

8130.9910 COMPUTER SOFTWARE.

Subpart 1. **Definitions.** For purposes of this part, the following words and phrases have the meanings given them in items A to I.

A. A "sale" and a "purchase" has the meaning given it in Minnesota Statutes, section 297A.01, subdivision 3, clause (k).

B. "Computer program" has the meaning given it in Minnesota Statutes, section 297A.01, subdivision 18, clause (3).

C. "Custom computer program" has the meaning given it in Minnesota Statutes, section 297A.01, subdivision 18.

D. "Canned or prewritten computer program" is defined in Minnesota Statutes, section 297A.01, subdivision 18, to mean a "program that is held or existing for general or repeated sale or lease, even if the prewritten or 'canned' program was initially developed on a custom basis or for in-house use."

A computer program is considered to be canned or prewritten if it meets the following guidelines:

(1) the object code of the program is not modified by the seller. Modification of the program by inserting file names or formatting data is not changing the object code;

(2) the program, copies of which are mass-produced by the manufacturer, is inventoried by a vendor, or otherwise held for repeated sale, license, or lease; and

(3) the program is sold, licensed under a written contract agreement, or leased by means of a shrink-wrapped, box-top, or tear-open license agreement or bill of sale.

E. "Computer" means an electronic device, including word processing equipment and testing equipment, or combination of components that is programmable and that includes a processor (central processing unit or microprocessor), internal memory, and input and output connections. An electronic device otherwise qualifying as a computer remains a computer even though it may be used for information processing, data acquisition, process control, or for the control of manufacturing machinery or equipment. As provided in Minnesota Statutes, section 297A.01, subdivision 18, clause (2), " 'computer' does not include tape-controlled automatic drilling, milling, or other manufacturing machinery or equipment."

F. "Maintenance agreement support services" means error corrections received by any means, consultation services, or technical support for computer programs.

G. "Upgrades or enhancements" means information and directions which provide new or significantly improved functionality to a computer program. It includes information

and directions that dictate the function performed by data processing equipment. Computer software, in any form which is provided under a maintenance agreement, and which does not provide new or significantly improved functionality is deemed to be a maintenance agreement support service.

H. "Computer program" means computer software.

I. "Storage media" has the meaning given it in Minnesota Statutes, section 297A.01, subdivision 18, clause (1).

Subp. 2. Tax applications.

A. Sales tax is due on the sale, lease, or license of a canned or prewritten program that is held or existing for general or repeated sale, lease, or license. The sale of canned or prewritten programs is the sale of tangible personal property. Minnesota Statutes, section 297A.01, subdivision 11, defines "tangible personal property" in part to include "computer software, whether contained on tape, discs, cards, or other devices."

B. Sales tax is not due on the sale, lease, or license of a custom computer program. The sale of a custom computer program is a service transaction. The purpose of the transaction is to obtain personalized service and the expert knowledge of the program creator. The transfer of any tangible personal property is incidental to the service being performed.

C. Charges for computer program maintenance furnished for a canned computer program are taxable if the customer is entitled to receive or receives canned computer software upgrades or enhancements. However, charges for computer program maintenance furnished for custom software are not taxable.

Maintenance contracts sold in connection with the sale or lease of canned software may provide that the purchaser will be entitled to receive upgrades or enhancements. The maintenance contract may also provide that the purchaser will be entitled to receive maintenance agreement support services.

(1) If the maintenance contract is required by the vendor as a condition of the sale or rental of canned software, it will be considered as part of the sale, or rental of the canned software, and the gross sales price is subject to tax whether or not the charge for the maintenance contract is separately stated from the charge for the software.

(2) If the maintenance contract is optional to the purchaser of canned software:

(a) then only the portion of the contract fee representing upgrades or enhancements delivered on storage media or by any other means is subject to sales tax if the fee for any maintenance agreement support services is separately stated;

(b) if the fee for any maintenance agreement support services is not separately stated from the fee for upgrades or enhancements delivered on storage media or by any other means, then 20 percent of the entire charge for the maintenance contract is subject to sales tax;

(c) if the maintenance contract only provides canned computer software upgrades or enhancements, and no maintenance agreement support services, then the entire contract is taxable;

(d) if the maintenance contract only provides maintenance agreement support services, and the customer is not entitled to or does not receive any canned computer software upgrades or enhancements, then the entire contract is exempt.

D. Separately stated charges for written training materials on the use of a canned computer program are taxable. Charges for written training materials on the use of a custom computer program are not taxable, whether or not separately stated. Charges for training services and similarly related services are nontaxable.

E. When a computer and canned computer programs are purchased together, the sales tax is due on the total charge.

F. When a computer and custom computer programs are purchased together, sales tax is due on the total charge if the charge for the custom computer program is not separately stated.

G. Master computer programs which are purchased and used to make copies for sale or lease are property purchased for resale and not subject to sales tax. See Minnesota Statutes, section 297A.01, subdivision 4.

H. Examples of services that do not result in custom software include loading parameters to initialize program settings and arranging preprogrammed modules to form a complete program.

No tax results when the modifications to existing prewritten software are required to meet the customers' specific needs. These modifications are considered to be custom programming.

When the charges for modification are not separately stated, the records of the transaction may be used to demonstrate to what extent the program has been modified.

The department will use the following records to determine the extent of modification to prewritten software when there is not a separate charge for the modification: logbooks, timesheets, dated documents, source codes, specifications of work to be done, design of the system, performance requirements, diagrams of programs, flow diagrams, coding sheets, error printouts, translation printouts, correction notes, and invoices or billing notices to the client.

If the charges for modification are not separately stated and the records of the transaction do not adequately document the extent of the modifications, the entire charge for the program is taxable.

I. Canned or prewritten computer programs may be transferred to the customer in the form of punched cards, data on magnetic tape, or by listing the program instructions on coding sheets. In some cases they are usable as written. However, in most cases it is necessary that the program be modified, adapted, and tested to meet the customer's particular needs. The sale of all property, including coding sheets, cards, or magnetic tape, on which or into which such programs have been coded, punched, or otherwise recorded is subject to tax.

J. The temporary transfer of possession of a canned or prewritten computer program, for a consideration, for the purpose of direct use or to be recorded by the customer, is a lease or the granting of a license to use or consume tangible personal property and the tax does apply. Where the consideration consists of license fees or royalty payments for canned or prewritten computer programs, all license fees or royalty payments, present or future, whether for a minimum use or for extended periods, are includable in the measure of tax.

K. Programming changes to a canned or prewritten computer program to adapt it to a customer's equipment, including translating a program to a language compatible with a customer's equipment, are in the nature of fabrication labor and are taxable.

L. Charges for assembler, compiler, utility, and other canned or prewritten computer programs provided to those who lease or purchase automatic processing equipment are subject to tax.

Statutory Authority: *MS s 270.06; 270C.06*

History: *18 SR 784; 18 SR 851; 18 SR 887; L 2005 c 151 art 1 s 114*

Published Electronically: *February 18, 2008*