04.29001. Duplication of custom software for the same person, or by the same person for its own use, is not subject to manufacturing B&O tax.

If a person duplicates custom software for sale to or use by another person other than the original purchaser, the software becomes prewritten computer software as defined in subsection (3) of this section and is subject to manufacturing B&O tax if the prewritten computer software is delivered by tangible storage media.

(c) **Sale of custom software.** If custom software is sold to another person other than the original purchaser, the software loses its character as custom software and becomes prewritten computer software as defined in subsection (3) of this section.

(d) **Use of custom software.** Use of custom software is not subject to use tax.

(e) The examples included in this rule identify a number of facts and then state a general conclusion; they should be used only as a general guide. Additionally, each fact pattern in each example is self contained (e.g., "stands on its own") unless otherwise indicated by reference to another example. The tax consequences of all situations must be determined after a review of all the facts and circumstances. Examples requiring that sales tax be collected by the seller assume that the seller has "tax nexus" with Washington and no exclusions or exemptions apply and the sale is sourced to Washington.

(f) **Example 1.** PFC, Inc., develops software for its client. PFC is not subject to manufacturing B&O tax because the software is custom software. PFC's income from the sale of the custom software to the one specific client is subject to service and other activities B&O tax.

(3) **What is prewritten computer software?** RCW 82.04.215 provides that "prewritten computer software" is computer software, including prewritten upgrades, patches, fixes, etc., that is not designed and developed by the author or other creator to the specifications of a specific purchaser.

The combining of two or more prewritten computer software programs or prewritten portions thereof does not result in custom software. Configuration of prewritten computer software to work with other computer software does constitute customization of prewritten computer software.

Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than such purchaser.

Where a person, who is not the author or creator, modifies or enhances prewritten computer software, that person is deemed to be the author or creator only of the modifications or enhancements made. Prewritten computer software, or a portion thereof, that is modified or enhanced to any degree, remains prewritten computer software, even though the modification or enhancement is designed and developed to the specifications of a specific purchaser. Where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for the modification or enhancement, the modification or enhancement will not be considered prewritten computer software.

(a) **Wholesale sales of prewritten computer software.** Gross proceeds from sales of prewritten computer software to persons other than consumers (e.g., sales for resale without intervening use) are subject

to B&O tax under the wholesaling classification, whether or not ownership or title passes to the buyer, and regardless of any express or implied restrictions upon the buyer. The method of delivery of pre-written computer software does not alter the wholesale nature of the transaction, whether it is through tangible storage media or any electronic means. Delivery of software manuals and backup copies of pre-written computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place. To verify the wholesale nature of the sale, the seller obtains a reseller permit from the buyer as provided by WAC 458-20-102 (Reseller permits).

(i) **Distinction between wholesale sales of prewritten computer software and royalties received for the licensing of prewritten computer software.** Sales of prewritten computer software constitute wholesale sales if the reseller, who has no right to reproduce the software for further sales, sells the same software to its customers. The true object of the sale to the reseller is the sale of the software. On the other hand, income received for granting an intangible right to reproduce and distribute copies of prewritten computer software for sale constitutes royalties. The true object of the transaction that generates royalty income is the right to reproduce and relicense the software. See subsection (8) of this section for more information on royalties.

(ii) **Examples.**

(A) **Example 2.** UM Computers, Inc., develops engineering software. UM sells the prewritten computer software at wholesale to OX Computers, Inc., in shrink-wrapped packages. UM delivers the software to OX. OX then resells the software to customers in the same shrink-wrapped packages. Sales of prewritten computer software by UM are subject to wholesaling B&O tax. Sales by OX to consumers are retail sales subject to retailing B&O tax and retail sales tax.

(B) **Example 3.** GB Computers, Inc., develops engineering software. GB grants SE Computers, Inc., the right to reproduce and distribute copies of the prewritten computer software for sale to end users. GB retains all of its ownership rights to the software and delivers one copy of the software to SE to reproduce and sell. Amounts received by GB from SE for granting the right to reproduce and distribute prewritten computer software are subject to royalties B&O tax. Sales by SE to consumers are retail sales subject to retailing B&O tax and retail sales tax.

(C) **Example 4.** DH Computers, Inc., develops engineering software. DH grants to WK Computers, Inc., the right to copy and redistribute its prewritten computer software. DH delivers the software electronically to WK. WK then sells the software to its customers, who download a copy of the software from WK. Income to DH from WK is subject to royalties B&O tax. Sales of prewritten computer software by WK to its customers are retail sales subject to retail sales tax.

(D) **Example 5.** AJ Soft, Inc., is a software developer of architectural drafting software. AJ Soft enters into an agreement with DJ Sales, Inc., to sell AJ Soft's drafting software. DJ Sales must pay a fee for each copy DJ Sales sells through its website. AJ Soft does not allow DJ Sales to reproduce the drafting software. Customers download the software, but are unaware the software is downloaded directly from AJ Soft. AJ Soft is making a wholesale sale of software to DJ Sales subject to wholesaling B&O tax. DJ Sales is making a retail sale to its Washington customers subject to retail sales tax.

(E) **Example 6.** Same facts as Example 5, however, instead of customers downloading the prewritten software, DJ Sales' customers access the prewritten software remotely on AJ Soft's servers. AJ Soft is still making a wholesale sale of remotely accessed prewritten software to DJ Sales subject to wholesaling B&O tax. DJ Sales is making a retail sale of remotely accessed prewritten software to its Washington customers subject to retail sales tax.

(b) **Retail sales of prewritten computer software.** Gross proceeds of sales of prewritten computer software to consumers are subject to B&O tax under the retailing classification, whether or not ownership or title passes to the buyer, and regardless of any express or implied restrictions upon the buyer. Regardless of the method of delivery, whether through tangible media or electronic means, prewritten computer software remains subject to retail sales tax and retailing B&O tax. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.

(c) **Use of prewritten computer software.** Prewritten computer software, regardless of the method of delivery, is generally subject to use tax upon use in this state if Washington retail sales tax was not previously paid. However, use of prewritten computer software is not taxable, if it is provided free of charge, or if it is provided for temporary use in viewing information, or both. RCW 82.12.020. This exception from use tax is limited to prewritten computer software provided free of charge or for temporary use in viewing information, such as free promotional software, donated software, free download of software, and software provided in beta testing to a third-party free of charge.

For purposes of this use tax exception, "beta testing" means the last stage of testing for prewritten computer software prior to its commercial release including the release to manufacturing (RTM). Beta testing may involve sending the software to a third party for the use of the third party. Beta testing is often preceded by a round of testing called alpha testing.

(i) **Example 7.** DS Computers, Inc., is a software developer. In order to perform beta testing of its new accounting software prior to commercial release, DS sends a copy of the software free of charge to KG Technologies, Inc. DS is not subject to use tax for the release of the beta software to KG. KG is not subject to use tax for the use of beta software free of charge.

(ii) **Example 8.** DH, Inc., provides free card games on-line to its customers. The customers, however, must download DH's free software in order to be able to play card games on-line at DH's website. Wendy downloads the software free of charge. Wendy is not subject to use tax for the use of the software.

(iii) **Example 9.** DW, Inc., provides free software to the public for anyone to watch videos on-line. Roger downloads the software free of charge. Roger is not subject to use tax for the use of the software.

(d) **Manufacturing of prewritten computer software.** Persons engaged in manufacturing prewritten computer software on tangible storage media are subject to manufacturing B&O tax upon the value of the products. See WAC 458-20-112 (Value of products) and WAC 458-20-136 (Manu-

facturing, processing for hire, fabricating). Manufacturers of pre-written computer software who sell their products at retail or wholesale are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) B&O tax classifications and may claim a multiple activities tax credit (MATC). See WAC 458-20-19301 (Multiple activities tax credits) for detailed information about the MATC. Income from the sale of prewritten software electronically delivered or transferred is not subject to manufacturing B&O tax.

(e) **Duplication of prewritten computer software.** Duplication of prewritten computer software on tangible media for sales to or use by more than one person is subject to manufacturing B&O tax upon the value of products which includes both the value of the tangible media and the software. Duplication of prewritten computer software on tangible media outside this state is not subject to manufacturing B&O tax regardless of where software development takes place.

Duplication of prewritten computer software is a manufacturing activity only if the prewritten computer software is delivered from the seller to the purchaser by means of tangible storage media which is retained by the purchaser. RCW 82.04.120.

When a software developer contracts with a third party to duplicate prewritten computer software, the parties must take into account the value of all tangible and intangible materials or ingredients, including the software code, when determining the relative value of all materials or ingredients furnished by each party. If the third party furnishes less than twenty percent of the total value of all materials or ingredients that become a part of the produced product, then the third party is presumed to be a processor for hire and the software developer is presumed to be a manufacturer. See WAC 458-20-136 (Manufacturing, processing for hire, fabricating) for more information.

(4) **Site license of prewritten computer software.** A site license provides a consumer acquiring prewritten computer software with the right to duplicate prewritten computer software for use on its own computers, based on the number of computers, the number of workers using the computers, or some other criteria. A site license agreement may cover one site or multiple sites of a purchaser.

(a) **Retail sales of a site license.** Gross proceeds of sales of a site license to a consumer are subject to B&O tax under the retailing classification, whether or not ownership or title passes to the consumer, and regardless of any express or implied restrictions upon the consumer. Delivery occurs when and where the prewritten computer software subject to the site license is received by the consumer, whether it is through tangible storage media or any electronic means, regardless of the method of delivery. See RCW 82.32.730 for more information on sourcing prewritten computer software. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the consumer in determining when and where the sale takes place. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.

If the prewritten software is hosted by the licensor or a third party for remote access by the licensee, then see subsection (10) of this section.

(b) **Duplication of prewritten computer software by a person under a site license.** A seller of a site license is subject to manufacturing

B&O tax for its own duplication of prewritten computer software. Duplication of prewritten computer software is subject to manufacturing B&O tax only if the prewritten computer software is delivered from the seller to the purchaser by means of tangible storage media which is retained by the purchaser. RCW 82.04.120. Purchaser of a site license is not subject to manufacturing B&O tax for the duplication of prewritten computer software for its own use, pursuant to a site license agreement with the seller.

(c) **Use of a site license partly in this state and partly outside this state.** The part of the site license used by the person in this state is subject to use tax, provided Washington state sales tax was not previously paid. For example, a person purchases and takes delivery of a site license in California. Pursuant to the multiple site license agreement, this person is licensed to use one thousand copies of prewritten computer software, of which four hundred copies will be used in Washington. Use tax is due on the four hundred copies of prewritten computer software used in this state. If the prewritten software purchased by the licensee is delivered in Washington, then the entire charge for the site license is subject to retail sales tax if purchased from a seller responsible for collecting Washington's sales tax. However, a purchaser can issue a multiple points of use exemption certificate under certain circumstances to minimize Washington tax as discussed below in subsection (11) of this section.

(d) **Sales and use of additional copies of prewritten computer software under the same site license.** In some cases, the buyer of a site license may subsequently purchase additional copies of prewritten computer software under the same site license agreement. The seller may or may not deliver any additional copy of the software to the buyer, because the original copy of the software has already been delivered.

(i) **Retail sales of additional copies of prewritten computer software under the same site license.** Retail sales of the additional copies of software occurs when and where the seller delivers any additional copy of prewritten computer software to the buyer, whether it is through tangible storage media or any electronic means, regardless of the method of delivery. If the seller does not deliver any additional copy of the software to the buyer, then the sales occur when the sales agreements are made to purchase the additional copies and where the original copy or copies of prewritten computer software was delivered. If the original sale of the site license was subject to manufacturing B&O tax, then the sale of additional licenses are also subject to manufacturing B&O tax.

Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place.

(ii) **Use of additional copies of prewritten computer software under the same site license.** Where the use of the additional copies of software is partly in this state and partly outside this state and was not previously subject to Washington sales tax, the part of the additional copies of software used by the person in this state is subject to use tax.

(e) **Examples.**

(i) **Example 10.** DEF Computers, Inc., is located in Washington and sells in this state, at retail, a multiple site license of its prewritten computer software to P's Design, Inc. A copy of the prewritten computer software is electronically delivered to P's Design in Wash-

ington. P's Design then electronically duplicates the software and distributes the software in Washington and several other states for its use. Neither DEF nor P's Design is subject to manufacturing B&O tax. DEF, however, is subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the entire sale of the software unless P's Design provides DEF with a multiple points of use exemption certificate as discussed in subsection (11) of this section.

(ii) **Example 11.** Same facts as Example 10, except that in addition, DEF delivers a backup copy of the software to P's Design outside Washington. The backup copy of the software is for disaster recovery purposes and is not downloaded to any of P's Design's computers for use. There is no separate charge for the delivery of the backup pre-written software. The software manuals are mailed to P's Design in Washington. DEF is still subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the entire sale of the software unless P's Design provides DEF with a multiple points of use exemption certificate as discussed in subsection (11) of this section. Delivery of the software manuals and the backup copy of the software are not relevant in determining when and where the sale takes place. This transaction is not subject to manufacturing B&O tax.

(iii) **Example 12.** Same facts as Example 10 of this subsection, except that in addition, P's Design subsequently purchases 50 additional copies of the software from DEF under the same site license agreement. P's Design merges with another company, and the additional copies are needed for the use of its new employees. No additional copy of the software is delivered to P's Design in fulfilling this new agreement. Neither DEF nor P's Design is subject to manufacturing B&O tax. DEF, however, is subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the subsequent sale of the 50 additional copies of software because the original copy of the software was delivered in Washington unless P's Design provides DEF with a multiple points of use exemption certificate as discussed in subsection (11) of this section. However, if the original sale of the license had included delivery of the prewritten software by a tangible storage device (and was therefore subject to manufacturing B&O tax), then the licensor is also subject to manufacturing B&O tax based on the value of the additional licenses.

(iv) **Example 13.** GH Computers, Inc., sells at retail a multiple site license of its prewritten computer software to Quick, Inc. GH is located outside Washington, while Quick is located in Washington, other states and other countries. The desktop software is licensed on an unlimited basis, which means that there are no restrictions of its use by Quick. The software is delivered to Quick outside Washington. Quick then electronically duplicates the software and distributes the software to all of its 500 employees, of which 100 employees are located in Washington. The software is electronically downloaded into the desktop computers of all employees and is immediately put into use. Use tax is due on the value of the 100 copies of prewritten computer software used in Washington.

(v) **Example 14.** Same facts as Example 13 of this subsection, except that under the original site license agreement, Quick is entitled to reproduce, distribute, and use up to 500 copies of the desktop software. Then Quick merges with another company, and additional copies are needed for the use of its new employees. Quick, therefore, subsequently purchases 100 additional copies of the software from GH under the same site license agreement. No additional copy of the software is delivered to Quick in fulfilling this new agreement. Quick

distributes the additional copies of the software to its 100 new employees, of which 50 employees are located in Washington. Use tax is due on the value of the 50 additional copies of prewritten computer software used in Washington.

(5) **Key to activate computer software.** A key, or an enabling or activating code, may be required in some instances to activate computer software and put the software into use, and the key may be delivered to a purchaser after the software is already delivered and in possession of the same purchaser. In such instances, the sale of computer software occurs when both the key and the software are delivered to the purchaser. The sale takes place where the software is received by the purchaser in accordance with RCW 82.32.730. However, if the place of receipt for the software is unavailable to the vendor because the software was delivered by a third party, then the sale takes place where the key is received in accordance with RCW 82.32.730. There is no separate sale of the key from the software, regardless of how such sale may be characterized by the vendor or by the purchaser.

See subsection (4) of this section for more information if a site license of prewritten computer software is involved. If the sale of the prewritten software is subject to manufacturing B&O tax, then the sale of the key required by that prewritten software is also subject to manufacturing B&O tax. The income from the sale of a key is part of a sale of prewritten computer software, whether the sales transactions are together or separate.

(a) **Example 15.** JKL Computers, Inc., an in-state business, sells at retail prewritten computer software to Rebecca. JKL delivers the software to Rebecca in this state. The prewritten computer software, however, cannot be activated without a key. JKL subsequently delivers the key in this state to Rebecca for a separate price. JKL is subject to retailing B&O tax, and it must collect retail sales tax from Rebecca on the entire sale of the software including the separate charge for the key. The entire sale takes place in this state (where the software is delivered) when both the software and the key are delivered to Rebecca. There is no separate sale of the key, regardless of the fact that JKL delivers the key to Rebecca for a separate charge.

(b) **Example 16.** Same facts as Example 15 of this subsection, except that JKL subsequently delivers the key outside this state to Rebecca for a separate price. JKL is subject to retailing B&O tax, and it must collect retail sales tax from Rebecca on the entire sale of the software including the separate charge for the key. The entire sale takes place in this state (where the software is delivered) when both the software and the key are delivered to Rebecca. There is no separate sale of the key, regardless of the fact that JKL delivers the key to Rebecca for a separate charge.

(c) **Example 17.** MNO Computers, Inc., is an in-state software developer. TKO Computers, Inc., an out-of-state original equipment manufacturer of computers (OEM), agrees in contract with MNO to distribute MNO's prewritten computer software on its computers. TKO delivers MNO's inoperable software to Sally as part of the sale of the computer system. Sally, however, must purchase a key directly from MNO in order to activate and use the software. MNO has no knowledge of where the software was initially delivered to Sally, but MNO knows that the key is delivered to Sally in this state. MNO is subject to retailing B&O tax, and it must collect retail sales tax from Sally on the entire sale of the key and the inoperable software. The entire sale takes place in this state because the key is delivered in this state and MNO

has no knowledge of where the inoperable software was initially delivered by TKO.

(6) **Client access license and server license for the server software.** A server license, paid for at the time the server software is purchased, grants the buyer the right to install the server software on the buyer's server. A client access license (CAL) grants the buyer the right to access the server software.

Charges for server licenses and CAL are a part of the sale of the server software, even if the charges are separately stated. The sales take place where the server software is delivered to the buyer.

In cases where server software is delivered to the buyer and used in multiple locations, see subsection (4) of this section on site licenses for more information.

(a) **Example 18.** ZZ Computers, Inc., an in-state business, sells at retail server software to Jack. ZZ delivers the server software to Jack in Washington. ZZ also provides Jack with client access licenses for free allowing Jack the right to access the server software from his personal computers. The sale of server software to Jack is subject to retailing B&O tax, and ZZ must collect retail sales tax from Jack for the same sale.

(b) **Example 19.** Same facts as Example 18 of this subsection, except that ZZ makes two separate sales at retail of two types of pre-written computer software to Jack. One is server software, and the other is client software (which is different from client access licenses). ZZ delivers the server software to Jack in Washington where Jack's server is located. ZZ delivers the client software to Jack outside Washington where all of Jack's personal computers are located. Only the sale of server software to Jack is subject to retailing B&O tax, and ZZ must collect retail sales tax from Jack for the same sale. Jack may use a multiple points of use exemption certificate for the server software. See subsection (11) of this section for more detail on multiple points of use.

(7) **Other activities associated with computer software.**

(a) **Customizing prewritten computer software.** Gross income received for customizing prewritten computer software is subject to service and other activities B&O tax. RCW 82.04.29001.

(i) **What is customizing prewritten computer software?** RCW 82.04.215 provides that "customization of prewritten computer software" is any alteration, modification, or development of applications using or incorporating prewritten computer software for a specific person.

"Customization of prewritten computer software" includes individualized configuration of software to work with other software and computer hardware but does not include routine installation. Customization of prewritten computer software does not change the underlying character or taxability of the original prewritten computer software.

(ii) **One nonitemized price for prewritten computer software, customization, and routine installation.** If prewritten computer software, customization of prewritten computer software, and routine installation are sold for a one nonitemized price, the entire charge is considered to be subject to retail sales tax. See (a)(iv) of this subsection for more information on routine installation.

(iii) **Separately stated charge for customization of prewritten computer software.** Where there is a reasonable separately stated charge on an invoice or other statement of the price given to the purchaser for customization of prewritten computer software (including installation that is not routine, see (a)(i) of this subsection), such

customization is subject to service and other activities B&O tax. If a charge for customization of prewritten computer software is not separately stated from a sale of prewritten computer software, the entire charge is considered a retail sale subject to retail sales tax.

(iv) **Customization of prewritten computer software versus routine installation.** Customization of prewritten computer software includes custom installations but does not include routine installation. "Routine installation" means the process of loading program files and installation files onto a computer. Routine installation includes the process of "clicking through" dialog boxes to install prewritten software. Routine installation does not require any specialized knowledge or skills. Custom installation generally requires programming by a programmer to integrate customized elements of prewritten computer software.

(v) **Separately stated charge for routine installation from customization of prewritten computer software.** Where there is a reasonable separately stated charge on an invoice or other statement of the price given to the purchaser for routine installation from customization of prewritten computer software, routine installation is subject to retailing B&O tax and retail sales tax. If a charge for routine installation is not separately stated from customization of prewritten computer software and is de minimis, the transaction would not be subject to retail sales tax, but instead subject to service and other activities B&O tax.

(vi) **Examples.**

(A) **Example 20.** Tee, Inc., needs financial modeling software that can tie into its existing computer systems. Because of its unique business, however, Tee needs the industry-wide computer software offered by PQR Computers, Inc., to be modified to meet the needs of Tee. Both Tee and PQR are in-state corporations, and the software is delivered in this state. PQR provides a separately stated charge to Tee for customization of prewritten computer software performed in this state that is supported by the terms of the sales agreement. PQR is subject to retailing B&O tax, and it must collect retail sales tax from Tee for the sale of prewritten computer software in Washington. PQR, in addition, is subject to service and other activities B&O tax for the customization of prewritten computer software in Washington.

(B) **Example 21.** Same facts as Example 20 of this subsection, except that, in addition, PQR provides a separately stated charge to Tee for routine installation of prewritten computer software in this state. This charge represents installation of only the prewritten portion of the software. In addition to the tax treatments in Example 20 of this subsection, PQR is subject to retailing B&O tax and it must collect retail sales tax from Tee for the routine installation in Washington.

(b) **Installing or uninstalling computer software.**

(i) Gross income received from installing or uninstalling custom software is subject to service and other activities B&O tax.

(ii) Gross proceeds of sales for routine installation of prewritten computer software are subject to retailing B&O tax and retail sales tax. See (a)(iv) of this subsection for more information on routine installation. Routine installation of prewritten computer software includes charges for labor and services in respect to the installation, such as travel costs for the routine installation of the software. As of July 1, 2008, if the routine installation occurs through remote access by someone outside the state of Washington, then the installation is sourced pursuant to RCW 82.32.730.

Example 22. XYZ Computers, Inc., is hired by Dan for routine installation of prewritten software onto Dan's computers. XYZ's out-of-state employee remotely accesses Dan's computers in Washington to install the prewritten software on his computers. If XYZ has nexus with Washington, then it must collect and remit the sales tax. If XYZ does not have nexus, then Dan must pay use tax.

Gross proceeds of sales from uninstalling prewritten computer software are subject to retailing B&O tax and retail sales tax.

Example 23. XYZ Computers, Inc., is hired by Dan to remove prewritten computer software from his computers. Removal of the prewritten computer software requires uninstalling the software from the computer. XYZ sends an employee to Dan's location to remove the software from his computers. Charges for removal of the prewritten computer software are subject to retailing B&O tax and retail sales tax.

(c) **Repairing, altering, or modifying computer software.** Repair of prewritten computer software for more than one person may be distributed as a fix or patch by tangible storage media or electronically in the nature of software upgrades and updates. The sale of prewritten computer software upgrades and updates is a sale of prewritten computer software subject to retailing B&O tax and retail sales tax.

Alteration or modification of prewritten computer software performed for a specific person is subject to the service and other activities B&O tax. Such alteration or modification of prewritten computer software for a specific person constitutes customization of prewritten computer software. See RCW 82.04.215.

(i) **Example 24.** STU Computers, Inc., a Washington company, is hired by Betty to perform repairs (using primarily human effort) via remote access on her prewritten computer software in Washington. STU is performing alteration or modification of prewritten computer software for a specific person and is subject to service and other activities B&O tax.

(ii) **Example 25.** VW Computers, Inc., an out-of-state service provider, is hired by Clyde to perform alterations or modifications (using primarily human effort) via remote access on his prewritten computer software located in this state. VW's facility is located outside this state. VW may be subject to service and other activities B&O tax if it has nexus with Washington.

(d) **Maintaining computer software.** Computer software maintenance agreements typically include, but are not limited to, support activities such as telephone consulting, help desk services, remote diagnostic services, and software upgrades and updates.

(i) **Tax treatment of computer software maintenance agreements in general.** Sales of stand-alone computer software maintenance agreements that include telephone consulting, help desk services, remote diagnostic services, and other professional services only, are taxable under the service and other activities B&O tax. However, if the services are part of a sale of an extended warranty on or after July 1, 2005, then the sale is subject to retailing B&O tax and retail sales tax. See WAC 458-20-257 (Warranties and maintenance agreements) for information about extended warranties.

Stand-alone sales of updates or upgrades to prewritten computer software are retail sales of tangible personal property subject to retailing B&O tax and retail sales tax.

(ii) **Prewritten computer software maintenance agreement with mixed elements.** The sale of a prewritten computer software maintenance agreement for a single nonitemized price that includes professional service components such as telephone consulting and retail components

such as upgrades and updates of prewritten computer software is generally considered a retail sale subject to retailing B&O tax and retail sales tax unless charges for the upgrades and updates are de minimis.

In cases where the charges for the professional service component(s) and the retail component(s) are separately stated within a prewritten computer software maintenance agreement and invoice, then each activity is taxed according to the nature of the activity.

(iii) **Duplication of prewritten computer software upgrades and updates.** Duplication of prewritten computer software upgrades and updates is subject to manufacturing B&O tax upon the value of products, if the software upgrades and updates are delivered by means of tangible storage media which is retained by the purchaser. This is the case regardless of any maintenance agreement with mixed elements involved. The measure of tax is presumed to be the contract price of the maintenance agreement, unless the person can prove otherwise. See WAC 458-20-112 (Value of products) for more information.

If the software upgrades and updates are delivered from the seller by means other than tangible storage media which is retained by the purchaser, then the software upgrades and updates are not subject to manufacturing B&O tax.

(iv) **Maintenance agreement on custom software and customized elements of prewritten computer software.** Sales of maintenance or support services relating to custom software or the customized elements of prewritten computer software are subject to the service and other activities B&O tax. Such services, including upgrades and updates, are rendered in respect to the custom or customized software and take on the underlying character and taxability of the custom or customized software.

(v) **Examples.**

(A) **Example 26.** On December 15, 2005, CBA Computers, Inc., sells at retail a prewritten computer software maintenance agreement to Frank for his prewritten software. The software maintenance agreement includes an extended warranty for the software, software upgrades and updates, and telephone consulting services for a single nonitemized price. The consulting services are not offered exclusively in connection with the software, nor are they essential to use of the software. CBA delivers the software upgrades and updates electronically. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the sale of the mixed agreement.

(B) **Example 27.** Same facts as Example 26 of this subsection, except that CBA delivers the software upgrades and updates on compact disks. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the sale of the mixed agreement. In addition, CBA is subject to manufacturing B&O tax on duplication of software upgrades and updates. The measure of tax is presumed to be the contract price of the maintenance agreement, unless CBA can prove otherwise.

(C) **Example 28.** Same facts as Example 26 of this subsection, except that CBA provides a separately stated charge for each component of the maintenance agreement. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the charges on prewritten software upgrades and updates and on the extended warranty purchased after July 1, 2005. CBA is subject to service and other activities B&O tax for the charge on telephone consulting services.

(D) **Example 29.** FED Computers, Inc., sells at retail a computer software maintenance agreement to Greta for her software. The maintenance agreement covers only software upgrades and updates. Greta's software is prewritten computer software with customized elements. FED

provides the maintenance services to Greta at one nonitemized charge. FED is subject to retailing B&O tax, and it must collect retail sales tax from Greta for the sale of the entire maintenance agreement of the prewritten computer software.

(E) **Example 30.** Same facts as Example 29 of this subsection, except that FED provides a separately stated charge for maintaining the customized elements. FED is subject to service and other activities B&O tax on the charges for maintaining the customized elements. FED is subject to retailing B&O tax, and it must collect retail sales tax from Greta for the charge on maintaining prewritten computer software.

(e) **Computer software training.** Gross income received for training on the use of custom software is subject to service and other activities B&O tax. Gross income received for training on the use of prewritten computer software is subject to service and other activities B&O tax, if the charge for such training is separately stated from the sale of prewritten computer software. If the charge for software training is not separately stated from the sale of prewritten computer software and the prewritten software value is more than de minimis, the entire charge is considered to be a retail sale subject to retailing B&O tax and retail sales tax.

(8) **Licensing computer software - Royalties.** Income received from charges in the nature of royalties for certain licensing of computer software is taxable under the royalties B&O tax classification.

(a) **What are royalties?** RCW 82.04.2907 provides that "royalties" means compensation for the use of intangible property, such as copy-rights, patents, licenses, franchises, trademarks, trade names, and similar items. The true object of a transaction involving royalties is to grant an intangible right to reproduce and distribute copies of computer software for sale. It does not, however, include compensation for the licensing of prewritten computer software to the end user. The manner in which computer software is sold (e.g., volume of transactions, subscription license, term license, or perpetual license) or the manner in which payment amount is determined (e.g., fixed fee per copy, percentage of receipts, lump sum, etc.) does not alter the royalty nature of the transaction.

(b) **Royalties versus site license.** Regarding royalties, the true object of the transaction is to grant an intangible right to reproduce and distribute copies of computer software for sale. In contrast, the true object of a site license is the sale to an end user of prewritten computer software for use on its computers. See subsection (4) of this section for more information on site licenses.

(c) **Royalties versus wholesale sales of prewritten computer software.** See subsection (3)(a) of this section for more information.

(d) **Examples.**

(i) **Example 31.** HG Computers, Inc., an original equipment manufacturer (OEM), acquires prewritten computer software from LL Software, Inc., under a license to reproduce and distribute the prewritten computer software as part of a bundled computer hardware and software package HG sells to end users. LL retains all of its ownership rights to the software. The gross income received by LL from granting intangible rights to reproduce and distribute prewritten computer software to HG is subject to royalties B&O tax.

(ii) **Example 32.** Same facts as Example 31 of this subsection, except that, in addition, HG acquires a site license from LL for the purposes of copying and using the prewritten computer software as an end user. LL delivers the software to HG. Amounts received by LL for

the sale of a site license are subject to retailing B&O tax and retail sales tax.

(9) **Special use tax exemption for computer hardware and computer software donated to certain schools or colleges.** Use tax does not apply to the use of computer hardware and prewritten software irrevocably donated to any public or private nonprofit school or college, as defined under chapter 84.36 RCW. RCW 82.12.0284.

(10) **Sales of remote access software.**

(a) **Remote access custom software.** Sales of remote access custom software on the seller's (or a third-party's) servers are subject to service and other B&O tax.

(b) **Remote access prewritten software.** Sales of remote access prewritten software on the seller's (or a third-party's) servers are subject to retail sales tax, when the sale is sourced to Washington pursuant to RCW 82.32.730. Sale of remote access prewritten software prior to July 26, 2009, were subject to service and other activities B&O tax.

Example 33. BE Software, Inc., a Washington corporation, offers a variety of prewritten software products on-line, but not for download, to its customers for a monthly subscription fee. BE Software must charge Washington customers retail sales tax and is subject to retailing B&O tax for the subscription fees received from its Washington customers.

(c) **Exemptions from retail sales or use tax for remote access prewritten software.** The following exemptions only apply to remote access prewritten software, and not other types of prewritten software sold.

(i) **Offered free.** Purchases of prewritten software that will be offered remotely by the purchaser to its own customers is exempt from retail sales tax. RCW 82.04.190 (2)(f). The purchaser of the prewritten software must provide an exemption certificate to the seller in order to receive the exemption. The income from the sale of the prewritten software is subject to retailing B&O tax.

Example 34. BE Software, a Washington company, purchases prewritten software from Joe's Software Developer Co., that BE will provide remotely to its customers. BE provides an exemption certificate to Joe's for the purchase of prewritten software. Joe's does not collect or remit retail sales tax, but does pay retailing B&O tax on the income from the sale. BE would generally charge and collect retail sales tax and pay retailing B&O tax on income received from the sale of the prewritten software remotely accessed by consumers.

(ii) **Made available free to the general public.** Retail sales and use taxes do not apply to the purchase or use by a business or other organization of remote access prewritten software in order to make that remote access prewritten software available free of charge for the use or enjoyment of the general public. Buyers claiming this exemption must provide the seller with a properly completed "Digital Products and Remote Access Software Exemption Certificate" or other exemption certificate acceptable to the department.

(A) **Available for free. In order to qualify, the remote access prewritten software purchased must be made available for free.** In this context, "free" means that the recipient of the remote access prewritten software does not need to provide anything of significant value. If the purchaser requires something of significant value from the recipient in exchange for the remote access prewritten software, it is not given away for free.

(B) **"General public"** means all persons and is not limited or restricted to a particular class of persons, except that the general public includes:

(I) Certain classes of persons defined by their residency or ownership: The general public includes a class of persons residing or owning property within the boundaries of any state (e.g., Washington), political subdivision of a state (e.g., King County), or a municipal corporation (e.g., Seattle).

(II) Library customers. With respect to libraries, the term general public includes authorized library patrons.

(C) **Purchaser must have the legal rights to provide the remote access prewritten software to the general public:** The exemption provided in subsection (3) of this section does not apply unless the purchaser has the legal right to broadcast, rebroadcast, transmit, retransmit, license, relicense, distribute, redistribute, or exhibit the remote access prewritten software, in whole or in part, to the general public.

(11) **Multiple points of use (MPU) exemptions.**

(a) The retail sales tax does not apply to the sale of prewritten computer software or remote access prewritten software if the buyer correctly provides the seller with an exemption certificate claiming multiple points of use.

(b) If the sale of the prewritten software or the remote access prewritten software (including retail sales of licenses to prewritten software and remote access prewritten software) is sourced to Washington and the purchaser does not provide an exemption certificate, then the entire charge is subject to retail sales tax. Buyers may use the department's "Digital Products and Remote Access Software Exemption Certificate" to claim this exemption.

(i) **Requirements.** A buyer is entitled to use an exemption certificate claiming MPU only if the buyer is a business or other organization and the prewritten software or remote access prewritten software purchased will be concurrently available for use within and outside Washington. A buyer is not entitled to use an exemption certificate claiming MPU for prewritten software purchased for personal use.

(ii) **Concurrently available.** "Concurrently for use within and outside this state" means that employees or other agents of the buyer may use the prewritten software or remote access prewritten software simultaneously from one or more locations within this state and one or more locations outside this state.

(iii) **Apportionment (allocation) of use tax.** For purposes of this subsection on MPU, "allocation" and "apportionment" will have the same meaning. A business or other organization subject to use tax on prewritten software or remote access prewritten software that is concurrently available for use within and outside this state is entitled to apportion the amount of tax due this state based on users in this state compared to users everywhere. Additionally, the department may authorize or require an alternative method of apportionment supported by the taxpayer's records that fairly reflects the proportion of in-state to out-of-state use by the taxpayer.

(c) **Records requirement.** No allocation under this section is allowed unless the allocation method is supported by the taxpayer's records kept in the ordinary course of business.

(i) **"User"** means an employee or agent of the taxpayer who is authorized by the taxpayer to use the prewritten software or remote access prewritten software purchased in the performance of his or her duties as an employee or other agent of the taxpayer.

(ii) **Example 35.** Neymar operates an accounting firm headquartered in Seattle. Neymar purchases from Lionel prewritten software which Neymar installs on a server in Seattle. The software is accessed and used concurrently by 5 employees at his Seattle office and 5 employees at his California office. Neymar provides Lionel with a sales tax exemption certificate claiming multiple points of use. Neymar is only required to pay use tax for the value attributed to his employee's use at the Seattle office (i.e., 50%). Neymar does not pay use tax to Washington for the value of the software used in his California offices even though the software resides on servers in Seattle.

[Statutory Authority: RCW 82.32.200 and 82.01.060. WSR 13-06-015, § 458-20-15502, filed 2/25/13, effective 3/28/13.]