5-2700-7455-1

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA DEPARTMENT OF REVENUE

In the Matter of the Proposed Amended Rule and Proposed Permanent Rule Relating to Sales and Use Tax on Automatic Data Processing and Computer Software; Minnesota Rules, part 8130 subparts .9700 and .9910.

REPORT OF THE ADMINISTRATIVE LAW JUDGE

The above-entitled matter came on for hearing before Administrative Law Judge Howard L. Kaibel, Jr. on March 29, 1993, at 9:00 a.m. in the Skjegstad Seminar Room of the Minnesota Department of Revenue Building in St. Paul, Minnesota.

This Report is part of a rulemaking proceeding held pursuant to Minn. Stat. §§ 14.131 to 14.20 to hear public comment, determine whether the Minnesota Department of Revenue ("the Department") has fulfilled all relevant substantive and procedural requirements of law or rule applicable to the adoption of the rules, determine whether the proposed rules are needed and reasonable, and determine whether or not modifications to the rules proposed by the Department after initial publication are substantially different from those originally proposed.

The Department's hearing panel consisted of John Streiff and Gregory Heck, Department Staff Attorneys. Fifty persons attended the hearing. Twenty-nine persons signed the hearing register. Procedural exhibits from the Department and public exhibits were received as evidence during the hearing. The hearing continued until all interested persons, groups or associations had an opportunity to be heard.

The record remained open for the submission of written comments until April 19, 1993, twenty calendar days following the date of the hearing. Pursuant to Minn. Stat. § 14.15, subd. 1, another five working days were allowed for the filing of responsive comments. At the close of business on April 26, 1993, the rulemaking record closed for all purposes. A number of post-hearing written comments were received from interested persons. The Department representatives submitted written comments responding to matters discussed at the hearing and comments filed during the comment period. The Department made a modification to the rule at the hearing and another during the comment period. At the close of the record, an agreement was reached between the Department and some commentators to further modify the language of the rule.

The agency must wait at least five working days before taking any final action on the rules; during that period, this Report must be made available to all interested persons upon request.

Pursuant to the provisions of Minn. Stat. § 14.15, subd. 3 and 4, this Report has been submitted to the Chief Administrative Law Judge for his approval. If the Chief Administrative Law Judge approves the adverse findings of this Report, he will advise the agency of actions which will correct the defects and the agency may not adopt the rule until the Chief Administrative Law Judge determines that the defects have been corrected. However, in those instances where the Chief Administrative Law Judge identifies defects which relate to the issues of need or reasonableness, the agency may either adopt the Chief Administrative Law Judge's suggested actions to cure the defects or, in the alternative, if the agency does not elect to adopt the suggested actions, it must submit the proposed rule to the Legislative Commission to Review Administrative Rules for the Commission's advice and comment.

If the agency elects to adopt the suggested actions of the Chief Administrative Law Judge and makes no other changes and the Chief Administrative Law Judge determines that the defects have been corrected, then the agency may proceed to adopt the rule and submit it to the Revisor of Statutes for a review of the form. If the agency makes changes in the rule other than those suggested by the Administrative Law Judge and the Chief Administrative Law Judge, then it shall submit the rule, with the complete record, to the Chief Administrative Law Judge for a review of the changes before adopting it and submitting it to the Revisor of Statutes.

When the agency files the rule with the Secretary of State, it shall give notice on the day of filing to all persons who requested that they be informed of the filing.

Based upon all the testimony, exhibits, and written comments, the Administrative Law Judge makes the following:

## FINDINGS OF FACT

### Procedural Requirements

1. On January 28, 1993, the Department filed the following documents with the Chief Administrative Law Judge:

(a) a copy of the proposed rules as certified by the Revisor of Statutes;

(b) the Order for Hearing;

(c) the Notice of Hearing;

(d) the Statement of Need and Reasonableness (SONAR); and

(e) an estimate of the number of persons who were expected to attend the hearing and an estimate of the length of the Department's presentation.

2. On February 8, 1993, the Department mailed the Notice of Intent to Adopt a Rule With a Public Hearing to all persons and associations who had registered their names with the Department for the purpose of receiving such notice.

3. On February 8, 1993, the Department mailed the Notice of Hearing to all persons and associations who had submitted a written request for a public hearing.

4. On November 30, 1992, the proposed rules and a notice that the rule would be adopted without a hearing unless 25 or more persons requested a hearing were published in 17 State Register 1351.

5. On February 16, 1993, the Notice of Hearing was published in 17 State Register 2006. That Notice referenced the previous publication of the proposed rule at 17 State Register 1351.

6. On March 25, 1993, the Department filed the following documents with the Administrative Law Judge:

(a) the Notice of Hearing as mailed;

(b) a copy of the State Register pages containing the Notice of Hearing and referencing the location of the proposed rules in the State Register;

(c) an affidavit stating that the Notice of Hearing was mailed on February 8, 1993, to all persons who submitted a written request for a public hearing in response to the Department's Notice of Intent to Adopt a Rule Without a Public Hearing;

(d) a copy of the Notice of Solicitation of Outside Information or Opinions published in 16 State Register 2570, on May 26, 1992, together with the materials received by the Department in response to the solicitations; and

(e) the names of agency personnel who would represent the Department at the hearing.

7. All documents were available for inspection and copying at the Office of Administrative Hearings from the date of filing to April 26, 1993, the date the rulemaking record closed. Minn. Rule 1400.0600 requires that the documents listed in the foregoing Finding be filed with the Administrative Law Judge at least 25 days before the hearing. The documents were filed four days before the hearing. No participants expressed an interest in the documents prior to the hearing. The documents only reflect actions taken by the Department. Failing to file them in a timely fashion has not impaired anyone's ability to participate in this rulemaking. Under Minn. Stat. 14.15, subdivision 5, the untimely filing constitutes a harmless error and not a defect in this rulemaking.

Nature of the Proposed Rules

8. A sales and use tax is imposed on tangible personal property transfers in Minnesota. Among the items subject to this tax is "canned" computer software. Minn. Stat. § 297A.01, subd. 3(k). "Custom" computer software is exempt from this tax. Id. The Department is modifying its rules to clarify the difference between canned and custom computer software and what taxable effect arises from changes to software programs, sometimes called "updates" or "fixes," that are included in service contracts for computer programs.

Statutory Authority

9. In its Notice of Hearing and SONAR, the Department cites Minn. Stat. § 270.06, subd. 13, as statutory authority for issuance of the proposed rules. That subdivision provides that the Commissioner of Revenue shall:

> administer and enforce the assessment and collection of state taxes and, from time to time, make, publish, and distribute rules for the administration and enforcement of state tax laws. The rules have the force of law.

Minn. Stat. § 270.06, subd. 13.
The Department has adequately documented statutory authority to promulgate these rules.

Small Business Considerations in Rulemaking

10. Minn. Stat. § 14.115, subd. 2, requires that state agencies proposing rules which may affect small businesses must consider methods for reducing adverse impact on those businesses. In its Notice of Hearing and SONAR, the Department indicated that the impact of the proposed rules on small businesses had been considered. It does not expect that any additional burden on small businesses will be imposed by these rules. No commentator maintained that an exemption for small businesses, rather than for computer software, was appropriate. To exempt small businesses from any part of the proposed rules would be contrary to the intent of the sales and use tax statutes. The Department has met the requirements of Minn. Stat. § 14.115, subd. 2.

Fiscal Note

11. Minn. Stat. § 14.11, subd. 1, requires agencies proposing rules that will require the expenditure of public funds in excess of $100,000 per year by local public bodies to publish an estimate of the total cost to local public bodies for the two years immediately following adoption of the rule. In its Notice of Hearing, the Department stated that the proposed rules would not require any expenditure of public money by local units of government. The Department is not required to prepare a fiscal note.

Impact on Agricultural Land

12. Minn. Stat. § 14.11, subd. 2, requires that agencies proposing rules that have a "direct and substantial adverse impact on agricultural land in the state" comply with the requirements set forth in Minn. Stat. §§ 17.80 to 17.84. Under those statutory provisions, adverse impact is deemed to include acquisition of farmland for a nonagricultural purpose, granting a permit for the nonagricultural use of farmland, the lease of state-owned land for nonagricultural purposes, or granting or loaning state funds for uses incompatible with agriculture. Minn. Stat. § 17.81, subd. 2 (1990). Because the proposed rules will not have a direct and substantial adverse impact on agricultural land, Minn. Stat. § 14.11, subd. 2, does not apply.

Substantive Provisions

13. The Department must establish the need for and reasonableness of the proposed rules by an affirmative presentation of facts. The Department prepared a Statement of Need and Reasonableness (SONAR) in support of the adoption of the proposed rules and supplemented its SONAR at the hearing.

The question of whether a rule is reasonable focuses on whether it has a rational basis. The Minnesota Court of Appeals has held a rule to be reasonable if it is rationally related to the end sought to be achieved by the statute. Broen Memorial Home v. Minnesota Department of Human Services, 364 N.W.2d 436, 440 (Minn.App. 1985); Blocker Outdoor Advertising Company v. Minnesota Department of Transportation, 347 N.W.2d 88, 91 (Minn.App. 1984). The Supreme Court of Minnesota has further defined the burden by requiring that the agency "explain on what evidence it is relying and how the evidence connects rationally with the agency's choice of action to be taken." Manufactured Housing Institute v. Pettersen, 347 N.W.2d 238, 244 (Minn. 1984).

This Report is generally limited to discussion of the portions of the proposed rules that received significant critical comment. Because most sections of the proposed rules were not opposed and were adequately supported by the SONAR, a detailed discussion of each section of the proposed rules is unnecessary. The need for and reasonableness of the provisions that are not discussed in this Report have been demonstrated by an affirmative presentation of facts, and such provisions are specifically authorized by statute.

A number of changes were proposed by the Department from the rules as published in the State Register. The Report will assess whether these changes, as well as those suggested by commentators or suggested by the Administrative Law Judge are substantial changes.

The most prominent issues in this proceeding were the taxability of service contracts and instructions.

Minnesota Rule 8130.9910 - Computer Software

Subpart 1 - Definitions

14. Subpart 1 of part 8130.9910 creates eight definitions for use in these rules. Five of the definitions adopt the statutory definitions found in Minn. Stat. § 297A.01. One of those five definitions, item D, defining "canned or prewritten computer program," adds three standards to the statutory treatment of noncustom computer programs. Those standards are: 1) the object code is not modified by the seller; 2) the program is mass-produced for repeated sale, license, or lease; and, 3) a shrink-wrapped, box-top, or tear-open license agreement is used to sell or lease the program. The statutory definition of custom computer program excludes canned or prewritten programs which are:

> 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. Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification. Minn. Stat. § 297A.01, subd. 18.

The additional standards are consistent with the statutory treatment of canned computer software. The Department has demonstrated that item D is needed and reasonable.

15. The most controversial provision of the proposed rules was the proposed tax treatment of maintenance agreements. That term is defined in subpart 1, item F of the proposed rules as:

> "Maintenance agreements" means providing error corrections, improvements, updates, or technical support for computer programs.

Dale H. Busacker, a Principal of Ernst & Young, and Thomas Zessman, also of Ernst & Young, represent a coalition of Minnesota businesses (hereinafter the "Software Maintenance Coalition"), each of which uses computer software and would be affected by the proposed rules. The Software Maintenance Coalition; Sean Nicholson and Rod Backered, both of Target Stores (a division of Dayton-Hudson Corporation); Michael Meinz of the Information Systems Department of General Mills and Henry Duitsman, Director of State and Local Taxes for General Mills; Wayne Olhoft, President of Integrity Engineering; Bill LeBrun of St. Paul Companies; Susan Haffield, Tax Manager of Cargill; Marybeth Brady, Tax Manager for First Bank Systems; Karen Piehler-Shaw, Tax Manager for MTS Corporation; Michael L. Weiner, Vice President for Corporate Tax with IDS Corporation, and Paul Bork, Senior Software Planning Consultant of IDS; Frank Farrell, Jr. and Richard Daly for the Minnesota Software Association; and, Betsy O'Berry, C.P.A. and owner of GGO Enterprises argued strongly that the primary purpose of maintenance agreements is to correct problems that arise through the normal operation of a computer program, which should be considered nontaxable intangibles. Improvements, updates, "fixes," and other new software are often included in the contract between the vendor and purchaser, to be provided on an as-needed basis at the purchaser's demand.

The extensive discussion between Department staff and these commentators at the hearing clarified that both services and items of tangible personal property were included under this definition. Department staff agreed at the hearing to meet with representatives of persons attending to attempt to resolve the conflict over the treatment of maintenance agreements. They did so, and as part of the agreement reached between them, item F is proposed to be modified to read:

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

The agreed-upon language recognizes and defines the services and tangible personal property as separate entities. The new language will allow correction of errors diagnosed off-site to be corrected by supplying a disk with the correction without triggering a taxable event. A clear standard is provided to measure when updates or fixes are taxable. The new language is needed and reasonable. The modification arises directly from the discussions held in the hearing and does not constitute a substantial change.

However, there appears to be a nonsubstantive error in the form of the agreed-upon language. In its proposed format, two definitions would be contained in one item F of subpart 1. While this is not a defect in the proposed rules, it would seem to be more consistent with the existing format to move "upgrades or enhancements" and the accompanying definition to the end of the subpart as a new item I.

Subpart 2 - Tax Applications

16. Subpart 2 sets out the various transactions which occur in the transfer of computer programs and service contracts, and indicates whether each is a taxable or nontaxable event. Item A requires sales tax be paid on the sale, lease, or license of canned computer programs. Item B restates the statutory exemption for custom computer programs. Item C describe the tax treatment of maintenance on computer programs. Item C was significantly modified under the agreement between the Department and commentators. As modified, item C reads as follows:

General Rule 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 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 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% 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.

The agreed upon language meets the needs of the commentators, who unanimously expressed the need to separate (and thereby make nontaxable) the service portion of maintenance contracts from upgrades and enhancements (which are properly taxable). The modified language is, for the most part, needed and reasonable to accomplish this outcome. There appear to be some difficulties with the language agreed to, however, that could be resolved without changing the meaning.

The initial language contained in subpart 2C states that "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." In subitem (2), however, several significant limitations are set out which substantially contradict the "general rule." The contradictions potentially introduce ambiguity and vagueness in the rule. This contradiction can be eliminated by adding ", except as provided in subitem (2)" to the end of the initial language in subpart 2C. The agreed upon language is not legally defective and this is just a suggestion. Likewise, the heading "general rule" should be deleted. All of these rules are general rules and no other item has such a heading. Also, the word "however," should be deleted as unnecessary. With the suggested changes, the first paragraph of subpart 2C would read as follows:

> 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, except as provided in subitem (2). Charges for computer program maintenance furnished for custom software are not taxable.

Neither these changes nor the proposed agreed upon revisions would be substantial changes.

17. The agreed upon revision of the second paragraph attempts to improve on the nonrule character of the original proposed language which purported to describe maintenance contracts, by specifying what "may" be

included, in particular upgrades or enhancements and maintenance agreement support services. However, the paragraph basically introduces a new term, "maintenance contracts" without defining it. Perhaps it would be better to simply eliminate the paragraph altogether. That would not be a substantial change.

If the term is to be defined it should have a full definition and be located in subpart 1. The following definition would appear to accomplish this by rewriting the paragraph and moving it to the end of that subpart:

> J. "Maintenance contract" means an agreement entered into in connection with the sale or lease of software that provides the purchaser will be entitled to receive upgrades or enhancements; maintenance agreement support services; or other services related to the proper operation of the software.

The suggested language would define "maintenance contract" in accordance with the intent of the agreed-upon language and is needed and reasonable. The modification would not be substantial change from either the rule as published in the State Register or the agreed-upon language.

18. The Department staff stated at the hearing that the normal practice in imposing sales tax on maintenance contracts is to determine if the cost of the contract is already included in the sale price. If the cost is included, the entire amount paid is subject to sales tax. Even where the maintenance contract cost is separately stated, the amount is subject to sales tax if the maintenance contract is required to be purchased as a condition of sale. That principle is reflected in subitem (1). The agreed-upon language includes a clarification that the vendor must require the purchase of the maintenance contract for that portion to be taxable. The subitem, as modified, is needed and reasonable. The change is not a substantial change.

19. Where the maintenance contract is optional for the purchaser, the tax status of maintenance contracts is less clear-cut. To resolve the controversy over when optional contracts are taxable and in what amounts, the Department and representatives of objectors agreed on the following language in subpart 2C(2):

> (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% 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.

Under (a), optional maintenance contracts with separately stated charges for maintenance agreement support services are nontaxable to the extent of that separately stated charge. The addition of "or by any other means" is apparently intended to incorporate upgrades or enhancements transferred by modem or entered manually, as well as those transferred by disk.

The Department and the commentators concluded that, as a practical matter, a benchmark figure of 20% accurately reflected the portion of a maintenance contract's cost which went to upgrades and enhancements. Where that cost is not separately stated, 20% of the cost is deemed to be for upgrades and enhancements under (b). That 20% is taxable.

The language in (c) renders the entire cost of a maintenance contract taxable where that contract only provides for canned computer software upgrade or enhancements. This treatment is an appropriate clarification of the tax statutes relating to such upgrades or enhancements. The converse situation is covered in (d) where only maintenance agreement support services are included in the maintenance contract. In that instance, the entire contract cost is nontaxable. The language in (a), (b), (c) and (d) is needed and reasonable. The language in (b) could more clearly state when the 20% treatment applies, by rewording the paragraph as follows:

(b) Where the maintenance contract provides both canned computer software upgrades or enhancements and maintenance agreement support services, and the fee for the 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% of the entire charge for the maintenance contract is subject to sales tax;

This suggested language would clarify the conditions for the 20% treatment, as opposed to the contracts in (c) or (d). The agreed upon language was not legally defective and this revision is merely a suggestion for improvement.

20. Subpart 2D was criticized by Bennett I. Moyle, President of B.I. Moyle Associates, Inc. (BIM), as being unclear as to whether "instructions" means the written manual for a canned computer program or the service of personally training individuals in the use of a program. The Department responded to this comment by amending subpart 2D to read as follows:

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.

The new language removes any potential confusion as to what is or is not taxable for "instructions" or instruction. Subpart 2D is needed and reasonable, as modified. The changes do not constitute substantial changes.

21. Another portion of the rules which uses the "separately stated" charge to determine taxablility is subpart 2H. In that item, two standards are used to determine how much of the cost is taxable when existing prewritten software is modified. The cost is nontaxable custom programming only to the extent of the modification and to the extent that the actual amount is separately stated. In the event that the modification charge is not separately stated, the rule would provide that a modification will be deemed to create a custom program if the charge for the custom programming services was more than (or less than, if it was previously marketed) 50% of the total price to the purchaser.

Marybeth Brady, Assistant Vice President - Tax for First Bank System, objected to the item as providing different treatment for identically prepared computer programs based only on the vendor's contract. She urged that any contract for which more than 50% of the cost is for modification, should be treated as a custom program, whether or not the charges are separately stated. The Department responded that Minn. Stat. § 297A.01, subd. 18 sets out the conditions for determining whether a program is a custom computer program and to vary from the statutory standard would create confusion and uncertainty.

The sales and use tax statute defines "custom computer program." Regarding modifications, the statutory definition states:

> Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification. Minn. Stat. § 297A.01, subd. 18

The Department's approach follows that statutory formula for programs which have separately stated charges. The Department staff would take a different approach for modified programs without separately stated charges. In that case, the staff proposal would treat the program as taxable "unless the modification is so significant that the new program qualifies as a custom program." The Department's approach creates an additional definition for "custom computer program" which is not present in the statute and is at odds with that definition. The rule language potentially both denies a tax exemption to persons who qualify for a partial one and extends a total tax exemption to persons who qualify for something less.

The Department is not statutorily authorized to define "custom computer program" differently from the definition in the statute. The most that the Department can do in this rulemaking is establish a methodology to determine "the extent of the modification" as that phrase is used in Minn. Stat. § 297A.01, subdivision 18. To correct this defect, the Department must delete the language which exceeds the statutory definition for "custom computer program." To carry out the task of determining how much of an exemption applies, the Department may use the following language in the second paragraph of subpart 2H:

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 third paragraph contains a list of records which are acceptable to the Department in determining the extent of the modification to the program. The wording of the third paragraph thus dovetails with the suggested language for the second paragraph. As modified, subpart 2H is needed and reasonable. The changes would not be substantial changes.

22. First Bank System also criticized the Department for the treatment of "preexisting routines" as improper, since these routines are often assembled to meet the particular needs of customers. Just as the statute defines "custom computer program" for determining the tax treatment of portions of the cost, the statute also defines "computer program" to determine the components of custom or canned programs. Minn. Stat. § 297A.01, subdivision 18(3) states:

> (3) "Computer program" means the complete plan for the solution of a problem, such as the complete sequence of automatic data processing equipment instructions necessary to solve a problem and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs.

The statute requires routines to be treated as computer programs for the purpose of determining their tax status. The Department cannot exempt those programs from the statutory definition. The treatment of routines in the proposed rules is needed and reasonable.

23. The Department modified subpart 2J at the hearing to correct a typographical error. The word "not" had been inadvertently left in the rule. The Department deleted that word. The change was not objected to by any commentator and does not constitute a substantial change.

24. BIM objected to subpart 2K as being too general. The item renders work performed to adapt canned programs to a customer's equipment taxable as fabrication labor. The commentator cites circumstances where the employer's own employee or a third party does the work, instead of the vendor. The commentator did not object to the taxable treatment of the vendor's service, only to the possible interpretation of the rule to cover other persons providing the service. The wording of subpart 2K is not ambiguous and cannot be reasonably interpreted to extend to situations outside of services provided with a sale of a canned computer program. Subpart 2K is needed and reasonable as proposed.

25. Subpart 2L is criticized by BIM as being redundant. Subpart 2L renders taxable those charges incurred for "assembler, compiler, utility, and other canned or prewritten computer programs ... [for] ... automatic processing equipment ...." Automatic processing equipment is a subset of that equipment properly termed "computers." A different rule expressly related to automatic processing equipment has been noticed for adoption and this approach was not objected to by any commentators. Clarifying that canned programs for automatic data processing equipment are treated the same as for computers generally is not redundant. Subpart 2L is needed and reasonable as proposed.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

## CONCLUSIONS

1. The Minnesota Department of Revenue gave proper notice of this rulemaking hearing.

2. The Department has fulfilled the procedural requirements of Minn. Stat. § 14.14, subds. 1, 1a, and 2, and all other procedural requirements of law or rule so as to allow it to adopt the proposed rules.

3. The Department has demonstrated its statutory authority to adopt the proposed rules, and has fulfilled all other substantive requirements of law or rule within the meaning of Minn. Stat. §§ 14.05, subd. 1, 14.15, subd. 3, and 14.50(i) and (ii) (1990), except as noted at Finding 21.

4. The Department has demonstrated the need for and reasonableness of the proposed rules by an affirmative presentation of facts in the record within the meaning of Minn. Stat. §§ 14.14, subd. 2, and 14.50(iii) (1990).

5. The additions and amendments to the proposed rules which were suggested by the Department after publication of the proposed rules in the State Register do not result in rules which are substantially different from the proposed rules as published in the State Register within the meaning of Minn. Stat. § 14.15, subd. 3 (1990), and Minn. Rules pts. 1400.1000, subp. 1 and 1400.1100 (1991).

6. The Administrative Law Judge has suggested action to correct the defects cited in Conclusion 3 as noted in Finding 21.

7. Due to Conclusion 3 and Finding 21 this Report has been submitted to the Chief Administrative Law Judge for his approval pursuant to Minn. Stat. 14.15, subd. 3.

8. Any Findings which might properly be termed conclusions and any Conclusions which might properly be termed Findings are hereby adopted as such.

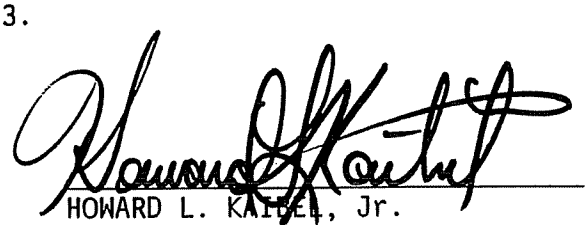
9. A Finding or Conclusion of need and reasonableness in regard to any particular rule subsection does not preclude and should not discourage the Department from further modification of the proposed rules based upon an examination of the public comments, provided that no substantial change is made from the proposed rules as originally published, and provided that the rule finally adopted is based upon facts appearing in this rule hearing record.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

## RECOMMENDATION

IT IS HEREBY RECOMMENDED that the proposed rules be adopted except where specifically otherwise noted above.

Dated this 26th day of May, 1993.



HOWARD L. KAIBEL, Jr.
Administrative Law Judge

Reported: Tape Recorded, No Transcript.