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Revenue Administrative Bulletin 1999-5

SALES AND USE TAXATION OF COMPUTER SOFTWARE

Approved: September 28, 1999

(Replaces Revenue Administrative Bulletin 1988-41)

RAB 99-5. This Revenue Administrative Bulletin (RAB) describes how the Michigan Sales and Use Tax applies to computer software. In addition, it describes the taxation of computer software when the method of delivery is by electronic transfer or download. This bulletin supersedes RAB 1988-41.

ISSUES

- I. Is computer software subject to tax?
- II. Does the method of delivery affect the sales or use taxation of computer software?
- III. When is sales tax due? When is use tax due?
- IV. What is the effective date of this RAB?

CONCLUSIONS

- I. Computer software that is offered for sale to the general public (canned software) is subject to Michigan sales or use tax. This includes license agreements for use of such software. Computer software offered for sale to the general public is taxable, regardless of whether the software has been modified for an individual customer. The seller's charge to modify canned software is subject to tax unless it is separately stated on the invoice. Computer software that is originally designed for the exclusive use and needs of a particular purchaser (custom software) is not subject to sales or use tax. A custom software program designed for a particular customer will become canned software if it is offered for sale to others.
- II. Computer software is defined as "a set of statements or instructions that when incorporated in a machine usable medium is capable of causing a machine or device having information processing capabilities to indicate, perform, or achieve a particular function, task, or result." MCL 205.51(1)(f); MSA 7.521(f). There are various types of

software including operating software, application software, and system software. All types of software are subject to sales or use tax if the software is available to the general public as opposed to being custom software. The deciding factor for the taxability of computer software is whether it is canned or custom software.

- III. Canned software, whether modified or not, is subject to the sales or use tax regardless of the method of delivery. A computer program transferred electronically by a network, intranet, the Internet or by any other electronic method is taxable, if the software being transferred is within the definition of canned software.
- IV. Canned software is subject to sales tax when purchased in Michigan from a Michigan retailer. Canned software is subject to seller's use tax when purchased from an out-of-state seller registered for use tax. When purchased from a seller not registered for either sales tax or seller's use tax, the purchaser is subject to consumer's use tax. In this case, the consumer is liable for the tax and must file a use tax return. As in II, canned software is taxable regardless of the method used to deliver the software to the purchaser.
- V. This RAB replaces Revenue Administrative Bulletin 1988-41 and is effective October 1, 1999.

LAW AND ANALYSIS

The Sales Tax Act specifically includes canned computer software in the definition of a "sale at retail". The sale of canned software by a Michigan seller is subject to sales tax regardless of the method of delivery.

Computer software is defined in both the Sales Tax and Use Tax Acts, as

. . . a set of statements or instructions that when incorporated in a machine usable medium is capable of causing a machine or device having information processing capabilities to indicate, perform, or achieve a particular function, task, or result. MCL 205.51(f); MSA 7.521(f) and MCL 205.92(k); MSA 7.555(2)(k).

This includes operating software, systems software, or application software as described in the Single Business Tax Act at MCL 208.9(4)(g)(viii); MSA 7.588 and any other software that meets this definition. The Sales Tax is imposed on sales at retail and

"Sale at retail" includes computer software offered for general sale to the public or software modified or adapted to the user's needs or equipment by the seller, only if the software is available for sale from a seller of software on an as is basis or as an end product without modification or adaptation. Sale at retail does not include specific charges for technical support or for adapting or modifying prewritten, standard, or canned computer software programs to a purchaser's needs or equipment if those charges are separately stated and identified. Sale at retail does not include

computer software originally designed for the exclusive use and special needs of the purchaser. . . . [MCL 205.51(f); MSA 7.521(f)]

Therefore, sales tax is due on the sale of canned computer software and canned software that has been modified by the seller at the request of the purchaser. The charge to modify the software is exempt from sales tax if it is separately stated on the invoice.

A sale at retail, however, does not include computer software originally designed for the exclusive use and special needs of the purchaser. This exemption refers to purely custom computer software, including enhancements and upgrading.

The Use Tax Act is complementary to the Sales Tax Act and is imposed on the storage, use, or consumption of tangible personal property in this state. However, use tax is not levied on property that was subject to the sales tax. The Use Tax Act provides that

"Tangible personal property" includes computer software offered for general use by the public or software modified or adapted to the user's needs or equipment by the seller, only if the software is available from a seller of software on an as is basis or as an end product without modification or adaptation. Tangible personal property does not include computer software originally designed for the exclusive use and special needs of the purchaser. As used in this subdivision, "computer software" means a set of statements or instructions that when incorporated in a machine usable medium is capable of causing a machine or device having information processing capabilities to indicate, perform, or achieve a particular function, task, or result. [MCL 205.92(k); MSA 7.555(2)(k)].

As with the sales tax provisions, use tax is imposed on canned computer software and canned computer software that has been modified. Tangible personal property subject to use tax, however, does not include computer software originally designed for the exclusive use and special needs of a particular purchaser. In other words, purely custom software is not subject to use tax.

The Use Tax Act defines "price" in MCL 205.92(f); MSA 7.55(2)(f) and states that price does not include specific charges for technical support or for adapting or modifying prewritten, standard, or canned computer software programs to a purchaser's needs or equipment if the charges are separately stated and identified. Therefore, as with the sales tax base, the charge for modifying canned software is not subject to use tax if the charge is separately itemized.

Canned computer software may be sold on various media including CDs, disks, tapes, other data processing storage media, computer cards, and printed material. Such software may be licensed by written agreement or sold outright. The Michigan statutes define sales of canned software as sales of tangible personal property and sales at retail for the Use Tax Act and the Sales Tax Act respectively, without distinguishing between methods of delivery. MCL 205.92(k); MSA 7.555(2)(k); MCL 205.51(f); MSA 7.521(f). Accordingly, neither the software medium nor the method of delivery (i.e., tangible or electronic form) has any bearing on the taxability of the

software. Canned computer software programs number in the thousands and many are available for purchase and download via networks, intranets, the Internet, or other electronic methods. All are subject to Michigan sales or use tax.