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REVENUE ADMINISTRATIVE BULLETIN 1988-41

Approved: June 10, 1988

SALES AND USE TAX - COMPUTER SOFTWARE

(Replaces RAB-87-7)

RAB-88-41. P.A. 259 and P.A. 260 of the Acts of 1987, being MCL 205.51(f) and 205.92(f) and (k), Sales and Use Tax, respectively, provide for the taxation of computer software. The purpose of this Revenue Administrative Bulletin is to revoke and replace Revenue Administrative Bulletin 1987-7 Sales and Use Tax - Computer Software, issued August 12, 1987, and to state the Department's position regarding the 1987 legislation.

Definition of Computer Software

In both the Sales Tax and Use Tax Amendments, computer software is defined as ". . . a set of statements or instructions that when incorporated in a machine usable medium is used to cause a machine or device having information processing capabilities to indicate, perform, or achieve a particular function, task, or result." This includes license agreements.

Sales Tax Amendment

The Sales Tax Amendment provides that a sale at retail includes:

1. Computer software offered for sale to the public, or
2. Software modified or adapted to the user's needs or equipment by the seller, but *only*
 - A. If the software is available for sale from a seller of software on an *as is* basis, or
 - B. As an end product without modification or adaptation.

The statute provides two exceptions to the taxability of computer software. The first exemption is partial. It states that a 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*. Second, sale at retail does not include computer software originally designed for the exclusive use and special needs of the purchaser. This second exemption refers to purely custom software including enhancements and upgrading.



Under the first exception to sales taxation, the adaptation or modification of canned computer software to a purchaser's needs or equipment is not taxable if those charges are separately stated. Under this provision, however, the basic software does remain subject to the sales tax as well as enhancements and upgrading.

Example:

Company X requires computer software to run its payroll. Seller Y has a program that is basically intact but requires modification for the specific needs of Company X. Seller Y modifies the program for Company X and separately identifies and states that charge on the bill of sale. The sales tax is due on the basic software itself, but no tax is due for the modification of the computer software.

Use Tax Amendment

The Use Tax Amendment provides that tangible personal property includes computer software offered for 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. There is one specific exception to taxation under new MCL section 205.92(k). Tangible personal property does not include computer software originally designed for the exclusive use and special needs of the purchaser. In other words, purely custom software is not taxable under the use tax including any enhancements and upgrading.

The Use Tax Amendment also amended the definition of "price" in MCL 205.92(f) to state 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. This provision has the same effect on taxability under the use tax as the example in the sales tax example above.

Discussion

Prior to the amendments to the sales and use taxes described above, the taxation of computer software was authorized under the general provisions of the two statutes. Taxation of computer software was defined by court cases and the Department's Revenue Administrative Bulletin. Under these authorities, canned computer software was fully taxable. If modifications to the software were required to make it perform, it was considered custom and was not subject to either tax. Under the current law, purely canned software remains taxable as before. However, custom software is redefined as software that is developed by the seller specifically for the purchaser or user. This is a very narrow definition leaving few computer software programs exempt from tax under the sales or use taxes. The new legislation defines software that is basically formatted, but for modifications or adaptations to suit the specific needs of the user or purchaser or equipment of the user or purchaser, as taxable. The new legislation subjects a much wider range of computer software to taxation under the sales and use taxes than did prior law.

Canned Software

Canned computer software may be sold on computer cards, disks, tapes, or other data processing storage media as printed material or transmitted via communication devices. Some examples of canned programs are: MacWrite, Lisa, Electric Desk, MacPhone, MegaMerge, Soft Maker II, IBM Writing Assistant, Word Proof, Bank Street Writer III, Display Write I, Crossfire, Kings Quest, MacVegas, Fun Pack, MacEdge, etc.