



STATE OF MICHIGAN  
DEPARTMENT OF TREASURY  
LANSING

GRETCHEN WHITMER  
GOVERNOR

RACHAEL EUBANKS  
STATE TREASURER

January 31, 2024

[REDACTED]

Re: Request for Letter Ruling re Sales Tax Treatment of Certain Transactions Involving Software

Dear [REDACTED]:

Thank you for your letter dated December 5, 2023, requesting a letter ruling regarding the sales tax treatment of certain transactions of [REDACTED] (the "Taxpayer") involving software. 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**

Your letter provides the following purported facts:

The Taxpayer is a foreign-based company whose headquarters are located outside of the United States and whose software is hosted on servers [that] are located outside the state of Michigan. The Taxpayer sells subscriptions to access information hosted in the cloud through a web portal or by a downloaded application onto mobile cell phones (i.e., iPhones and Android phones), or other electronic mobile devices (i.e., iPads or tablets), to customers ("Members") in the United States. The Taxpayer engages in providing a [REDACTED] through customized [REDACTED] services ("Services"). The Taxpayer provides access to [REDACTED]. The Taxpayer also has a [REDACTED]

The Taxpayer offers these Services to Members along with some limited services available to non-members free of charge. To become a Member, a new customer can: 1) create an account on the Taxpayer's website and sign up through a subscription charge or 2) download the free Taxpayer's application ("App") via

application marketplaces, such as the Apple Store or Google Play Store (collectively referred to as the "App Store") and sign up through a subscription charge. With the initiation of the subscription charge, the Taxpayer grants to the Member a non-transferable, non-exclusive, license (without the right to sublicense) to use the Services, solely for the Member's personal use. With either option, the frequency of the subscription charge is selected by the Member. If the subscription expires, the Member loses access to the purchased Services. The Services are fundamentally Software as a Service, and the majority of Services are unattainable without access to the Internet. There are limited functions available in offline mode such as the ability to use various [REDACTED] and to download [REDACTED]. However, most of the offline functions are available in the App for free to anyone who has downloaded it, whether they are Members or not.

Regardless of the method selected to become a Member, the Member is prompted to answer a series of questions around [REDACTED]. These answers supplied by the Members are utilized by an algorithm to provide customized and detailed [REDACTED]. The [REDACTED] provided to a Member are solely determined and delivered by the algorithm and not done with any human interaction, direction, or involvement. The Services include compilations [REDACTED]

(collectively referred to hereafter as "Content") and access to [REDACTED]. Additional Content includes [REDACTED]

The Content is proprietary to the Taxpayer or to third parties. The information may be individualized to the Customer and the Customer receives a personalized [REDACTED]. There is also personalized [REDACTED] that may be digitally supplied to the Member. For an additional fee, Members may obtain [REDACTED]

As previously indicated, the services provided are primarily Software-as-a-Service, requiring an Internet connection for most of the App's Content and functionalities with some features available offline. These features are available to Member and non-members free of charge and include a [REDACTED] which can be downloaded. The [REDACTED] allows customers to log their [REDACTED] and view automatically compiled statistics, available free of charge for all iOS and Android users. However, Android users may incur a charge if they choose to access app-recommended [REDACTED].

Similarly, the [REDACTED] enables customers to record [REDACTED] and view online and offline statistics. This feature is free during a trial period on iOS, but a

Membership is required thereafter. In contrast, Android users can use the [REDACTED] free of charge and would only pay to access the recommended [REDACTED]. The [REDACTED], which collects [REDACTED] data from the user's phone, electronic device, or [REDACTED] via Bluetooth, also functions without an Internet connection. The [REDACTED] records users' [REDACTED] and provides statistics, accessible offline for both Members and non-members using iOS or Android. Finally, the App also offers non-personalized, [REDACTED] that are free and can be downloaded for offline viewing.

### Law and Analysis<sup>1</sup>

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..."<sup>2</sup> Michigan's Use Tax Act (UTA) imposes a 6% tax "for the privilege of using, storing, or consuming tangible personal property in this state..."<sup>3</sup> The Acts define "tangible personal property" to include "prewritten computer software."<sup>4</sup> 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 [all of] 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 if 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.<sup>5</sup>

"Computer software" is defined as "a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task."<sup>6</sup>

<sup>1</sup> For a general discussion of the sales and use taxation of computer software and digital goods, see RAB 2023-10.

<sup>2</sup> MCL 205.52(1).

<sup>3</sup> MCL 205.93(1). For purposes of this letter, "Acts" refers to both the GSTA and the UTA.

<sup>4</sup> MCL 205.51a(r) and MCL 205.92(k).

<sup>5</sup> MCL 205.51a(p) and MCL 205.92b(p).

<sup>6</sup> MCL 205.51a(c) and MCL 205.92b(c).

In *Auto-Owners Ins Co v Dep't of Treasury*,<sup>7</sup> 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 by any means.” 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...”<sup>8</sup>

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 service test to determine if the entire transaction was taxable or not.<sup>9</sup>

The “‘incidental to 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.”<sup>10</sup> The incidental to 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.<sup>11</sup>

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.<sup>12</sup>

When the product you have described is sold without software 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 services. Therefore, this constitutes a single-mixed transaction, requiring application of the incidental to service test.

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<sup>7</sup> 313 Mich App 56 (2015).

<sup>8</sup> *Id* at 73.

<sup>9</sup> *Id* at 78-82.

<sup>10</sup> *Catalina Mktg Sales Corp v Dep't of Treasury*, 470 Mich 13, 24-25 (2004).

<sup>11</sup> *Id* at 26.

<sup>12</sup> *See* RAB 2023-10.

[REDACTED]  
January 31, 2024

Page 5

Applying that test to the represented facts, the Taxpayer is in the business of providing [REDACTED] [REDACTED] services. The buyer of this product is seeking those services. The tangible personal property (i.e., the application) is provided free of charge. The Taxpayer is charging for its services rather than for the application. The application is not available for sale and would not, except for some incidental functions, be useful without also paying for the services the Taxpayer offers.

The Department concludes that the transactions, as represented in your letter, constitute the sale of nontaxable services and are not subject to Michigan sales or use tax, consistent with the Court of Appeals decision in *Auto-Owners*.

Very truly yours,

/s/ David Matelski

David Matelski  
Administrator, Tax Policy Division