

State of Rhode Island - Division of Taxation

Sales and Use Tax

Regulation SU 11-25

Computers, Software, and Related Systems

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RULE 1. PURPOSE

This regulation implements Chapter 44-18 and 44-19 of the Rhode Island General Laws. These Chapters provide for Sales and Use Taxes Liability and Computation and Sales and Use Taxes Enforcement and Collection in regard to computers, software, and related systems.

RULE 2. AUTHORITY

This regulation is promulgated pursuant to RIGL Chapter 44-18 and 44-19 as amended. These rules have been prepared in accordance with the requirements of RIGL Chapter 44-1-1 et. seq. and 44-19-33.

RULE 3. APPLICATION

The terms and provisions of these rules and regulations shall be liberally construed to permit the Department of Revenue to effectuate the purposes of RIGL Chapter 44-18 and 44-19 and other applicable state laws and regulations.

RULE 4. SEVERABILITY

If any provision of these rules and regulations, or the application thereof to any person or circumstances, is held invalid by a court of competent jurisdiction, the validity of the remainder of the rules and regulations shall not be affected thereby.

RULE 5. DEFINITIONS

“Canned software” – See Prewritten computer software.

“Computer” means an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions, and shall include but is not limited to desk top computers, laptop computers, smart phones, and other similar devices.

“Computer hardware” means the physical components of a computer system.

“Computer software” means a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task.

“Computer software maintenance contract” means a contract that obligates a vendor of computer software to provide a customer with future updates or upgrades to computer software, support services with respect to prewritten computer software, or both.

“Custom software” means a program created specifically for one user and prepared to the special order of that user.

“Delivered electronically” means delivered to the purchaser by means other than tangible storage media.

“Electronic” means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

“License” means the right to use, copy or access software.

“Load and leave” means delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser.

“Prewritten computer software” means computer software, including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more prewritten computer software programs or prewritten portions thereof does not cause the combination to be other than prewritten computer software. Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the specific purchaser. Where a person modifies or enhances computer software of which the person is not the author or creator, the person shall be deemed to be the author or creator only of such person’s modifications or enhancements. Prewritten computer software or a prewritten portion thereof that is modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software; provided, however, that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute “prewritten computer software.”

“Specified digital products” means electronically transferred:

- (a) **“Digital Audio-Visual Works”** which means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any:
- (b) **“Digital Audio Works”** which means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones. For purposes of the definition of “digital audio works”, “ringtones” means digitized sound files that are downloaded onto a device and that may be used to alert the customer with respect to a communication.
- (c) **“Digital Books”** which means works that are generally recognized in the ordinary and usual sense as “books”.

RULE 6. COMPUTER HARDWARE

The sale to a consumer of a computer and its related components is taxable when delivered to a customer in this state. The rental of a computer and its related components, including terminal equipment (hardware) which is physically located in this state, is taxable.

RULE 7. COMPUTER SOFTWARE

- (1) Prewritten computer software - The sale of prewritten computer software (“canned”) delivered in tangible form is taxable *including charges by the seller for any services (training, maintenance consultation etc) necessary to complete the sale.* However, installation labor separately stated is not subject to tax.
- (2) Effective October 1, 2011, the sale of prewritten computer software, including application software, delivered electronically or by load and leave, is taxable *including charges by the seller for any services (training, maintenance consultation etc) necessary to complete the sale.*
- (3) When an agreement exists for a vendor to host software from their equipment and may be accessed by a customer, the transaction is not considered prewritten computer software delivered electronically and therefore is not subject to tax, provided there is no downloading of prewritten computer software.
- (4) Modifications to prewritten computer software that are designed to make the software conform to a purchaser’s specifications are not subject to tax, provided the charges are separately stated.
- (5) Custom Software – The sale of custom software as defined above is not subject to tax. This includes any services incidental thereto and any modifications.

If custom software sold to a single purchaser is later sold to others, the later sales are considered sales of prewritten software and are subject to tax.

(6) Specified digital products such as digital audio visual works, digital audio works, digital books, movies, music downloads, and ringtones which are delivered electronically, are not subject to tax, as they are not considered to be prewritten computer software.

RULE 8. MAINTENANCE AGREEMENTS

(1) For periods prior to October 1, 2011, taxability as it pertains to a prewritten computer software maintenance agreement or contract is based on both tangible personal property, and how the updates/upgrades/services per the agreement are received. A computer software maintenance contract in which updates/upgrades are delivered in tangible form is taxable. Updates/upgrades delivered electronically with respect to prewritten software also received electronically are not subject to tax. Updates/upgrades delivered electronically with respect to prewritten software received in tangible format (ex: disk or CD) are subject to tax. However, a contract for mere technical support services is not subject to tax.

The total sale price of tangible prewritten computer software including separately stated charges for computer software maintenance contracts whether received electronically or in tangible format is subject to tax.

(2) Effective October 1, 2011, all prewritten computer software maintenance agreements or contracts delivered electronically are subject to tax regardless of whether the related prewritten computer software was purchased in tangible format or received electronically. However, a contract for mere technical support services is not subject to tax.

The following examples are effective October 1, 2011.

Example #1

A software company has the following charges to a customer:

Prewritten computer software	\$5,000.00
Software maintenance agreement (\$100 per year for five years, paid upfront as part of purchase agreement included with software)	500.00
Sales Tax	385.00
Total	\$5,885.00

Example #2

A software company has the following charges to a customer:

Prewritten computer software	\$5,000.00
Software maintenance agreement (\$100 paid at time of software purchase, and \$100 per year for next 4 years per purchase agreement)	100.00
Sales Tax	357.00
Total	\$5,457.00

Remaining annual payments of \$100 per the computer software maintenance contract delivered electronically or in tangible format are subject to tax.

Example #3

A software company has the following charges to a customer:

Prewritten computer software (tangible format or delivered electronically)	\$5,000.00
Sales Tax	350.00
Total	\$5,350.00
Software maintenance agreement (purchased after the original software purchase and received electronically)	\$ 500.00
Sales Tax	35.00
Total	\$ 535.00

Note: A computer software maintenance agreement purchased on or after October 1, 2011 delivered electronically or in tangible format is subject to tax.

Example #4

A software company has the following charges to a customer:

Custom computer software (tangible)	\$5,000.00
Computer software maintenance contract (\$100 per year for five years, paid upfront as part of purchase agreement included with software)	500.00
Sales Tax	-0-
Total	\$5,500.00

Custom software and related services are not subject to tax.

Example #5

An individual purchases the following:

Prewritten computer software package delivered electronically	\$200.00 *
E-book delivered via digital download	50.00
Music delivered via digital download	75.00
Ringtone delivered via digital download	5.00
Wireless (cellular) phone application	100.00 *
Computer game delivered via digital download	50.00 *
Sales Tax (* items subject to tax)	24.50
Total	\$504.50

RULE 9. SOURCING TRANSACTIONS

(A) Excluding the lease or rental of tangible personal property which is sourced in accordance with RIGL 44-18.1-11(B); the retail sale of a product shall be sourced in accordance with RIGL 44-18.1-11(A) as follows:

(1) When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

(2) When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.

(3) When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.

(4) When subsections (A)(1), (A)(2) and (A)(3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.

(5) When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A)(4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

(B) For the purposes of § 44-18.1-11, subsection (A), the terms "receive" and "receipt" mean:

(1) Taking possession of tangible personal property,

(2) Making first use of services, or

(3) Taking possession or making first use of digital goods, whichever comes first. The terms "receive" and "receipt" do not include possession by a shipping company on behalf of the purchaser.

RULE 10. EFFECTIVE DATE

This regulation takes effect October 1, 2011 and shall amend and supercede regulation SU 09-25 promulgated January 1, 2010.

RULE 11. CROSS REFERENCE

SU 00-126 “Optional Service, Maintenance and Extended Warranty Contracts”

DAVID SULLIVAN
TAX ADMINISTRATOR