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STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

GRETCHEN WHITMER
GOVERNOR

RACHAEL EUBANKS
STATE TREASURER

October 4, 2019

[redacted]

Re: [redacted] (d/b/a [redacted])

Dear [redacted]:

Thank you for your letter dated May 16, 2019, requesting a letter ruling regarding the sales and use tax treatment of a software product sold by [redacted] (d/b/a [redacted]) Revenue Administrative Bulletin (RAB) 2016-20 provides that the Department may decline to issue a letter ruling in its sole discretion. Due to the fact specific nature of this inquiry, please consider this response a technical advice letter instead of a letter ruling. Technical advice letters may still be relied on by the taxpayer.

Represented Facts:

[redacted] provides a software product that assists its customers in [redacted]. [redacted] product consists of remote access software that wholly resides on its own servers and a downloadable software application. Aside from the application, [redacted]'s customers cannot install, download, or transfer the software to their own computers. Therefore, the customer has no control over the network, servers, operating systems, storage, or other capabilities of the software. [redacted] software application is downloaded to personal devices of its customers and allows them to input data regarding [redacted] and [redacted]. The application is only operable if the device is connected to the internet. It is anticipated, however, that in the future the application will be usable when offline and then allow for the information to be uploaded to the remote software when the device reconnects to the internet. The application is not necessary to the service provided by [redacted], but most customers make use of the application. Aside from its remote access software and the downloaded application, [redacted] sells no other tangible personal property to its customers. [redacted] customers can access the uploaded data through a website on their computers or through the application.

Law and analysis:

Michigan's General Sales Tax Act (GSTA) imposes a 6% sales tax on the gross proceeds of "all persons engaged in the business of making sales at retail, by which ownership of tangible

personal property is transferred for consideration…"[1] Michigan's Use Tax Act (UTA) imposes a 6% tax "for the privilege of using, storing, or consuming tangible personal property in this state…"[2] The Acts define "tangible personal property" to include "prewritten computer software."[3] The Acts define "prewritten computer software" as:

> [C]omputer software, including prewritten upgrades, that is delivered by any means and that is not designed and developed by the author or other creator to the specifications of a specific purchaser. Prewritten computer software includes the following:
>
> (i) Any combination of 2 or more prewritten computer software programs or portions of prewritten computer software programs.
>
> (ii) Computer software designed and developed by the author or other creator to the specifications of a specific purchaser if it is sold to a person other than that specific purchaser.
>
> (iii) The modification or enhancement of prewritten computer software or portions of prewritten computer software where the modification or enhancement is designed and developed to the specifications of a specific purchaser unless there is a reasonable, separately stated charge or an invoice or other statement of the price is given to the purchaser for the modification or enhancement. If a person other than the original author or creator modifies or enhances prewritten computer software, that person is considered to be the author or creator of only that person's modifications or enhancements.[4]

"Computer software" is defined as "an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions."[5]

In *Auto-Owners Ins Co v Dep't of Treasury*,[6] the Michigan Court of Appeals reviewed two types of software products to determine if they constituted taxable "prewritten computer software." The first type of software consisted of products that did not include the delivery of code that enabled the system to operate. These products did not satisfy the requirement that prewritten computer software must be delivered, in any manner. Rather, the user merely accessed the software that was hosted on a third-party server through a website. The court held that this type of software was not "used" for purposes of the Use Tax Act's definition of "use" because the taxpayer did not exercise "a right or power over the code incident to the ownership of that code…"[7]

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[1] MCL 205.52(1).
[2] MCL 205.93(1). For purposes of this letter, "Acts" refers to both the GSTA and the UTA.
[3] MCL 205.51a(r) and MCL 205.92(k).
[4] MCL 205.51a(p) and MCL 205.92b(p).
[5] MCL 205.51a(c) and MCL 205.92b(c).
[6] 313 Mich App 56 (2015).
[7] *Id* at 73.

The second type of software *Auto-Owners* addressed were products where some prewritten computer software was electronically delivered to the user (i.e., a local client or desktop agent). The court held that the desktop agent constituted the delivery and use of prewritten computer software. However, the court determined that the software was merely incidental to the vendor's professional services. Therefore, it applied the incidental to the service test to determine if the entire transaction was taxable or not.[8]

The "incidental to the service test looks objectively at the entire transaction to determine whether the transaction is principally a transfer of tangible personal property or a provision of a service."[9] The incidental to the service test considers the following factors, none of which is dispositive:

1. what the buyer sought as the object of the transaction,
2. what the seller or service provider is in the business of doing,
3. whether the goods were provided as a retail enterprise with a profit-making motive,
4. whether the tangible goods were available for sale without the service,
5. the extent to which intangible services have contributed to the value of the physical item that is transferred, and
6. any other factors relevant to the particular transaction.[10]

Determining the taxability of computer software is a fact intensive inquiry. Each product must be analyzed based on the type of software and what is delivered to the customer.

When the product you have described is sold without the software application being downloaded it falls within the first type of software at issue in *Auto-Owners*. Therefore, it does not constitute the sale of prewritten computer software and it is not taxable.

When the product is sold with the downloaded application, there is a sale of tangible personal property (i.e., prewritten computer software). In conjunction with the application the customer is also purchasing [redacted] services. Therefore, this constitutes a single-mixed transaction requiring application of the incidental to the service test. [redacted] is in the business of providing [redacted] services. The buyer of this product is seeking [redacted] services. The tangible personal property (i.e., the application) is provided free of charge. [redacted] is charging for its services rather than for the application. The application is not available for sale and would not be useful without also paying for the service [redacted] offers. The Department concludes that the transaction constitutes the sale of a nontaxable service and is not subject to Michigan sales or use tax, consistent with the Court of Appeals decision in *Auto-Owners.*

[8] *Id* at 78.
[9] *Catalina Mktg Sales Corp v Dep't of Treasury*, 470 Mich 13, 24-25 (2004).
[10] *Id* at 26.

Please contact me if you have any further questions regarding this matter.

Sincerely,

Lance R. Wilkinson, Director
Bureau of Tax Policy