

STATE OF COLORADO

DEPARTMENT OF REVENUE
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GIL-2008-16

Bill Ritter, Jr.
Governor

Roxy Huber
Executive Director

XXXXXXXXXXXXX
Attn: XXXXXXXXX
XXXXXXXXXXXXX
XXXXXXXXXXXXX

February 28, 2008

Re: software updates and support services

Dear XXXXXXXXXX,

This letter is in response to your letter to the Colorado Department of Revenue, dated December 10, 2007, re: the taxability of software updates and support services.

Issues

1. Are software updates to "canned" software taxable if sales tax has already been collected on the original software?
2. Are support services offered in conjunction with the software updates taxable?

Background

You provide the following background. [Company] develops, markets, and licenses web operable human resource management software which the company offers under a traditional perpetual license agreement. The software is characterized as "canned" and delivered to licensees on a DVD media device. Sales tax is collected at the time of licensing.

[Company] also offers an annual maintenance contract for which it charges a fee. Although not expressly stated in your letter, I assume [Company] recommends, but does not require, the licensee purchase the maintenance contract as part of the software licensing agreement. As part of maintenance contract, the company provides licensees with updates to the software. You state that the updates are not necessarily related to the warranty, but they may be updates to fix "bugs" in the programming. Updates are delivered on DVD media devices. The company also provides, as part of the maintenance contract, telephone technical support.

Discussion

Colorado imposes sales and use tax on the sale, use, storage and consumption of tangible personal property and some services. §39-26-104(1)(a), C.R.S. Computer software is taxable if it is pre-packaged "canned" software capable of repeated sale or licensing, delivered to the customer in a

tangible medium, and has a non-negotiable license. See, Department Special Regulation 7 (Computer Software). It appears that the company correctly determined that the original sale (licensing) of its software is taxable.

You ask for guidance regarding the taxability of the software updates and support services. When a retailer requires that, as part of the sale of taxable tangible personal property, the consumer also purchase services for the maintenance or servicing of the property, then the charge for the service is taxable. See, §39-26-105(2), C.R.S. Tax applies to the service charge even if the charge is separately stated in the contract or invoice.

If the customer has the option to purchase the property without also purchasing the warranty or maintenance service, then the charge for such service is not taxable. In some cases, the retailer may also transfer tangible personal property (e.g., a replacement part) to the customer as part of the maintenance or service work. If the property is used to repair, correct, maintain, or otherwise service the original property, then the retailer, not the customer, is considered the consumer of the property. This is because the retailer is replacing defective, damaged, or worn property that was already purchased by the customer. Therefore, the retailer, not the customer, is liable for sales or use tax on such property. Tax is computed on the costs incurred by the retailer to purchase and/or manufacture the warranty or maintenance property. In the context of a software update developed by the retailer, the retailer pays a use tax based on the fair market value of the upgrade.

However, when a software retailer provides enhancements, upgrades, and other software that are other than updates to repair, correct or maintain the original programming (collectively referred to here as “upgrades”), the licensee is acquiring new property. In such cases, the licensee, not the retailer, is the consumer of the property and is liable for sales tax, if any, due on that purchase. If the maintenance contract is optional to the licensee of the canned software, then only the portion of the maintenance fee representing upgrades is taxable, provided the fees for consultation, support services, error corrections, and training services are separately stated and such separate statement is not used as a means of avoiding imposition of tax upon the actual gross receipts from the furnishing of upgrades or manuals. Tax is due on such upgrades if the upgrades meet the criteria set forth in Special Regulation 7 (Computer Software) – i.e., are delivered to the consumer on tangible media, are subject to non-negotiable license, and are not customized for any particular customer (i.e., are repeatedly sold as a pre-package software). If fees for upgrades are not separately stated, the entire charge for the maintenance contract is taxable.

Finally, the Department makes a good faith effort to provide accurate and complete answers to questions posed to it by taxpayers. However, the information and answers provided here are not binding on the Colorado Department of Revenue, nor do they replace, alter, or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having authority to bind the Department, has not formally reviewed and/or approved this response.

Respectfully,

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