



# RULE-MAKING ORDER

**CR-103P (May 2009)**  
(Implements RCW 34.05.360)

**Agency:** Department of Revenue

**Permanent Rule Only**

**Effective date of rule:**

**Permanent Rules**

31 days after filing.

Other (specify) \_\_\_\_\_ ( If less than 31 days after filing, a specific finding under RCW 34.05.380(3) is required and should be stated below)

**Any other findings required by other provisions of law as precondition to adoption or effectiveness of rule?**

Yes  No If Yes, explain:

**Purpose:** The Department engaged in this rule making to amend Rule 15501, adopt two new rules (Rules 15502 and 15503), and repeal Rule 155 to explain the impacts of the 2009 and 2010 legislation, and to address other tax issues related to computer hardware, computer software, and computer services described below.

- Chapter 535, Laws of 2009 (ESHB 2075), made major changes to the taxation of certain products and services provided or furnished electronically (commonly referred to as "digital products"). This legislation specifically imposed sales and use tax on digital products such as: Digital goods, including digital audio works, digital audio-visual works, and digital books; digital automated services; digital codes used to obtain digital goods or digital automated services; and remote-access software. The legislation also provided a number of sales and use tax exemptions.
- Chapter 111, Laws of 2010 (SHB 2620), clarified ambiguities and corrected unintended consequences related to the 2009 legislation.

**Citation of existing rules affected by this order:**

Repealed: WAC 458-20-155 (information and computer services)  
Amended: WAC 458-20-15501 (taxation of computer systems and hardware)  
Suspended:

**Statutory authority for adoption:** RCW 82.32.200 and 82.01.060

**Other authority :**

**PERMANENT RULE (Including Expedited Rule Making)**

Adopted under notice filed as WSR 12-17-161 on August 22, 2012 (date).

Describe any changes other than editing from proposed to adopted version:

**See Attachment**

If a preliminary cost-benefit analysis was prepared under RCW 34.05.328, a final cost-benefit analysis is available by contacting: **Analysis not prepared**

Name: \_\_\_\_\_ phone ( ) \_\_\_\_\_  
Address: \_\_\_\_\_ e-mail \_\_\_\_\_

**Date adopted:** February 25, 2013

**NAME**  
Alan R. Lynn

**SIGNATURE**

**TITLE**  
Rules Coordinator

**CODE REVISER USE ONLY**

OFFICE OF THE CODE REVISER  
STATE OF WASHINGTON  
FILED

**DATE: February 25, 2013**  
**TIME: 3:13 PM**

**WSR 13-06-015**

**Note: If any category is left blank, it will be calculated as zero.  
No descriptive text.**

**Count by whole WAC sections only, from the WAC number through the history note.  
A section may be counted in more than one category.**

**The number of sections adopted in order to comply with:**

<b>Federal statute:</b>	New		Amended		Repealed	
<b>Federal rules or standards:</b>	New		Amended		Repealed	
<b>Recently enacted state statutes:</b>	New	2	Amended	1	Repealed	1

**The number of sections adopted at the request of a nongovernmental entity:**

New	Amended	Repealed
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**Not applicable**

**The number of sections adopted in the agency's own initiative:**

New	2	Amended	1	Repealed	1
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**The number of sections adopted in order to clarify, streamline, or reform agency procedures:**

New	Amended	Repealed
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**Not applicable**

**The number of sections adopted using:**

<b>Negotiated rule making:</b>	New	Amended	Repealed
<b>Pilot rule making:</b>	New	Amended	Repealed
<b>Other alternative rule making:</b>	New	Amended	Repealed



STATE OF WASHINGTON  
**DEPARTMENT OF REVENUE**

**Attachment to CR103**

WAC 458-20-155 (Information and Computer Services)  
WAC 458-20-15501 (Taxation of Computer Systems and Hardware)  
WAC 458-20-15502 (Taxation of Computer Software)  
WAC 458-20-15503 (Digital Products)

**1. Describe any changes other than editing from proposed to adopted version.**

**Rule 155**

- None.

**Rule 15501**

- None

**Rule 15502**

- Added section 2(e) to clarify that certain examples assume nexus, are only a general guide, and stand on their own unless otherwise indicated.
- Added language in 3(b) to clarify that prewritten software remained taxable regardless of method of delivery.
- Added language in section 10 to clarify that the sale of remote access prewritten software was subject to service and other B&O prior to July 26, 2009.
- Added section 10(a) to clarify that remote access to software is a general term that may include custom software which is not subject to retail sales tax.
- Added language to section 11(b) to clarify what exemption certificate should be used.
- Added example 35 to clarify the benefits of the MPU to purchasers.

**Rule 15503**

- Added language in the introduction to the rule to clarify how the rule is supposed to be used similar to a “decision tree.”
- Added language to most examples clarifying tax conclusions for the facts in the example.
- Reordered some existing examples to fit better within the structure of the rule.
- Added language in section 302(d)(i) to clarify that end user transactions involving photography are subject to retail sales tax, and certain other photography transactions remain subject to royalties B&O.
- Added and deleted language in section 303(a) addressing the primarily human effort exclusion in order to simplify and streamline the analysis. We reduced the number of factors to consider to two (time and cost only), clarified that cost includes direct costs only, and also provided for an alternative method for doing the analysis in certain situations. We also deleted previous examples and provided a more simplified example.

- Added language to section (401) to clarify that sales sourced outside Washington are not subject to Washington sales tax.
- Added language to section (505) to clarify that the solely for a business purpose exemption is only available when the buyer provides the seller an exemption certificate.
- Added example 39 to clarify that certain photography transactions remain subject to royalties B&O tax.

REPEALER

The following section of the Washington Administrative Code is repealed:

WAC 458-20-155

Information and computer services.

This rule was adopted on February 25, 2013 and becomes effective March 28, 2013. It may be used to determine tax liability on and after the effective date, until the codified version is available from the code reviser's office.

AMENDATORY SECTION (Amending WSR 09-01-088, filed 12/16/08, effective 1/16/09)

~~WAC 458-20-15501 ((Computer hardware, computer software, information service, and computer services.)) Taxation of computer systems and hardware. ((1) Introduction. This section explains the business and occupation (B&O), retail sales, and use tax treatment of activities related to computer hardware, computer software, information service, and computer services. Such activities include, but are not limited to, selling, leasing, manufacturing, installing, repairing, and maintaining computer hardware and software, as well as developing, duplicating, configuring, licensing, downloading, and accessing computer software.~~

~~This section contains examples that identify a number of facts and then state a conclusion. The examples should be used only as a general guide. The tax results in all situations must be determined after a review of all facts and circumstances.~~

~~The information provided in this section is divided into five parts:~~

~~(a) Part I provides information on taxation of computer systems.~~

~~(b) Part II provides information on taxation of computer hardware.~~

~~(c) Part III provides information on taxation of computer software.~~

~~(d) Part IV provides information on taxation of information services and computer services.~~

~~(e) Part V provides reference to WAC 458-20-155 (Information and computer services) on the distinction between sales of products and sales of services.~~

#### ~~PART I - TAXATION OF COMPUTER SYSTEM~~

~~(101)) (1) Taxation of computer systems.~~

~~(a) **What is a computer?** A "computer" is an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions. RCW 82.04.215. Examples of a computer include, but are not limited to, mainframe computer, laptop, workstation, and desktop computer. "Computer" also includes automatic data processing equipment, which is a computer used for data processing~~

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purposes. "Computer" does not include any computer software or peripheral devices.

(b) **Computer systems and computer networks distinguished.**

A "computer system" is a functional unit, consisting of one computer and associated computer software, whereas a computer network is two or more computers and associated computer software that uses common storage. A computer system may or may not include peripheral devices.

(c) **Wholesale sale of computer systems.** Gross proceeds of sales of computer systems to persons other than consumers (e.g., sales for resale without intervening use) are subject to B&O tax under the wholesaling classification. To verify the wholesale nature of the sale, the seller should obtain a (~~resale certificate~~) reseller permit from the buyer as provided by WAC 458-20-102 (~~(Resale certificates)~~) (Reseller permits).

(d) **Retail sale of computer systems.** Gross proceeds of sales of computer systems to consumers are subject to B&O tax under the retailing classification. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law. If the seller is required to collect Washington sales tax (such as in the case of the seller having nexus with Washington), but does not collect Washington sales tax, the buyer is responsible for remitting retail sales tax (commonly referred to as deferred sales tax), unless the sale is specifically exempt by law. If the seller is not required to collect Washington sales tax, then the buyer is responsible for remitting use tax, unless the transaction is specifically exempt by law. Separately stated charges for custom software sold with the computer system are subject to service B&O tax. (~~(See subsection (302) of this section)~~)

(e) **Manufacturing of computer systems.** Persons manufacturing computer systems are subject to manufacturing B&O tax upon the value of the products. See WAC 458-20-112 (Value of products) and 458-20-136 (Manufacturing, processing for hire, fabricating). Manufacturers of computer systems who sell their products at retail or wholesale are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) B&O tax classifications and may claim a multiple activities tax credit (MATC). See WAC 458-20-19301 (Multiple activities tax credits) for detailed information about the MATC.

(i) Separately stated charges for custom programming sold with the computer system are not subject to manufacturing B&O tax, but are subject to service B&O tax. (~~(See subsection (302) of this section.)~~)

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(ii) Separately stated charges for computer software sold and installed after the sale of a computer system are not subject to manufacturing B&O tax.

(iii) The combining of a computer system with certain peripheral devices is considered a packaging activity not subject to manufacturing B&O tax, when the following occurs:

(A) The peripheral devices remain in the original packaging;

(B) The person does not attach its own label to the peripheral devices;

(C) The person maintains a separate inventory of the peripheral devices for sale apart from the sale of the computer system; and

(D) The charge for the sale of peripheral devices is separately stated from the charge for the sale of computer systems.

~~((+102))~~ (2) Examples.

(a) ABC Computers, Inc., an in-state manufacturer, manufactures and sells at retail computer systems. ABC sells a computer system to Steve for one flat charge. The computer system includes a disk drive, memory, CPU, keyboard, mouse, monitor, and bundled prewritten computer software. ABC is subject to retailing B&O tax and must collect retail sales tax on the sale to Steve. In addition, ABC is subject to manufacturing B&O tax on the value of the product sold (which is generally the sales price). ABC is entitled to claim a multiple activities tax credit.

(b) ADE Computers, Inc., manufactures and sells computer systems at retail to customers. ADE sells to Julie a computer system with certain peripheral devices at separate charges. The computer system without the peripheral devices consists of a disk drive, memory, CPU, and bundled prewritten computer software. The peripheral devices include a keyboard, mouse, and monitor. All peripheral devices remain in the original packaging of the manufacturers. ADE does not attach its own label to the peripheral devices. Finally, ADE maintains a separate inventory of the peripheral devices for sale apart from the sale of ADE's computer systems. ADE is subject to retailing B&O tax and must collect retail sales tax from Julie on the sales of the computer system including the peripheral devices. ADE is subject to manufacturing B&O tax on the value of the computer system excluding the peripheral devices. ADE is entitled to claim a multiple activities tax credit. ADE is not subject to manufacturing B&O tax on the value of the peripheral devices~~((7))~~ because the combining of a computer system with the peripheral devices in this case constitutes packaging activities.

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(c) AFG Computers, Inc., an in-state company, manufactures and sells at retail computer systems. AFG sells a computer system to Joe for a lump sum. Joe purchases from AFG, as part of the sales package, prewritten computer software developed by a third-party software developer. AFG installs the prewritten computer software to Joe's computer. AFG is subject to retailing B&O tax and must collect retail sales tax from Joe on the sale of the computer system, including the bundled prewritten computer software. Also, AFG is subject to manufacturing B&O tax on the value of the computer system, including the value of the prewritten computer software. AFG is entitled to claim a multiple activities tax credit.

(d) Same facts as (c) of this subsection, except that AFG sells and installs the prewritten computer software after Joe purchases and takes possession of the computer system. AFG is subject to retailing B&O tax and must collect retail sales tax from Joe on the sale of the computer system and the prewritten computer software. Also, AFG is subject to manufacturing B&O tax on the value of the computer system. AFG is entitled to claim a multiple activities tax credit. AFG is not subject to manufacturing B&O tax on the value of the prewritten computer software because the installation of the software by AFG is not a part of AFG's manufacturing activity.

~~((PART II -- TAXATION OF COMPUTER HARDWARE~~

~~(201))~~ (3) Taxation of computer hardware, both internal and external peripheral devices.

(a) **What is computer hardware?** For purposes of this section, "computer hardware" includes, but is not limited to, the mechanical, magnetic, electronic, or electrical components of a computer system such as towers, motherboards, central processing units (CPU), hard disk drives, memory, as well as internal and external peripheral devices such as compact disk read-only memory (CD-ROM) drives, compact disk (~~rewriteable~~) rewritable (CD-RW) drives, zip drives, internal and external modems, wireless fidelity (Wi-Fi) devices, floppy disks, compact disks (CDs), digital versatile disks (DVDs), cables, mice, keyboards, printers, monitors, scanners, web cameras, speakers, and microphones.

(b) **Wholesale sale of computer hardware.** Gross proceeds of sales of computer hardware to persons other than consumers (e.g., sales for resale without intervening use) are subject to B&O tax under the wholesaling classification. To verify the wholesale nature of the sale, the seller should obtain a (~~resale certificate~~) reseller permit from the buyer as provided by WAC 458-20-102 (~~(Resale certificates)~~) (Reseller

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permits).

(c) **Retail sale of computer hardware.** Gross proceeds of sales of computer hardware to consumers are subject to B&O tax under the retailing classification. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.

(d) **Manufacturing of computer hardware.** Persons manufacturing computer hardware are subject to manufacturing B&O tax upon the value of the products. See WAC 458-20-112 (Value of products) and 458-20-136 (Manufacturing, processing for hire, fabricating). Manufacturers of computer hardware who sell their products at retail or wholesale are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) B&O tax classifications and may claim a multiple activities tax credit (MATC). See WAC 458-20-19301 (Multiple activities tax credits) for detailed information about the MATC.

~~((202))~~ (4) **Examples.**

(a) ALM Computers, Inc., purchases used computers. ALM replaces a built-in CD-ROM drive with a CD-RW drive and adds a zip drive, additional memory, and an upgraded CPU. ALM is engaged in manufacturing activity subject to manufacturing B&O tax with respect to that computer.

(b) AJK Computers, Inc., acquires damaged computers for refurbishment and sale. AJK removes damaged hardware components and replaces them with new components without upgrading these components. Refurbishing computers in this manner is not a manufacturing activity. Retail sales of such refurbished computers are subject to retailing B&O tax and retail sales tax.

(c) APQ Computers, Inc., purchases computers for refurbishment and sale. APQ replaces the failed zip drive on one of the computers with an upgraded zip drive because the upgrade is the nearest version of the failed component that is available. The manufacturer has discontinued manufacturing the original version of the zip drive because of a flaw in the design. APQ is not engaged in manufacturing activity with respect to that computer. Retail sale of that refurbished computer is subject to retailing B&O tax and retail sales tax.

(d) ATV Computers, Inc., is hired by a call center company to repair damaged computers. ATV removes damaged hardware components and replaces them with new components without upgrading these components. Refurbishing computers in this manner is not a manufacturing activity; however, it is a retail service. Refurbishing computers in this manner is subject to retailing B&O tax and retail sales tax must be collected. See

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WAC 458-20-173 (~~((services on tangible personal property))~~) Installing, cleaning, repairing or otherwise altering or improving personal property of consumers for more information on repairs and maintenance.

~~((203))~~ **(5) Taxation of other activities associated with computer hardware.**

(a) **Installing computer hardware.** Gross proceeds of sales for installing computer hardware are subject to wholesaling or retailing B&O tax, as the case may be. Installation of computer hardware for consumers is subject to retail sales tax. See ~~((WAC 458-20-145))~~ RCW 82.32.730 (sourcing) for more information on sourcing retail sales of computer services. See WAC 458-20-173 (~~((services on tangible personal property))~~) Installing, cleaning, repairing or otherwise altering or improving personal property of consumers for more information on installations.

(b) **Repairing or maintaining computer hardware.** Gross proceeds of sales for repair or maintenance of computer hardware are subject to wholesaling or retailing B&O tax. Repair of computer hardware for consumers is subject to retail sales tax. See ~~((WAC 458-20-145 (sourcing))~~) RCW 82.32.730 for more information on sourcing ~~((retail sales))~~. See WAC 458-20-173 (~~((services on tangible personal property))~~) Installing, cleaning, repairing or otherwise altering or improving personal property of consumers for more information on repairs and maintenance. Also, see WAC 458-20-257 (Warranties and maintenance agreements) for information about repair performed as part of a warranty or maintenance agreement.

### ~~((PART III - TAXATION OF COMPUTER SOFTWARE~~

~~((301) What is computer software?~~ RCW 82.04.215 provides that "computer software" is a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task. All software is classified as either prewritten or custom. "Computer software" includes only those sets of coded instructions intended for use by an end user and specifically excludes retained rights in software and master copies of software. Computer software does not include data.

~~((a) How is computer software delivered?~~ Computer software may be delivered either by intangible means such as electronically or by tangible means such as tangible storage media.

~~((b) What is automatic data processing equipment?~~ "Automatic data processing equipment" includes computers used for data processing purposes and their peripheral equipment.

~~((c) What are retained rights?~~ "Retained rights" means any and all rights, including intellectual property rights such as

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~~those rights arising from copyrights, patents, and trade secret laws, that are owned or are held under contract or license by a software developer, author, inventor, publisher, licensor, sublicensor, or distributor. RCW 82.04.215.~~

~~(d) **What are master copies of software?** "Master copies" of software means copies of software from which a software developer, author, inventor, publisher, licensor, sublicensor, or distributor makes copies for sale or license. RCW 82.04.215.~~

~~(i) **Development of a master copy of software.** Development of a master copy of software by a software developer, or a third party hired by the software developer, that is used to produce copies of software for sale or commercial or industrial use, is not a manufacturing activity. A third party charge for development of a master copy of software is a charge for custom software development and is subject to service and other activities B&O tax.~~

~~(ii) **Use of prewritten computer software by software developer.** The internal use of prewritten computer software by the developer of that software is not subject to use tax because the software developer is not an end user of its own internally developed software. For example, VV Software, Inc., an in state software developer, creates accounting software generally used by small businesses. VV plans to sell its newly created software to other companies. VV also plans to make a copy of this software and use it for its accounting operation. The copy of software used by VV for its accounting operation is not subject to use tax.~~

~~(302) **What is custom software?** "Custom software" is software created for a single person. RCW 82.04.215. The use of library files in software development does not preclude such software from being characterized as custom software, as long as the software is created for a single person. The nature of custom software does not change when ownership is transferred to a person with no rights retained by the transferor.~~

~~For purposes of this section, "library files" are a collection of precompiled and frequently used routines that a software developer can use in developing the software.~~

~~(a) **Creation of custom software.** Gross income received for creating custom software is subject to service and other activities B&O tax.~~

~~(b) **Duplication of custom software.** Duplication of custom software for the same person, or by the same person for the person's own use, does not change the character of the custom software. RCW 82.04.29001. Duplication of custom software for the same person, or by the same person for its own use, is not subject to manufacturing B&O tax.~~

~~If a person duplicates custom software for sale to or use~~

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~~by another person other than the original purchaser, the software becomes prewritten computer software as defined in subsection (303) of this section and is subject to manufacturing B&O tax if the prewritten computer software is delivered by tangible storage media.~~

~~(c) **Sale of custom software.** If custom software is sold to another person other than the original purchaser, the software loses its character as custom software and becomes prewritten computer software as defined in subsection (303) of this section.~~

~~(d) **Use of custom software.** Use of custom software is not subject to use tax.~~

~~(e) **Example.** PFC, Inc., offers data base management software on line to its client through remote access for a monthly fee. PFC developed its software for the specific client and stored the software on its server. PFC is not subject to manufacturing B&O tax or use tax because the data base management software is custom software. PFC's income from the sale of the custom software to the one specific client is subject to service and other activities B&O tax. Additionally, income received for client access and use of the software is subject to service and other activities B&O tax. PFC is hosting its own software for client access and use. See subsection (401)(g) of this section for treatment of gross income received for providing remote access to software applications such as an ASP provides.~~

~~(303) **What is prewritten computer software?** RCW 82.04.215 provides that "prewritten computer software" is computer software, including prewritten upgrades, that 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 result in custom software. Configuration of prewritten computer software to work with other computer software does constitute customization of 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 such purchaser.~~

~~Where a person, who is not the author or creator, modifies or enhances prewritten computer software, that person is deemed to be the author or creator only of the modifications or enhancements made. Prewritten computer software, or a portion thereof, that is modified or enhanced to any degree, remains prewritten computer software, even though the modification or enhancement is designed and developed to the specifications of a~~

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~~specific purchaser. Where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for the modification or enhancement, the modification or enhancement will not be considered prewritten computer software.~~

~~(a) **Wholesale sales of prewritten computer software.** Gross proceeds from sales of prewritten computer software to persons other than consumers (e.g., sales for resale without intervening use) are subject to B&O tax under the wholesaling classification, whether or not ownership or title passes to the buyer, and regardless of any express or implied restrictions upon the buyer. The method of delivery of prewritten computer software does not alter the wholesale nature of the transaction, whether it is through tangible storage media or any electronic means. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place. To verify the wholesale nature of the sale, the seller obtains a resale certificate from the buyer as provided by WAC 458-20-102 (Resale certificates).~~

~~(i) **Distinction between wholesale sales of prewritten computer software and royalties received for the licensing of prewritten computer software.** Sales of prewritten computer software constitute wholesale sales if the reseller, who has no right to reproduce the software for further sales, sells the same software to its customers. The true object of the sale to the reseller is the sale of the software. On the other hand, income received for granting an intangible right to reproduce and distribute copies of prewritten computer software for sale constitutes royalties. The true object of the transaction that generates royalty income is the right to reproduce and relicense the software. See subsection (308) of this section for more information on royalties.~~

~~(ii) **Examples.** The examples presume sellers have nexus with Washington.~~

~~(A) UM Computers, Inc., is a software developer that develops engineering software. UM sells the prewritten computer software at wholesale to OX Computers, Inc., in shrink-wrapped packages. UM delivers the software to OX. OX then resells the software to customers in the same shrink wrapped packages. Sales of prewritten computer software by UM are subject to wholesaling B&O tax. Sales by OX to consumers are retail sales subject to retailing B&O tax and retail sales tax.~~

~~(B) GB Computers, Inc., is a software developer that develops engineering software. GB grants SE Computers, Inc., the right to reproduce and distribute copies of the prewritten~~

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~~computer software for sale. GB retains all of its ownership rights to the software and delivers one copy of the software to SE to reproduce. Amounts received from GB granting the right to reproduce and distribute prewritten computer software to SE are subject to royalties B&O tax. Sales by SE to consumers are retail sales subject to retailing B&O tax and retail sales tax.~~

~~(C) DH Computers, Inc., is a software developer that develops engineering software. DH grants the right to sell its engineering prewritten computer software to WK Computers, Inc. DH delivers the software electronically to WK. WK then sells the software to its customers, who download the software from WK. Income to DH is subject to royalties B&O tax. Sales of prewritten computer software by WK to its customers are retail sales subject to retail sales tax.~~

~~(D) AJ Soft, Inc., is a software developer of architectural drafting software. AJ Soft enters into an agreement with DJ Sales, Inc., to sell AJ Soft's drafting software. DJ Sales must pay a fee for each copy DJ Sales sells through its web site. AJ Soft does not allow DJ Sales to reproduce the drafting software. Customers download the software, but are unaware the software is downloaded directly from AJ Soft. AJ Soft is making a wholesale sale of software to DJ Sales subject to wholesaling B&O tax. DJ Sales is making a retail sale to its Washington customers subject to retail sales tax.~~

~~(b) **Retail sales of prewritten computer software.** Gross proceeds of sales of prewritten computer software to consumers are subject to B&O tax under the retailing classification, whether or not ownership or title passes to the buyer, and regardless of any express or implied restrictions upon the buyer. The method of delivery of prewritten computer software does not alter the retail nature of the transaction, whether it is through tangible storage media or any electronic means. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.~~

~~(c) **Use of prewritten computer software.** Prewritten computer software, regardless of the method of delivery, is generally subject to use tax upon use in this state if Washington retail sales tax was not previously paid. However, use of prewritten computer software is not taxable, if it is provided free of charge, or if it is provided for temporary use in viewing information, or both. RCW 82.12.020. This exception from use tax is limited to prewritten computer software provided~~

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~~free of charge or for temporary use in viewing information, such as free promotional software, donated software, free download of software, and software provided in beta testing to a third party free of charge.~~

~~For purposes of this use tax exception, "beta testing" means the last stage of testing for prewritten computer software prior to its commercial release including the release to manufacturing (RTM). Beta testing may involve sending the software to a third party for the use of the third party. Beta testing is often preceded by a round of testing called alpha testing.~~

~~(i) **Example.** DS Computers, Inc., is a software developer. In order to perform beta testing of its new accounting software prior to commercial release, DS sends a copy of the software free of charge to KG Technologies, Inc. DS is not subject to use tax for the release of the beta software to KG. KG is not subject to use tax for the use of beta software free of charge.~~

~~(ii) **Example.** DH, Inc., provides free card games on-line to its customers. The customers, however, must download DH's free software in order to be able to play card games on-line at DH's web site. Wendy downloads the software free of charge. Wendy is not subject to use tax for the use of the software.~~

~~(iii) **Example.** DW, Inc., provides free software to the public for anyone to watch videos on-line. Roger downloads the software free of charge. Roger is not subject to use tax for the use of the software.~~

~~(d) **Manufacturing of prewritten computer software.** Persons engaged in manufacturing prewritten computer software are subject to manufacturing B&O tax upon the value of the products. See WAC 458 20 112 (Value of products) and WAC 458 20 136 (Manufacturing, processing for hire, fabricating). Manufacturers of prewritten computer software who sell their products at retail or wholesale are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) B&O tax classifications and may claim a multiple activities tax credit (MATC). See WAC 458 20 19301 (Multiple activities tax credits) for detailed information about the MATC.~~

~~(e) **Duplication of prewritten computer software.** Duplication of prewritten computer software for sales to or use by more than one person is subject to manufacturing B&O tax upon the value of products. Duplication of prewritten computer software outside this state is not subject to manufacturing B&O tax regardless of where software development takes place.~~

~~Duplication of prewritten computer software is a manufacturing activity only if the prewritten computer software~~

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~~is delivered from the seller to the purchaser by means of tangible storage media which is retained by the purchaser. RCW 82.04.120.~~

~~When a software developer contracts with a third party to duplicate prewritten computer software, the parties must take into account the value of all tangible and intangible materials or ingredients, including the software code, when determining the relative value of all materials or ingredients furnished by each party. If the third party furnishes less than twenty percent of the total value of all materials or ingredients that become a part of the produced product, then the third party is presumed to be a processor for hire and the software developer is presumed to be a manufacturer. See WAC 458-20-136 (Manufacturing, processing for hire, fabricating) for more information.~~

~~(304) **Site license of prewritten computer software.** A site license provides a consumer acquiring prewritten computer software with the right to duplicate prewritten computer software for use on its own computers, based on the number of computers, the number of workers using the computers, or some other criteria. A site license agreement may cover one site or multiple sites of a purchaser.~~

~~(a) **Retail sales of a site license.** Cross proceeds of sales of a site license to a consumer are subject to B&O tax under the retailing classification, whether or not ownership or title passes to the consumer, and regardless of any express or implied restrictions upon the consumer. Delivery occurs when and where the prewritten computer software subject to the site license is received by the consumer, whether it is through tangible storage media or any electronic means, regardless of the method of delivery. See WAC 458-20-145 (sourcing) for more information on sourcing prewritten computer software. See also WAC 458-20-197 (When tax liability arises) and WAC 458-20-199 (Accounting methods) for details regarding reporting procedures and revenue recognition of retail sales of a site license. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the consumer in determining when and where the sale takes place. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.~~

~~If the prewritten software is hosted by the licensor or a third party for remote access by the licensee (e.g., an Application Service Provider (ASP)), then see subsection (401)(g) of this section.~~

~~(b) **Duplication of prewritten computer software by a person**~~

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~~under a site license.~~ A seller of a site license is subject to manufacturing B&O tax for its own duplication of prewritten computer software. Duplication of prewritten computer software is subject to manufacturing B&O tax only if the prewritten computer software is delivered from the seller to the purchaser by means of tangible storage media which is retained by the purchaser. RCW 82.04.120. Purchaser of a site license is not subject to manufacturing B&O tax for the duplication of prewritten computer software for its own use, pursuant to a site license agreement with the seller.

~~(c) Use of a site license partly in this state and partly outside this state.~~ Where the use of a site license is partly in this state and partly outside this state, the part of the site license used by the person in this state is subject to use tax, provided Washington state sales tax was not previously paid. For example, a person purchases and takes delivery of a site license in California. Pursuant to the multiple site license agreement, this person is licensed to use one thousand copies of prewritten computer software, of which four hundred copies will be used in Washington. Use tax is due on the four hundred copies of prewritten computer software used in this state. If the prewritten software purchased by the licensee is delivered in Washington, then the entire charge for the site license is subject to retail sales tax if purchased from a seller responsible for collecting Washington's sales tax.

~~(d) Sales and use of additional copies of prewritten computer software under the same site license.~~ In some cases, the buyer of a site license may subsequently purchase additional copies of prewritten computer software under the same site license agreement. The seller may or may not deliver any additional copy of the software to the buyer, because the original copy of the software has already been delivered.

~~(i) Retail sales of additional copies of prewritten computer software under the same site license.~~ Retail sales of the additional copies of software occurs when and where the seller delivers any additional copy of prewritten computer software to the buyer, whether it is through tangible storage media or any electronic means, regardless of the method of delivery. See WAC 458-20-145 (sourcing) for more information on sourcing retail sales of prewritten computer software. If the seller does not deliver any additional copy of the software to the buyer, then the sales occur when the sales agreements are made to purchase the additional copies and where the original copy or copies of prewritten computer software was delivered. If the original sale of the site license was subject to manufacturing B&O tax, then the sale of additional licenses are also subject to manufacturing B&O tax.

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~~Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place.~~

~~(ii) **Use of additional copies of prewritten computer software under the same site license.** Where the use of the additional copies of software is partly in this state and partly outside this state and was not previously subject to Washington sales tax, the part of the additional copies of software used by the person in this state is subject to use tax.~~

~~(c) **Examples.**~~

~~(i) DEF Computers, Inc., is located in Washington and sells in this state at retail a multiple site license of its prewritten computer software to P's Design, Inc. A copy of the prewritten computer software is electronically delivered to P's Design in Washington. P's Design then electronically duplicates the software and distributes the software in Washington and several other states for its use. Neither DEF nor P's Design is subject to manufacturing B&O tax. DEF, however, is subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the entire sale of the software.~~

~~(ii) Same facts as (c)(i) of this subsection, except that in addition, DEF delivers a backup copy of the software to P's Design outside Washington. The backup copy of the software is for disaster recovery purposes and is not downloaded to any of P's Design's computers for use. There is no separate charge for the delivery of the backup software. The software manuals are mailed to P's Design in Washington. DEF is still subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the entire sale of the software. Delivery of the software manuals and the backup copy of the software are not relevant in determining when and where the sale takes place. This transaction is not subject to manufacturing B&O tax.~~

~~(iii) Same facts as (c)(i) of this subsection, except that in addition, P's Design subsequently purchases 50 additional copies of the software from DEF under the same site license agreement. P's Design merges with another company, and the additional copies are needed for the use of its new employees. No additional copy of the software is delivered to P's Design in fulfilling this new agreement. Neither DEF nor P's Design is subject to manufacturing B&O tax. DEF, however, is subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the subsequent sale of the 50 additional copies of software because the original copy of the software was delivered in Washington. However, if the original sale of the license had included delivery of the prewritten software by a tangible storage device (and was therefore subject to manufacturing B&O~~

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~~tax), then the licensor is also subject to manufacturing B&O tax based on the value of the additional licenses.~~

~~(iv) GH Computers, Inc., sells at retail a multiple site license of its prewritten computer software to Quick, Inc. GH is located outside Washington, while Quick is located in Washington and in other states and outside the U.S. The desktop software is licensed on an unlimited basis, which means that there are no restrictions of its use by Quick. The software is delivered to Quick outside Washington. Quick then electronically duplicates the software and distributes the software to all of its 500 employees, of which 100 employees are located in Washington. The software is electronically downloaded into the desktop computers of all employees and is immediately put into use. Use tax is due on the value of the 100 copies of prewritten computer software used in Washington.~~

~~(v) Same facts as (c)(iv) of this subsection, except that under the original site license agreement, Quick is entitled to reproduce, distribute, and use up to 500 copies of the desktop software. Then Quick merges with another company, and additional copies are needed for the use of its new employees. Quick, therefore, subsequently purchases 100 additional copies of the software from GH under the same site license agreement. No additional copy of the software is delivered to Quick in fulfilling this new agreement. Quick distributes the additional copies of the software to its 100 new employees, of which 50 employees are located in Washington. Use tax is due on the value of the 50 additional copies of prewritten computer software used in Washington.~~

~~(vi) JJ Computers, Inc., sells at retail a multiple site license of its prewritten computer (server) software to Rest, Inc. JJ is located outside Washington, but Rest is located in Washington and in other states. The server software is delivered to Rest outside Washington. Rest then electronically duplicates the software and distributes the software to its three servers for immediate use. One of the servers is located in Washington, and the other two servers are located outside Washington. Use tax is due on the value of the copy of the prewritten computer (server) software on the server in Washington.~~

~~(305) **Key to activate computer software.** A key, or an enabling or activating code, may be required in some instances to activate computer software and put the software into use, and the key may be delivered to a purchaser after the software is already delivered and in possession of the same purchaser. In such instances, the entire sale of computer software occurs when both the key and the software are delivered to the purchaser. The sale takes place where the software is received by the~~

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~~purchaser in accordance with RCW 82.32.730. However, if the receiving location for the software is unavailable to the vendor because the software was delivered by a third party, then the sale takes place where the key is received in accordance with RCW 82.32.730. There is no separate sale of the key from the software, regardless of how such sale may be characterized by the vendor or by the purchaser.~~

~~See subsection (304) of this section for more information if a site license of prewritten computer software is involved. If the sale of the prewritten software is subject to manufacturing B&O tax, then the sale of the key required by that prewritten software is also subject to manufacturing B&O tax. The income from the sale of a key is part of a sale of prewritten computer software, whether the sales transactions are together or separate.~~

~~(a) **Example.** JKL Computers, Inc., an in state business, sells at retail prewritten computer software to Rebecca. JKL delivers the software to Rebecca in this state. The prewritten computer software, however, cannot be activated without a key. JKL subsequently delivers the key in this state to Rebecca for a separate price. JKL is subject to retailing B&O tax, and it must collect retail sales tax from Rebecca on the entire sale of the software including the separate charge for the key. The entire sale takes place in this state (where the software is delivered) when both the software and the key are delivered to Rebecca. There is no separate sale of the key, regardless of the fact that JKL delivers the key to Rebecca for a separate charge.~~

~~(b) **Example.** Same facts as (a) of this subsection, except that JKL subsequently delivers the key outside this state to Rebecca for a separate price. JKL is subject to retailing B&O tax, and it must collect retail sales tax from Rebecca on the entire sale of the software including the separate charge for the key. The entire sale takes place in this state (where the software is delivered) when both the software and the key are delivered to Rebecca. There is no separate sale of the key, regardless of the fact that JKL delivers the key to Rebecca for a separate charge.~~

~~(c) **Example.** MNO Computers, Inc., is an in state software developer. TKO Computers, Inc., an out-of-state original equipment manufacturer (OEM), agrees in contract with MNO to distribute MNO's prewritten computer software. TKO delivers MNO's inoperable software to Sally as part of the sale of the computer system. Sally, however, must purchase a key directly from MNO in order to activate and use the software. MNO has no knowledge of where the software was initially delivered to Sally, but MNO knows that the key is delivered to Sally in this~~

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~~state. MNO is subject to retailing B&O tax, and it must collect retail sales tax from Sally on the entire sale of the key and the inoperable software. The entire sale takes place in this state because the key is delivered in this state and MNO has no knowledge of where the inoperable software was initially delivered by TKO. Assuming TKO delivers MNO's software to Sally electronically, then duplication of the key would not be subject to manufacturing B&O tax. If TKO delivers the software on tangible storage media, then the key would be subject to manufacturing B&O tax.~~

~~(306) **Client access license and server license for the server software.** A server license, paid for at the time the server software is purchased, grants the buyer the right to install the server software on the buyer's server. A client access license (CAL) grants the buyer the right to access the server software. The CAL is not computer software and is not downloaded into the buyer's computer.~~

~~Charges for server licenses and CAL are a part of the sale of the server software, even if the charges are separately stated. The sales take place where the server software is delivered to the buyer.~~

~~In cases where server software is delivered to the buyer and used in multiple locations, see subsection (304) of this section on site licenses for more information.~~

~~(a) **Example.** ZZ Computers, Inc., an in state business, sells at retail server software to Jack. ZZ delivers the server software to Jack in Washington. ZZ also provides Jack with client access licenses allowing Jack the right to access the server software from his personal computers. The sale of server software to Jack is subject to retailing B&O tax, and ZZ must collect retail sales tax from Jack for the same sale.~~

~~(b) **Example.** Same facts as (a) of this subsection, except that ZZ makes two separate sales at retail of two types of prewritten computer software to Jack. One is server software, and the other is client software (which is different from client access licenses). ZZ delivers the server software to Jack in Washington where Jack's server is located. ZZ delivers the client software to Jack outside Washington where all of Jack's personal computers are located. Only the sale of server software to Jack is subject to retailing B&O tax, and ZZ must collect retail sales tax from Jack for the same sale.~~

~~(307) **Other activities associated with computer software.**~~

~~(a) **Customizing prewritten computer software.** Gross income received for customizing prewritten computer software is subject to service and other activities B&O tax. RCW 82.04.29001.~~

~~(i) **What is customizing prewritten computer software?** RCW 82.04.215 provides that "customization of prewritten computer~~

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software" is any alteration, modification, or development of applications using or incorporating prewritten computer software for a specific person.

"Customization of prewritten computer software" includes individualized configuration of software to work with other software and computer hardware but does not include routine installation. Customization of prewritten computer software does not change the underlying character or taxability of the original prewritten computer software.

~~(ii) Combined charge for prewritten computer software, customization, and routine installation.~~ If a lump-sum charge is made for a sale of prewritten computer software, customization of prewritten computer software, and routine installation, the entire charge is considered to be a sale of prewritten computer software. See (a)(iv) of this subsection for more information on routine installation.

~~(iii) Separately stated charge for customization of prewritten computer software.~~ Where there is a reasonable separately stated charge on an invoice or other statement of the price given to the purchaser for customization of prewritten computer software (including installation that is not routine, see (a)(i) of this subsection), such customization is subject to service and other activities B&O tax. If a charge for customization of prewritten computer software is not separately stated from a sale of prewritten computer software, the entire charge is considered a sale of prewritten computer software.

~~(iv) Customization of prewritten computer software versus routine installation.~~ Customization of prewritten computer software does not include routine installation. "Routine installation" means the process of loading program files and installation files onto a computer. Routine installation does not include installation of the customized elements of prewritten computer software.

~~(v) Separately stated charge for routine installation from customization of prewritten computer software.~~ Where there is a separately stated charge on an invoice or other statement of the price given to the purchaser for routine installation from customization of prewritten computer software, routine installation is subject to retailing B&O tax and retail sales tax. If a charge for routine installation is not separately stated from customization of prewritten computer software, the predominant nature of the transaction determines taxability.

~~(vi) Examples.~~

~~(A) Tee, Inc., is in need of financial modeling software that can tie into most of its existing computer systems. Because of its unique business, however, Tee needs the industry-wide computer software offered by PQR Computers, Inc., that is~~

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~~modified to meet the needs of Tee. Both Tee and PQR are in-state corporations, and the software is delivered in this state. PQR provides a separately stated charge to Tee for customization of prewritten computer software performed in this state that is supported by the terms of the sales agreement. PQR is subject to retailing B&O tax, and it must collect retail sales tax from Tee for the sale of prewritten computer software in Washington. PQR, in addition, is subject to service and other activities B&O tax for the customization of prewritten computer software in Washington.~~

~~(B) Same facts as (a)(vi)(A) of this subsection, except that, in addition, PQR provides a separately stated charge to Tee for routine installation of prewritten computer software in this state. This charge represents installation of only the prewritten portion of the software. In addition to the tax treatments in (a)(vi)(A) of this subsection, PQR is subject to retailing B&O tax and it must collect retail sales tax from Tee for the routine installation in Washington.~~

~~(b) **Installing or uninstalling computer software.**~~

~~(i) Gross income received from installing or uninstalling custom software is subject to service and other activities B&O tax.~~

~~(ii) Gross proceeds of sales for routine installation of prewritten computer software are subject to retailing B&O tax and retail sales tax. See (a)(iv) of this subsection for more information on routine installation. See WAC 458-20-145 (sourcing) for more information on sourcing retail sales of prewritten software and routine installation. Routine installation of prewritten computer software includes charges for labor and services in respect to the installation, such as travel costs for the routine installation of the software. As of July 1, 2008, if the routine installation occurs through remote access by someone outside the state of Washington, then the installation is sourced to where first use occurs. For example, XYZ Computers, Inc., is hired by Dan for routine installation of prewritten software onto Dan's computers. XYZ's out-of-state employee remotely accesses Dan's computers in Washington to install the prewritten software on his computers. If XYZ has nexus with Washington, then it must collect and remit the sales tax. If XYZ does not have nexus, then Dan must pay use tax.~~

~~Gross proceeds of sales of uninstalling prewritten computer software are subject to retailing B&O tax and retail sales tax.~~

~~For example, XYZ Computers, Inc., is hired by Dan to remove spy ware from his computers. Spy ware is prewritten computer software. Removal of spy ware requires uninstalling the spy ware from the computer. XYZ sends an employee to Dan's location~~

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~~to remove spy ware from its computers. Charges for removal of spy ware are subject to retailing B&O tax and retail sales tax.~~

~~(c) **Repairing, altering, or modifying computer software.** Repair of prewritten computer software for more than one person may be distributed as a fix or patch by tangible storage media or electronically in the nature of software upgrades and updates. The sale of prewritten computer software upgrades and updates is a sale of prewritten computer software subject to retailing B&O tax and retail sales tax. See WAC 458-20-145 (sourcing) for more information on sourcing retail sales of computer services.~~

~~Alteration or modification of prewritten computer software performed for a specific person is subject to the service and other activities B&O tax. Such alteration or modification of prewritten computer software for a specific person constitutes customization of prewritten computer software. See RCW 82.04.215.~~

~~Alteration or modification of custom software is subject to service and other activities B&O tax.~~

~~(i) **Example.** STU Computers, Inc., a Washington company, is hired by Betty to perform repairs via remote access on her prewritten computer software in Washington. STU is performing alteration or modification of prewritten computer software for a specific person and is subject to service and other activities B&O tax.~~

~~(ii) **Example.** VW Computers, Inc., an out-of-state service provider, is hired by Clyde to perform alterations or modifications via remote access on his prewritten computer software located in this state. VW's facility is located outside this state. VW may be subject to service and other activities B&O tax if it has nexus with Washington. See WAC 458-20-194 (Apportionment).~~

~~(d) **Maintaining computer software.** Computer software maintenance agreements typically include, but are not limited to, support activities such as telephone consulting, help desk services, remote diagnostic services, and software upgrades and updates.~~

~~(i) **Tax treatment of computer software maintenance agreements in general.** Sales of stand-alone computer software maintenance agreements that include telephone consulting, help desk services, remote diagnostic services, and other professional services are taxable under the service and other activities B&O tax. However, if the services are part of a sale of an extended warranty on or after July 1, 2005, then the sale is subject to retailing B&O tax and retail sales tax. See WAC 458-20-257 (Warranties and maintenance agreements) for information about extended warranties.~~

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~~Stand alone sales of updates or upgrades to prewritten computer software are retail sales of tangible personal property subject to retailing B&O tax and retail sales tax.~~

~~(ii) **Prewritten computer software maintenance agreement with mixed elements.** The sale of a prewritten computer software maintenance agreement that includes professional service components such as telephone consulting and retail components such as upgrades and updates of prewritten computer software is a retail sale subject to retailing B&O tax and retail sales tax.~~

~~In cases where the charges for the professional service component(s) and the retail component(s) are separately stated within a prewritten computer software maintenance agreement and invoice, then each activity is taxed according to the nature of the activity.~~

~~(iii) **Duplication of prewritten computer software upgrades and updates.** Duplication of prewritten computer software upgrades and updates is subject to manufacturing B&O tax upon the value of products, if the software upgrades and updates are delivered by means of tangible storage media which is retained by the purchaser. This is the case regardless of any maintenance agreement with mixed elements involved. The measure of tax is presumed to be the contract price of the maintenance agreement, unless the person can prove otherwise. See WAC 458-20-112 (Value of products) for more information.~~

~~If the software upgrades and updates are delivered from the seller by means other than tangible storage media which is retained by the purchaser, then the software upgrades and updates are not subject to manufacturing B&O tax.~~

~~(iv) **Maintenance agreement on custom software and customized elements of prewritten computer software.** Sales of maintenance or support services relating to custom software or the customized elements of prewritten computer software are subject to the service and other activities B&O tax. Such services, including upgrades and updates, are rendered in respect to the custom or customized software and take on the underlying character and taxability of the custom or customized software.~~

~~(v) **Examples.**~~

~~(A) On December 15, 2005, CBA Computers, Inc., sells at retail a prewritten computer software maintenance agreement to Frank for his software. The software maintenance agreement includes an extended warranty for the software, software upgrades and updates, and telephone consulting services. CBA delivers the software upgrades and updates electronically, as well as provides the maintenance services to Frank at one charge. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the sale of the mixed~~

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agreement.

~~(B) Same facts as (d)(v)(A) of this subsection, except that CBA delivers the software upgrades and updates on compact disks. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the sale of the mixed agreement. In addition, CBA is subject to manufacturing B&O tax on duplication of software upgrades and updates. The measure of tax is presumed to be the contract price of the maintenance agreement, unless CBA can prove otherwise.~~

~~(C) Same facts as (d)(v)(A) of this subsection, except that CBA provides a separately stated charge for each component of the maintenance agreement. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the charges on software upgrades and updates and on the extended warranty purchased after July 1, 2005. CBA is subject to service and other activities B&O tax for the charge on telephone consulting services.~~

~~(D) FED Computers, Inc., sells at retail a computer software maintenance agreement to Greta for her software. The maintenance agreement covers only software upgrades and updates. Greta's software is prewritten computer software with customized elements. FED provides the maintenance services to Greta at one charge. FED is subject to retailing B&O tax, and it must collect retail sales tax from Greta for the sale of the entire maintenance agreement of the prewritten computer software.~~

~~(E) Same facts as (d)(v)(D) of this subsection, except that FED provides a separately stated charge for maintaining the customized elements. FED is subject to service and other activities B&O tax for the charge on maintaining the customized elements. FED is subject to retailing B&O tax, and it must collect retail sales tax from Greta for the charge on maintaining prewritten computer software.~~

~~(e) **Computer software training.** Gross income received for training on the use of custom software is subject to service and other activities B&O tax. Gross income received for training on the use of prewritten computer software is subject to service and other activities B&O tax, if the charge for such training is separately stated from the sale of prewritten computer software. If the charge for software training is not separately stated from the sale of prewritten computer software, the entire charge is considered to be a sale of prewritten computer software subject to retailing B&O tax and retail sales tax.~~

~~(308) **Licensing computer software - royalties.** Income received from charges in the nature of royalties for the licensing of computer software is taxable under the royalties B&O tax classification.~~

~~(a) **What are royalties?** RCW 82.04.2907 provides that~~

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~~"royalties" is compensation for the use of intangible property, such as copyrights, patents, licenses, franchises, trademarks, trade names, and similar items. The true object of a transaction involving royalties is to grant an intangible right to reproduce and distribute copies of computer software for sale. It does not, however, include compensation for the licensing of prewritten computer software to the end user. The manner in which computer software is sold (e.g., volume of transactions, subscription license, term license, or perpetual license) or the manner in which payment amount is determined (e.g., fixed fee per copy, percentage of receipts, lump sum, etc.) does not alter the royalty nature of the transaction.~~

~~(b) **Royalties versus site license.** Regarding royalties, the true object of the transaction is to grant an intangible right to reproduce and distribute copies of computer software for sale. In contrast, the true object of a site license is the sale to an end user of prewritten computer software for use on its computers. See subsection (304) of this section for more information on site licenses.~~

~~(c) **Royalties versus wholesale sales of prewritten computer software.** See subsection (303)(a) of this section for more information.~~

~~(d) **Examples.**~~

~~(i) HG Computers, Inc., an original equipment manufacturer (OEM), acquires prewritten computer software from LL Software, Inc., under a license to reproduce and distribute the prewritten computer software as part of a bundled computer hardware and software package HG sells to end users. LL retains all of its ownership rights to the software. The gross income received by LL from granting intangible rights to reproduce and distribute prewritten computer software to HG is subject to royalties B&O tax.~~

~~(ii) Same facts as (d)(i) of this subsection, except that, in addition, HG acquires a site license from LL for the purposes of using the prewritten computer software as an end user. LL delivers the software to HG. Amounts received by LL for the sale of a site license are subject to retailing B&O tax and retail sales tax.~~

~~(309) Special use tax exemption for computer hardware and computer software donated to certain schools or colleges. Use tax does not apply to the use of computer hardware and computer software irrevocably donated to any public or private nonprofit school or college, as defined under chapter 84.36 RCW. RCW 82.12.0284.~~

~~**PART IV - TAXATION OF INFORMATION SERVICES AND COMPUTER SERVICES**~~

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~~(401) **Activities associated with information services and computer services.** For services described below that are subject to service and other activities B&O tax, see WAC 458-20-194 (Doing business inside and outside the state) for more information on the apportionment of service and other activities B&O tax for taxpayers who maintain places of business both within and without the state that contribute to the rendition of the services.~~

~~(a) **Sales of information services.** Gross income received for information services is subject to service and other activities B&O tax.~~

~~(i) **What are information services?** "Information services" means every business activity, process, or function by which a person transfers, transmits, or conveys data, facts, knowledge, procedures, and the like to any user of such information through any tangible or intangible medium. "Information services" does not include transfers of tangible personal property such as computer hardware or standard prewritten software programs. Neither does "information services" include telecommunication services defined under RCW 82.04.065.~~

~~Effective August 1, 2007, and in accordance with RCW 82.08.705 and 82.12.705, a sales and use tax exemption is provided for sales of electronically delivered standard financial information, if the sale is to an investment management company or a financial institution. Standard financial information is defined as "any collection of financial data or facts, not compiled for a specific consumer, including financial market data, bond ratings, credit ratings, and deposit, loan, or mortgage reports." See RCW 82.08.705.~~

~~(ii) **Examples.**~~

~~(A) XX Statistical Data, Inc., sells statistical data at the specific request of each customer. XX does not compile such statistical information to be available for all customers. Instead, each customer submits its own request of the statistical information based on its needs. XX compiles, analyzes, and summarizes the statistical information it gathers and sends the information to customers in a tangible medium. XX is subject to service and other activities B&O tax for the sales of statistical information, because XX is providing an information service at the specific request of each customer.~~

~~(B) ZZ Statistical Data, Inc., allows its customers to perform on line research of statistical information through its data base. ZZ bills its customers a monthly fee for having on-line access to the data base for research. Its customers do not download any information onto their computers. ZZ is subject to service and other activities B&O tax for providing information services to its customers.~~

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~~(C) WW Travel, Inc., bills its customers a monthly fee for having access to a travel reservation system that includes a charge for dedicated telephone lines. WW is subject to service and other activities B&O tax for providing information services, rather than a telecommunications service. The provider of dedicated telephone lines to WW must collect retail sales tax from WW on the sale of telecommunications service. WW is the consumer of telecommunications service.~~

~~(D) VV Telephone, Inc., provides a satellite based tracking and communications system that includes instant messaging between vehicles in transit and dispatch centers. Both the vehicles and the dispatch centers are operated by its customers, and information is both generated and received by the customers. This is not a sale of information service. The true object of the transaction is the transmission of data between the vehicles and the dispatch centers through VV's communications system. VV is providing telecommunications services subject to retailing B&O tax, and it must collect retail sales tax on the sale of telecommunications services. See RCW 82.32.520 for sourcing of telecommunications services.~~

~~(E) AA Data, Inc., provides a daily report of bond ratings for electronic download by its investment management company consumers. Each investment management company downloads the same report. As of August 1, 2007, AA provides standard financial information that falls within the exemption found in RCW 82.08.705 and 82.12.705. Therefore, AA does not collect or remit retail sales tax.~~

~~(b) **Sales of data processing services.** Gross income received for data processing services is subject to service and other activities B&O tax.~~

~~"Data processing services" includes, but is not limited to, word processing, data entry, data retrieval, data search, information compilation, payroll processing, business accounts processing, data production, and other computerized data and information storage or manipulation. "Data processing services" also includes the use of a computer or computer time for data processing whether the processing is performed by the provider of the computer or by the purchaser or other beneficiary of the service.~~

~~(i) **Example.** JK Processing, Inc., provides payroll processing services to other businesses. JK is subject to service and other activities B&O tax for providing data processing services.~~

~~(ii) **Example.** KL Processing, Inc., processes payroll data related to its employees. KL is not subject to manufacturing B&O tax or use tax for the electronic processing of its own data.~~

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~~(c) **Sales of internet services.** Gross income received for internet services are subject to service and other activities B&O tax.~~

~~(i) **What is the internet?** "Internet" means the international computer network of both federal and nonfederal interoperable packet switched data networks, including the graphical subnetwork called the world wide web. RCW 82.04.297.~~

~~(ii) **What are internet services?** "Internet service" is a service furnished by an internet service provider (ISP) that allows users access to the internet. The ISP must provide the service through use of computer processing applications that either provide the user with additional or restructured information or permit the user to interact with stored information through the internet or a proprietary subscriber network. "Internet service" includes the following services furnished by the ISP:~~

~~✍ Provision of internet electronic mail;~~

~~✍ Access to the internet for information retrieval; and~~

~~✍ Hosting of information for retrieval over the internet.~~

~~"Internet service" does not include telecommunications service as defined in RCW 82.04.065.~~

~~(iii) **What is a proprietary subscriber network?** "Proprietary subscriber network" means proprietarily or privately owned network in which its services are available to the public for fees. Proprietary subscriber network does not include intranets.~~

~~(iv) **Examples.**~~

~~(A) ISP, Inc., is an internet service provider that provides customers with access to the internet. ISP does not furnish any telephone lines to its customers in providing this access. ISP maintains its operation in Washington. Amelia is charged a monthly internet access fee from ISP for access to the internet in Washington. ISP is subject to service and other activities B&O tax for the monthly internet access fee charged to Amelia.~~

~~(B) Same facts as (c)(iv)(A) of this subsection, except that ISP provides customers with access to the internet along with telephone lines used to provide that access. Amelia is charged a combined monthly fee for access to the internet in Washington using the telephone lines. ISP is subject to service and other activities B&O tax for the combined fee, because the true object of the transaction is to provide access to the internet, rather than to provide telecommunications service.~~

~~(C) Telecomm Co. provides customers with telephone lines for telecommunications, including long distance service, and for access to the internet (internet services). Zoe is charged a combined monthly fee for access to the internet and for~~

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communication services in Washington using the telephone lines. Telecomm Co. is subject to retailing B&O tax for the combined fee because the primary purpose of the transaction is to provide telecommunications service, rather than to provide access to the internet. However, if Telecomm Co. separately states or can reasonably identify from its books and records the fees for telecommunications service and internet access, then Telecomm Co. will be subject to retail and service classifications respectively.

(D) ~~DD Computers, Inc., provides access to information through its web site for which it charges its users a fee. DD charges Stan, an out of state customer, a transaction fee to use DD's web site to search and retrieve real estate appraisal information. DD is not providing internet service because DD is not an ISP and does not provide customers with access to the internet. DD, however, is providing Stan access to its web site for informational search and retrieval which is subject to service and other activities B&O tax.~~

~~(d) **Sales of intranet services.** Gross proceeds of sales of intranet services are sales of telecommunications service defined under RCW 82.04.065 and are subject to retailing B&O tax and retail sales tax.~~

~~"Intranet service" means the service of providing a private or intracompany network used by a person to facilitate the sharing or accessing of internal information by the person's employees or other authorized parties.~~

~~(e) **Sales of Voice over Internet Protocol (VoIP) services.** "VoIP service" is a service that enables subscribers to use the internet as the transmission medium for telephone calls by sending voice data in packets in internet protocol. Gross proceeds of sales of VoIP services are sales of telecommunications service defined under RCW 82.04.065 subject to retailing B&O tax and retail sales tax.~~

~~(f) **Sales of network system support services.** Gross income received for network system support services is subject to service and other activities B&O tax. "Network system support" activities include analyzing and interpreting problems using diagnostic software, monitoring network to ensure network availability to users, and performing network system configurations. Network system support activities may be performed through remote telephone support or on site consulting.~~

~~(g) **Sales of remote access to prewritten software. I.e., application service providers (ASPs) or software as a service (SAAS).** Gross income received for providing remote access to applications on the host's servers are subject to service and other activities B&O tax, when the service is performed in~~

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Washington. Sellers of remote access to applications (e.g., ASPs) may be able to apportion income if they perform activities in multiple states (i.e., servers used in multiple states to host the software). See WAC 458-20-194 (apportionment).

"ASP" means a provider that generally offers customers with electronic access to applications on the ASP's server. ASP generally does not provide computer software for customers to download. ASP, however, may provide downloadable codes in order for customers to access its applications on its server that are only incidental to the services provided to customers.

(i) **Example.** BE Software, Inc., offers a variety of prewritten software products on line, but not for download, to its customers for a monthly subscription fee. BE Software is subject to service and other activities B&O tax for its subscription fees received.

(ii) **Example.** Same facts as (g)(i) of this subsection, except that, in addition, BE provides computer software for customers to download before the on line software can be used. The downloaded software does not provide any function other than confirm registration and provide access codes necessary for a customer to be able to use the on line software. The downloaded software is provided as part of the monthly subscription fee. Once the subscription ends, the access software the customers downloaded will not perform any function. BE Software is subject to service and other activities B&O tax for its subscription fees received, because the true object of the transaction is to provide on-line software to its customers.

(iii) **Example.** Same facts as (g)(i) of this subsection, except that, in addition, BE offers an option to allow its customers to download a limited number of software applications for an additional fee. Kelly purchases and downloads a number of additional prewritten software packages from BE in this state. BE is subject to retailing B&O tax, and BE must collect retail sales tax from Kelly on the additional fee for the sale of downloaded software.

(h) **Sales of web site development or hosting services.** Gross income received for web site development or hosting services are subject to service and other activities B&O tax.

"Web site development service" means the design and development of a web site provided by a web site developer to a customer. "Web site hosting service" means providing server space to host a customer's web site.

(i) **Sales of on-line advertising services.** Gross income received for on line advertising services are subject to service and other activities B&O tax. See RCW 82.04.280 and 82.04.214 for tax treatment of the electronic form of a printed newspaper.

For example, BB.com sells souvenir items through the

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~~internet. BB.com provides on line advertising services for third parties. Income received for on line advertising services is subject to service and other activities B&O tax.~~

~~(j) **Sales of data warehousing services.** Gross income received for data warehousing services is subject to service and other activities B&O tax. "Data warehousing service" means the service of a provider offering server space for a customer to store its data and to access, retrieve, or use the data as needed.~~

~~(i) **Example.** HH Recovery, Inc., provides substitute computer systems so that its customers may access its computer facilities for disaster recovery purposes, if such customers experience unplanned computer system failures. Lance pays a monthly subscription fee for this service. HH is subject to service and other activities B&O tax for the sale of data warehousing services to Lance.~~

~~(ii) **Example.** Same facts as (j)(i) of this subsection, except that, in addition, HH performs "live" data backup for disaster recovery purposes. HH purchases prewritten computer software to perform "live" backup of data. HH is subject to use tax for the use of prewritten computer software to perform "live" backup of data.~~

#### ~~PART V - DISTINCTION BETWEEN SALES AND SERVICES~~

~~(501) **Current WAC 458-20-155 makes a distinction between sales and services.** Liability for sales or use tax depends upon whether the subject of the sale is a product or a service. Professional and personal services rendered to a client are not generally subject to retail sales or use tax. If the consumer's true object of the transaction is obtaining professional or personal services, similar to those performed by a public accountant, architect, lawyer, etc., then the retail sales or use tax is not applicable. The retail sales and use tax is not applicable because these services are performed to meet a consumer's specific needs and any property transferred in the transaction is considered the medium in or on which those services are rendered and is merely the tangible evidence of a professional service rendered.~~

~~If the true object of the transaction is a product made available to any consumer and not created to meet the particular needs of a specific consumer, regardless of the method of delivery, then the transaction is taxable under the retailing B&O tax classification and taxable as a retail sale. The term "product" includes tangible personal property, such as prewritten software. This is no different from a usual inventory of tangible personal property held for sale or lease,~~

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~~and the sale or lease of such products is a sale at retail subject to retail sales tax or use tax.~~

~~Please see WAC 458-20-155 for more information.))~~

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NEW SECTION

**WAC 458-20-15502 Taxation of computer software.** (1) **What is computer software?** RCW 82.04.215 provides that "computer software" is a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task. All software is classified as either prewritten or custom. "Computer software" includes only those sets of coded instructions intended for use by an end user and specifically excludes retained rights in software and master copies of software. Computer software does not include data.

(a) **How is computer software delivered?** Computer software may be delivered either by intangible means such as electronically downloaded or by tangible means such as tangible storage media.

(b) **What is automatic data processing equipment?** "Automatic data processing equipment" includes computers used for data processing purposes and their peripheral equipment.

(c) **What are retained rights?** "Retained rights" means any and all rights, including intellectual property rights such as those rights arising from copyrights, patents, and trade secret laws, that are owned or are held under contract or license by a software developer, author, inventor, publisher, licensor, sublicensor, or distributor. RCW 82.04.215.

(d) **What are master copies of software?** "Master copies" of software means copies of software from which a software developer, author, inventor, publisher, licensor, sublicensor, or distributor makes copies for sale or license. RCW 82.04.215.

(i) **Development of a master copy of software.** Development of a master copy of software by a software developer, or a third party hired by the software developer, that is used to produce copies of software for sale or commercial or industrial use, is not a manufacturing activity. A third-party charge for development of a master copy of software is a charge for custom software development and is subject to service and other activities B&O tax.

(ii) **Use of prewritten computer software by software developer.** The internal use of prewritten computer software by the developer of that software is not subject to use tax because the software developer is not an end user of its own internally developed software. For example, VV Software, Inc., an in-state software developer, creates accounting software generally used

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by small businesses. VV plans to sell its newly created software to other companies. VV also plans to make a copy of this software and use it for its accounting operation. The copy of software used by VV for its accounting operation is not subject to use tax.

(2) **What is custom software?** "Custom software" is computer software created for a single person. RCW 82.04.215. The use of library files in software development does not preclude the developed software from being characterized as custom software, as long as the software is created for a single person. The nature of custom software does not change when ownership is transferred to a person with no rights retained by the transferor.

For purposes of this section, "library files" are a collection of precompiled and frequently used routines that a software developer can use in developing the software. The purchase or use of such "library files" may be subject to retail sales or use tax as the sale of prewritten software.

(a) **Creation of custom software.** Gross income received for creating custom software is subject to service and other activities B&O tax.

(b) **Duplication of custom software.** Duplication of custom software for the same person, or by the same person for the person's own use, does not change the character of the custom software. RCW 82.04.29001. Duplication of custom software for the same person, or by the same person for its own use, is not subject to manufacturing B&O tax.

If a person duplicates custom software for sale to or use by another person other than the original purchaser, the software becomes prewritten computer software as defined in subsection (3) of this section and is subject to manufacturing B&O tax if the prewritten computer software is delivered by tangible storage media.

(c) **Sale of custom software.** If custom software is sold to another person other than the original purchaser, the software loses its character as custom software and becomes prewritten computer software as defined in subsection (3) of this section.

(d) **Use of custom software.** Use of custom software is not subject to use tax.

(e) The examples included in this rule identify a number of facts and then state a general conclusion; they should be used only as a general guide. Additionally, each fact pattern in each example is self contained (e.g., "stands on its own") unless otherwise indicated by reference to another example. The tax consequences of all situations must be determined after a review of all the facts and circumstances. Examples requiring that sales tax be collected by the seller assume that the seller

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has "tax nexus" with Washington and no exclusions or exemptions apply and the sale is sourced to Washington.

(f) **Example 1.** PFC, Inc., develops software for its client. PFC is not subject to manufacturing B&O tax because the software is custom software. PFC's income from the sale of the custom software to the one specific client is subject to service and other activities B&O tax.

(3) **What is prewritten computer software?** RCW 82.04.215 provides that "prewritten computer software" is computer software, including prewritten upgrades, patches, fixes, etc., that 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 result in custom software. Configuration of prewritten computer software to work with other computer software does constitute customization of 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 such purchaser.

Where a person, who is not the author or creator, modifies or enhances prewritten computer software, that person is deemed to be the author or creator only of the modifications or enhancements made. Prewritten computer software, or a portion thereof, that is modified or enhanced to any degree, remains prewritten computer software, even though the modification or enhancement is designed and developed to the specifications of a specific purchaser. Where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for the modification or enhancement, the modification or enhancement will not be considered prewritten computer software.

(a) **Wholesale sales of prewritten computer software.** Gross proceeds from sales of prewritten computer software to persons other than consumers (e.g., sales for resale without intervening use) are subject to B&O tax under the wholesaling classification, whether or not ownership or title passes to the buyer, and regardless of any express or implied restrictions upon the buyer. The method of delivery of prewritten computer software does not alter the wholesale nature of the transaction, whether it is through tangible storage media or any electronic means. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place. To verify the wholesale nature of the sale, the seller obtains a

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reseller permit from the buyer as provided by WAC 458-20-102 (Reseller permits).

(i) **Distinction between wholesale sales of prewritten computer software and royalties received for the licensing of prewritten computer software.** Sales of prewritten computer software constitute wholesale sales if the reseller, who has no right to reproduce the software for further sales, sells the same software to its customers. The true object of the sale to the reseller is the sale of the software. On the other hand, income received for granting an intangible right to reproduce and distribute copies of prewritten computer software for sale constitutes royalties. The true object of the transaction that generates royalty income is the right to reproduce and relicense the software. See subsection (8) of this section for more information on royalties.

(ii) **Examples.**

(A) **Example 2.** UM Computers, Inc., develops engineering software. UM sells the prewritten computer software at wholesale to OX Computers, Inc., in shrink-wrapped packages. UM delivers the software to OX. OX then resells the software to customers in the same shrink-wrapped packages. Sales of prewritten computer software by UM are subject to wholesaling B&O tax. Sales by OX to consumers are retail sales subject to retailing B&O tax and retail sales tax.

(B) **Example 3.** GB Computers, Inc., develops engineering software. GB grants SE Computers, Inc., the right to reproduce and distribute copies of the prewritten computer software for sale to end users. GB retains all of its ownership rights to the software and delivers one copy of the software to SE to reproduce and sell. Amounts received by GB from SE for granting the right to reproduce and distribute prewritten computer software are subject to royalties B&O tax. Sales by SE to consumers are retail sales subject to retailing B&O tax and retail sales tax.

(C) **Example 4.** DH Computers, Inc., develops engineering software. DH grants to WK Computers, Inc., the right to copy and redistribute its prewritten computer software. DH delivers the software electronically to WK. WK then sells the software to its customers, who download a copy of the software from WK. Income to DH from WK is subject to royalties B&O tax. Sales of prewritten computer software by WK to its customers are retail sales subject to retail sales tax.

(D) **Example 5.** AJ Soft, Inc., is a software developer of architectural drafting software. AJ Soft enters into an agreement with DJ Sales, Inc., to sell AJ Soft's drafting software. DJ Sales must pay a fee for each copy DJ Sales sells through its web site. AJ Soft does not allow DJ Sales to

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reproduce the drafting software. Customers download the software, but are unaware the software is downloaded directly from AJ Soft. AJ Soft is making a wholesale sale of software to DJ Sales subject to wholesaling B&O tax. DJ Sales is making a retail sale to its Washington customers subject to retail sales tax.

(E) **Example 6.** Same facts as Example 5, however, instead of customers downloading the prewritten software, DJ Sales' customers access the prewritten software remotely on AJ Soft's servers. AJ Soft is still making a wholesale sale of remotely accessed prewritten software to DJ Sales subject to wholesaling B&O tax. DJ Sales is making a retail sale of remotely accessed prewritten software to its Washington customers subject to retail sales tax.

(b) **Retail sales of prewritten computer software.** Gross proceeds of sales of prewritten computer software to consumers are subject to B&O tax under the retailing classification, whether or not ownership or title passes to the buyer, and regardless of any express or implied restrictions upon the buyer. Regardless of the method of delivery, whether through tangible media or electronic means, prewritten computer software remains subject to retail sales tax and retailing B&O tax. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.

(c) **Use of prewritten computer software.** Prewritten computer software, regardless of the method of delivery, is generally subject to use tax upon use in this state if Washington retail sales tax was not previously paid. However, use of prewritten computer software is not taxable, if it is provided free of charge, or if it is provided for temporary use in viewing information, or both. RCW 82.12.020. This exception from use tax is limited to prewritten computer software provided free of charge or for temporary use in viewing information, such as free promotional software, donated software, free download of software, and software provided in beta testing to a third-party free of charge.

For purposes of this use tax exception, "beta testing" means the last stage of testing for prewritten computer software prior to its commercial release including the release to manufacturing (RTM). Beta testing may involve sending the software to a third party for the use of the third party. Beta testing is often preceded by a round of testing called alpha

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testing.

(i) **Example 7.** DS Computers, Inc., is a software developer. In order to perform beta testing of its new accounting software prior to commercial release, DS sends a copy of the software free of charge to KG Technologies, Inc. DS is not subject to use tax for the release of the beta software to KG. KG is not subject to use tax for the use of beta software free of charge.

(ii) **Example 8.** DH, Inc., provides free card games on-line to its customers. The customers, however, must download DH's free software in order to be able to play card games on-line at DH's web site. Wendy downloads the software free of charge. Wendy is not subject to use tax for the use of the software.

(iii) **Example 9.** DW, Inc., provides free software to the public for anyone to watch videos on-line. Roger downloads the software free of charge. Roger is not subject to use tax for the use of the software.

(d) **Manufacturing of prewritten computer software.** Persons engaged in manufacturing prewritten computer software on tangible storage media are subject to manufacturing B&O tax upon the value of the products. See WAC 458-20-112 (Value of products) and WAC 458-20-136 (Manufacturing, processing for hire, fabricating). Manufacturers of prewritten computer software who sell their products at retail or wholesale are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) B&O tax classifications and may claim a multiple activities tax credit (MATC). See WAC 458-20-19301 (Multiple activities tax credits) for detailed information about the MATC. Income from the sale of prewritten software electronically delivered or transferred is not subject to manufacturing B&O tax.

(e) **Duplication of prewritten computer software.** Duplication of prewritten computer software on tangible media for sales to or use by more than one person is subject to manufacturing B&O tax upon the value of products which includes both the value of the tangible media and the software. Duplication of prewritten computer software on tangible media outside this state is not subject to manufacturing B&O tax regardless of where software development takes place.

Duplication of prewritten computer software is a manufacturing activity only if the prewritten computer software is delivered from the seller to the purchaser by means of tangible storage media which is retained by the purchaser. RCW 82.04.120.

When a software developer contracts with a third party to

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duplicate prewritten computer software, the parties must take into account the value of all tangible and intangible materials or ingredients, including the software code, when determining the relative value of all materials or ingredients furnished by each party. If the third party furnishes less than twenty percent of the total value of all materials or ingredients that become a part of the produced product, then the third party is presumed to be a processor for hire and the software developer is presumed to be a manufacturer. See WAC 458-20-136 (Manufacturing, processing for hire, fabricating) for more information.

(4) **Site license of prewritten computer software.** A site license provides a consumer acquiring prewritten computer software with the right to duplicate prewritten computer software for use on its own computers, based on the number of computers, the number of workers using the computers, or some other criteria. A site license agreement may cover one site or multiple sites of a purchaser.

(a) **Retail sales of a site license.** Gross proceeds of sales of a site license to a consumer are subject to B&O tax under the retailing classification, whether or not ownership or title passes to the consumer, and regardless of any express or implied restrictions upon the consumer. Delivery occurs when and where the prewritten computer software subject to the site license is received by the consumer, whether it is through tangible storage media or any electronic means, regardless of the method of delivery. See RCW 82.32.730 for more information on sourcing prewritten computer software. Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the consumer in determining when and where the sale takes place. Persons making retail sales are responsible for collecting retail sales tax at the time of sale and remitting the tax to the department, unless the sale is specifically exempt by law.

If the prewritten software is hosted by the licensor or a third party for remote access by the licensee, then see subsection (10) of this section.

(b) **Duplication of prewritten computer software by a person under a site license.** A seller of a site license is subject to manufacturing B&O tax for its own duplication of prewritten computer software. Duplication of prewritten computer software is subject to manufacturing B&O tax only if the prewritten computer software is delivered from the seller to the purchaser by means of tangible storage media which is retained by the purchaser. RCW 82.04.120. Purchaser of a site license is not subject to manufacturing B&O tax for the duplication of

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prewritten computer software for its own use, pursuant to a site license agreement with the seller.

(c) **Use of a site license partly in this state and partly outside this state.** The part of the site license used by the person in this state is subject to use tax, provided Washington state sales tax was not previously paid. For example, a person purchases and takes delivery of a site license in California. Pursuant to the multiple site license agreement, this person is licensed to use one thousand copies of prewritten computer software, of which four hundred copies will be used in Washington. Use tax is due on the four hundred copies of prewritten computer software used in this state. If the prewritten software purchased by the licensee is delivered in Washington, then the entire charge for the site license is subject to retail sales tax if purchased from a seller responsible for collecting Washington's sales tax. However, a purchaser can issue a multiple points of use exemption certificate under certain circumstances to minimize Washington tax as discussed below in subsection (11) of this section.

(d) **Sales and use of additional copies of prewritten computer software under the same site license.** In some cases, the buyer of a site license may subsequently purchase additional copies of prewritten computer software under the same site license agreement. The seller may or may not deliver any additional copy of the software to the buyer, because the original copy of the software has already been delivered.

(i) **Retail sales of additional copies of prewritten computer software under the same site license.** Retail sales of the additional copies of software occurs when and where the seller delivers any additional copy of prewritten computer software to the buyer, whether it is through tangible storage media or any electronic means, regardless of the method of delivery. If the seller does not deliver any additional copy of the software to the buyer, then the sales occur when the sales agreements are made to purchase the additional copies and where the original copy or copies of prewritten computer software was delivered. If the original sale of the site license was subject to manufacturing B&O tax, then the sale of additional licenses are also subject to manufacturing B&O tax.

Delivery of software manuals and backup copies of prewritten computer software does not alter the delivery of the actual copy of prewritten computer software to be used by the buyer in determining when and where the sale takes place.

(ii) **Use of additional copies of prewritten computer software under the same site license.** Where the use of the additional copies of software is partly in this state and partly outside this state and was not previously subject to Washington

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sales tax, the part of the additional copies of software used by the person in this state is subject to use tax.

(e) **Examples.**

(i) **Example 10.** DEF Computers, Inc., is located in Washington and sells in this state, at retail, a multiple site license of its prewritten computer software to P's Design, Inc. A copy of the prewritten computer software is electronically delivered to P's Design in Washington. P's Design then electronically duplicates the software and distributes the software in Washington and several other states for its use. Neither DEF nor P's Design is subject to manufacturing B&O tax. DEF, however, is subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the entire sale of the software unless P's Design provides DEF with a multiple points of use exemption certificate as discussed in subsection (11) of this section.

(ii) **Example 11.** Same facts as Example 10, except that in addition, DEF delivers a backup copy of the software to P's Design outside Washington. The backup copy of the software is for disaster recovery purposes and is not downloaded to any of P's Design's computers for use. There is no separate charge for the delivery of the backup prewritten software. The software manuals are mailed to P's Design in Washington. DEF is still subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the entire sale of the software unless P's Design provides DEF with a multiple points of use exemption certificate as discussed in subsection (11) of this section. Delivery of the software manuals and the backup copy of the software are not relevant in determining when and where the sale takes place. This transaction is not subject to manufacturing B&O tax.

(iii) **Example 12.** Same facts as Example 10 of this subsection, except that in addition, P's Design subsequently purchases 50 additional copies of the software from DEF under the same site license agreement. P's Design merges with another company, and the additional copies are needed for the use of its new employees. No additional copy of the software is delivered to P's Design in fulfilling this new agreement. Neither DEF nor P's Design is subject to manufacturing B&O tax. DEF, however, is subject to retailing B&O tax, and it must collect retail sales tax from P's Design for the subsequent sale of the 50 additional copies of software because the original copy of the software was delivered in Washington unless P's Design provides DEF with a multiple points of use exemption certificate as discussed in subsection (11) of this section. However, if the original sale of the license had included delivery of the prewritten software by a tangible storage device (and was

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therefore subject to manufacturing B&O tax), then the licensor is also subject to manufacturing B&O tax based on the value of the additional licenses.

(iv) **Example 13.** GH Computers, Inc., sells at retail a multiple site license of its prewritten computer software to Quick, Inc. GH is located outside Washington, while Quick is located in Washington, other states and other countries. The desktop software is licensed on an unlimited basis, which means that there are no restrictions of its use by Quick. The software is delivered to Quick outside Washington. Quick then electronically duplicates the software and distributes the software to all of its 500 employees, of which 100 employees are located in Washington. The software is electronically downloaded into the desktop computers of all employees and is immediately put into use. Use tax is due on the value of the 100 copies of prewritten computer software used in Washington.

(v) **Example 14.** Same facts as Example 13 of this subsection, except that under the original site license agreement, Quick is entitled to reproduce, distribute, and use up to 500 copies of the desktop software. Then Quick merges with another company, and additional copies are needed for the use of its new employees. Quick, therefore, subsequently purchases 100 additional copies of the software from GH under the same site license agreement. No additional copy of the software is delivered to Quick in fulfilling this new agreement. Quick distributes the additional copies of the software to its 100 new employees, of which 50 employees are located in Washington. Use tax is due on the value of the 50 additional copies of prewritten computer software used in Washington.

(5) **Key to activate computer software.** A key, or an enabling or activating code, may be required in some instances to activate computer software and put the software into use, and the key may be delivered to a purchaser after the software is already delivered and in possession of the same purchaser. In such instances, the sale of computer software occurs when both the key and the software are delivered to the purchaser. The sale takes place where the software is received by the purchaser in accordance with RCW 82.32.730. However, if the place of receipt for the software is unavailable to the vendor because the software was delivered by a third party, then the sale takes place where the key is received in accordance with RCW 82.32.730. There is no separate sale of the key from the software, regardless of how such sale may be characterized by the vendor or by the purchaser.

See subsection (4) of this section for more information if a site license of prewritten computer software is involved. If the sale of the prewritten software is subject to manufacturing

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B&O tax, then the sale of the key required by that prewritten software is also subject to manufacturing B&O tax. The income from the sale of a key is part of a sale of prewritten computer software, whether the sales transactions are together or separate.

(a) **Example 15.** JKL Computers, Inc., an in-state business, sells at retail prewritten computer software to Rebecca. JKL delivers the software to Rebecca in this state. The prewritten computer software, however, cannot be activated without a key. JKL subsequently delivers the key in this state to Rebecca for a separate price. JKL is subject to retailing B&O tax, and it must collect retail sales tax from Rebecca on the entire sale of the software including the separate charge for the key. The entire sale takes place in this state (where the software is delivered) when both the software and the key are delivered to Rebecca. There is no separate sale of the key, regardless of the fact that JKL delivers the key to Rebecca for a separate charge.

(b) **Example 16.** Same facts as Example 15 of this subsection, except that JKL subsequently delivers the key outside this state to Rebecca for a separate price. JKL is subject to retailing B&O tax, and it must collect retail sales tax from Rebecca on the entire sale of the software including the separate charge for the key. The entire sale takes place in this state (where the software is delivered) when both the software and the key are delivered to Rebecca. There is no separate sale of the key, regardless of the fact that JKL delivers the key to Rebecca for a separate charge.

(c) **Example 17.** MNO Computers, Inc., is an in-state software developer. TKO Computers, Inc., an out-of-state original equipment manufacturer of computers (OEM), agrees in contract with MNO to distribute MNO's prewritten computer software on its computers. TKO delivers MNO's inoperable software to Sally as part of the sale of the computer system. Sally, however, must purchase a key directly from MNO in order to activate and use the software. MNO has no knowledge of where the software was initially delivered to Sally, but MNO knows that the key is delivered to Sally in this state. MNO is subject to retailing B&O tax, and it must collect retail sales tax from Sally on the entire sale of the key and the inoperable software. The entire sale takes place in this state because the key is delivered in this state and MNO has no knowledge of where the inoperable software was initially delivered by TKO.

(6) **Client access license and server license for the server software.** A server license, paid for at the time the server software is purchased, grants the buyer the right to install the server software on the buyer's server. A client access license

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(CAL) grants the buyer the right to access the server software.

Charges for server licenses and CAL are a part of the sale of the server software, even if the charges are separately stated. The sales take place where the server software is delivered to the buyer.

In cases where server software is delivered to the buyer and used in multiple locations, see subsection (4) of this section on site licenses for more information.

(a) **Example 18.** ZZ Computers, Inc., an in-state business, sells at retail server software to Jack. ZZ delivers the server software to Jack in Washington. ZZ also provides Jack with client access licenses for free allowing Jack the right to access the server software from his personal computers. The sale of server software to Jack is subject to retailing B&O tax, and ZZ must collect retail sales tax from Jack for the same sale.

(b) **Example 19.** Same facts as Example 18 of this subsection, except that ZZ makes two separate sales at retail of two types of prewritten computer software to Jack. One is server software, and the other is client software (which is different from client access licenses). ZZ delivers the server software to Jack in Washington where Jack's server is located. ZZ delivers the client software to Jack outside Washington where all of Jack's personal computers are located. Only the sale of server software to Jack is subject to retailing B&O tax, and ZZ must collect retail sales tax from Jack for the same sale. Jack may use a multiple points of use exemption certificate for the server software. See subsection (11) of this section for more detail on multiple points of use.

**(7) Other activities associated with computer software.**

(a) **Customizing prewritten computer software.** Gross income received for customizing prewritten computer software is subject to service and other activities B&O tax. RCW 82.04.29001.

(i) **What is customizing prewritten computer software?** RCW 82.04.215 provides that "customization of prewritten computer software" is any alteration, modification, or development of applications using or incorporating prewritten computer software for a specific person.

"Customization of prewritten computer software" includes individualized configuration of software to work with other software and computer hardware but does not include routine installation. Customization of prewritten computer software does not change the underlying character or taxability of the original prewritten computer software.

(ii) **One nonitemized price for prewritten computer software, customization, and routine installation.** If prewritten computer software, customization of prewritten

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computer software, and routine installation are sold for a one nonitemized price, the entire charge is considered to be subject to retail sales tax. See (a)(iv) of this subsection for more information on routine installation.

(iii) **Separately stated charge for customization of prewritten computer software.** Where there is a reasonable separately stated charge on an invoice or other statement of the price given to the purchaser for customization of prewritten computer software (including installation that is not routine, see (a)(i) of this subsection), such customization is subject to service and other activities B&O tax. If a charge for customization of prewritten computer software is not separately stated from a sale of prewritten computer software, the entire charge is considered a retail sale subject to retail sales tax.

(iv) **Customization of prewritten computer software versus routine installation.** Customization of prewritten computer software includes custom installations but does not include routine installation. "Routine installation" means the process of loading program files and installation files onto a computer. Routine installation includes the process of "clicking through" dialog boxes to install prewritten software. Routine installation does not require any specialized knowledge or skills. Custom installation generally requires programming by a programmer to integrate customized elements of prewritten computer software.

(v) **Separately stated charge for routine installation from customization of prewritten computer software.** Where there is a reasonable separately stated charge on an invoice or other statement of the price given to the purchaser for routine installation from customization of prewritten computer software, routine installation is subject to retailing B&O tax and retail sales tax. If a charge for routine installation is not separately stated from customization of prewritten computer software and is de minimis, the transaction would not be subject to retail sales tax, but instead subject to service and other activities B&O tax.

(vi) **Examples.**

(A) **Example 20.** Tee, Inc., needs financial modeling software that can tie into its existing computer systems. Because of its unique business, however, Tee needs the industry-wide computer software offered by PQR Computers, Inc., to be modified to meet the needs of Tee. Both Tee and PQR are in-state corporations, and the software is delivered in this state. PQR provides a separately stated charge to Tee for customization of prewritten computer software performed in this state that is supported by the terms of the sales agreement. PQR is subject to retailing B&O tax, and it must collect retail sales tax from

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Tee for the sale of prewritten computer software in Washington. PQR, in addition, is subject to service and other activities B&O tax for the customization of prewritten computer software in Washington.

(B) **Example 21.** Same facts as Example 20 of this subsection, except that, in addition, PQR provides a separately stated charge to Tee for routine installation of prewritten computer software in this state. This charge represents installation of only the prewritten portion of the software. In addition to the tax treatments in Example 20 of this subsection, PQR is subject to retailing B&O tax and it must collect retail sales tax from Tee for the routine installation in Washington.

(b) **Installing or uninstalling computer software.**

(i) Gross income received from installing or uninstalling custom software is subject to service and other activities B&O tax.

(ii) Gross proceeds of sales for routine installation of prewritten computer software are subject to retailing B&O tax and retail sales tax. See (a)(iv) of this subsection for more information on routine installation. Routine installation of prewritten computer software includes charges for labor and services in respect to the installation, such as travel costs for the routine installation of the software. As of July 1, 2008, if the routine installation occurs through remote access by someone outside the state of Washington, then the installation is sourced pursuant to RCW 82.32.730.

**Example 22.** XYZ Computers, Inc., is hired by Dan for routine installation of prewritten software onto Dan's computers. XYZ's out-of-state employee remotely accesses Dan's computers in Washington to install the prewritten software on his computers. If XYZ has nexus with Washington, then it must collect and remit the sales tax. If XYZ does not have nexus, then Dan must pay use tax.

Gross proceeds of sales from uninstalling prewritten computer software are subject to retailing B&O tax and retail sales tax.

**Example 23.** XYZ Computers, Inc., is hired by Dan to remove prewritten computer software from his computers. Removal of the prewritten computer software requires uninstalling the software from the computer. XYZ sends an employee to Dan's location to remove the software from his computers. Charges for removal of the prewritten computer software are subject to retailing B&O tax and retail sales tax.

(c) **Repairing, altering, or modifying computer software.**

Repair of prewritten computer software for more than one person may be distributed as a fix or patch by tangible storage media or electronically in the nature of software upgrades and

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updates. The sale of prewritten computer software upgrades and updates is a sale of prewritten computer software subject to retailing B&O tax and retail sales tax.

Alteration or modification of prewritten computer software performed for a specific person is subject to the service and other activities B&O tax. Such alteration or modification of prewritten computer software for a specific person constitutes customization of prewritten computer software. See RCW 82.04.215.

(i) **Example 24.** STU Computers, Inc., a Washington company, is hired by Betty to perform repairs (using primarily human effort) via remote access on her prewritten computer software in Washington. STU is performing alteration or modification of prewritten computer software for a specific person and is subject to service and other activities B&O tax.

(ii) **Example 25.** VW Computers, Inc., an out-of-state service provider, is hired by Clyde to perform alterations or modifications (using primarily human effort) via remote access on his prewritten computer software located in this state. VW's facility is located outside this state. VW may be subject to service and other activities B&O tax if it has nexus with Washington.

(d) **Maintaining computer software.** Computer software maintenance agreements typically include, but are not limited to, support activities such as telephone consulting, help desk services, remote diagnostic services, and software upgrades and updates.

(i) **Tax treatment of computer software maintenance agreements in general.** Sales of stand-alone computer software maintenance agreements that include telephone consulting, help desk services, remote diagnostic services, and other professional services only, are taxable under the service and other activities B&O tax. However, if the services are part of a sale of an extended warranty on or after July 1, 2005, then the sale is subject to retailing B&O tax and retail sales tax. See WAC 458-20-257 (Warranties and maintenance agreements) for information about extended warranties.

Stand-alone sales of updates or upgrades to prewritten computer software are retail sales of tangible personal property subject to retailing B&O tax and retail sales tax.

(ii) **Prewritten computer software maintenance agreement with mixed elements.** The sale of a prewritten computer software maintenance agreement for a single nonitemized price that includes professional service components such as telephone consulting and retail components such as upgrades and updates of prewritten computer software is generally considered a retail sale subject to retailing B&O tax and retail sales tax unless

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charges for the upgrades and updates are de minimis.

In cases where the charges for the professional service component(s) and the retail component(s) are separately stated within a prewritten computer software maintenance agreement and invoice, then each activity is taxed according to the nature of the activity.

(iii) **Duplication of prewritten computer software upgrades and updates.** Duplication of prewritten computer software upgrades and updates is subject to manufacturing B&O tax upon the value of products, if the software upgrades and updates are delivered by means of tangible storage media which is retained by the purchaser. This is the case regardless of any maintenance agreement with mixed elements involved. The measure of tax is presumed to be the contract price of the maintenance agreement, unless the person can prove otherwise. See WAC 458-20-112 (Value of products) for more information.

If the software upgrades and updates are delivered from the seller by means other than tangible storage media which is retained by the purchaser, then the software upgrades and updates are not subject to manufacturing B&O tax.

(iv) **Maintenance agreement on custom software and customized elements of prewritten computer software.** Sales of maintenance or support services relating to custom software or the customized elements of prewritten computer software are subject to the service and other activities B&O tax. Such services, including upgrades and updates, are rendered in respect to the custom or customized software and take on the underlying character and taxability of the custom or customized software.

(v) **Examples.**

(A) **Example 26.** On December 15, 2005, CBA Computers, Inc., sells at retail a prewritten computer software maintenance agreement to Frank for his prewritten software. The software maintenance agreement includes an extended warranty for the software, software upgrades and updates, and telephone consulting services for a single nonitemized price. The consulting services are not offered exclusively in connection with the software, nor are they essential to use of the software. CBA delivers the software upgrades and updates electronically. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the sale of the mixed agreement.

(B) **Example 27.** Same facts as Example 26 of this subsection, except that CBA delivers the software upgrades and updates on compact disks. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the sale of the mixed agreement. In addition, CBA is subject to

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manufacturing B&O tax on duplication of software upgrades and updates. The measure of tax is presumed to be the contract price of the maintenance agreement, unless CBA can prove otherwise.

(C) **Example 28.** Same facts as Example 26 of this subsection, except that CBA provides a separately stated charge for each component of the maintenance agreement. CBA is subject to retailing B&O tax, and it must collect retail sales tax from Frank for the charges on prewritten software upgrades and updates and on the extended warranty purchased after July 1, 2005. CBA is subject to service and other activities B&O tax for the charge on telephone consulting services.

(D) **Example 29.** FED Computers, Inc., sells at retail a computer software maintenance agreement to Greta for her software. The maintenance agreement covers only software upgrades and updates. Greta's software is prewritten computer software with customized elements. FED provides the maintenance services to Greta at one nonitemized charge. FED is subject to retailing B&O tax, and it must collect retail sales tax from Greta for the sale of the entire maintenance agreement of the prewritten computer software.

(E) **Example 30.** Same facts as Example 29 of this subsection, except that FED provides a separately stated charge for maintaining the customized elements. FED is subject to service and other activities B&O tax on the charges for maintaining the customized elements. FED is subject to retailing B&O tax, and it must collect retail sales tax from Greta for the charge on maintaining prewritten computer software.

(e) **Computer software training.** Gross income received for training on the use of custom software is subject to service and other activities B&O tax. Gross income received for training on the use of prewritten computer software is subject to service and other activities B&O tax, if the charge for such training is separately stated from the sale of prewritten computer software. If the charge for software training is not separately stated from the sale of prewritten computer software and the prewritten software value is more than de minimis, the entire charge is considered to be a retail sale subject to retailing B&O tax and retail sales tax.

(8) **Licensing computer software - Royalties.** Income received from charges in the nature of royalties for certain licensing of computer software is taxable under the royalties B&O tax classification.

(a) **What are royalties?** RCW 82.04.2907 provides that "royalties" means compensation for the use of intangible property, such as copyrights, patents, licenses, franchises,

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trademarks, trade names, and similar items. The true object of a transaction involving royalties is to grant an intangible right to reproduce and distribute copies of computer software for sale. It does not, however, include compensation for the licensing of prewritten computer software to the end user. The manner in which computer software is sold (e.g., volume of transactions, subscription license, term license, or perpetual license) or the manner in which payment amount is determined (e.g., fixed fee per copy, percentage of receipts, lump sum, etc.) does not alter the royalty nature of the transaction.

(b) **Royalties versus site license.** Regarding royalties, the true object of the transaction is to grant an intangible right to reproduce and distribute copies of computer software for sale. In contrast, the true object of a site license is the sale to an end user of prewritten computer software for use on its computers. See subsection (4) of this section for more information on site licenses.

(c) **Royalties versus wholesale sales of prewritten computer software.** See subsection (3)(a) of this section for more information.

(d) **Examples.**

(i) **Example 31.** HG Computers, Inc., an original equipment manufacturer (OEM), acquires prewritten computer software from LL Software, Inc., under a license to reproduce and distribute the prewritten computer software as part of a bundled computer hardware and software package HG sells to end users. LL retains all of its ownership rights to the software. The gross income received by LL from granting intangible rights to reproduce and distribute prewritten computer software to HG is subject to royalties B&O tax.

(ii) **Example 32.** Same facts as Example 31 of this subsection, except that, in addition, HG acquires a site license from LL for the purposes of copying and using the prewritten computer software as an end user. LL delivers the software to HG. Amounts received by LL for the sale of a site license are subject to retailing B&O tax and retail sales tax.

(9) **Special use tax exemption for computer hardware and computer software donated to certain schools or colleges.** Use tax does not apply to the use of computer hardware and prewritten software irrevocably donated to any public or private nonprofit school or college, as defined under chapter 84.36 RCW. RCW 82.12.0284.

(10) **Sales of remote access software.**

(a) **Remote access custom software.** Sales of remote access custom software on the seller's (or a third-party's) servers are subject to service and other B&O tax.

(b) **Remote access prewritten software.** Sales of remote

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access prewritten software on the seller's (or a third-party's) servers are subject to retail sales tax, when the sale is sourced to Washington pursuant to RCW 82.32.730. Sale of remote access prewritten software prior to July 26, 2009, were subject to service and other activities B&O tax.

**Example 33.** BE Software, Inc., a Washington corporation, offers a variety of prewritten software products on-line, but not for download, to its customers for a monthly subscription fee. BE Software must charge Washington customers retail sales tax and is subject to retailing B&O tax for the subscription fees received from its Washington customers.

(c) **Exemptions from retail sales or use tax for remote access prewritten software.** The following exemptions only apply to remote access prewritten software, and not other types of prewritten software sold.

(i) **Offered free.** Purchases of prewritten software that will be offered remotely by the purchaser to its own customers is exempt from retail sales tax. RCW 82.04.190 (2)(f). The purchaser of the prewritten software must provide an exemption certificate to the seller in order to receive the exemption. The income from the sale of the prewritten software is subject to retailing B&O tax.

**Example 34.** BE Software, a Washington company, purchases prewritten software from Joe's Software Developer Co., that BE will provide remotely to its customers. BE provides an exemption certificate to Joe's for the purchase of prewritten software. Joe's does not collect or remit retail sales tax, but does pay retailing B&O tax on the income from the sale. BE would generally charge and collect retail sales tax and pay retailing B&O tax on income received from the sale of the prewritten software remotely accessed by consumers.

(ii) **Made available free to the general public.** Retail sales and use taxes do not apply to the purchase or use by a business or other organization of remote access prewritten software in order to make that remote access prewritten software available free of charge for the use or enjoyment of the general public. Buyers claiming this exemption must provide the seller with a properly completed "Digital Products and Remote Access Software Exemption Certificate" or other exemption certificate acceptable to the department.

(A) **Available for free.** In order to qualify, the remote access prewritten software purchased must be made available for free. In this context, "free" means that the recipient of the remote access prewritten software does not need to provide anything of significant value. If the purchaser requires something of significant value from the recipient in exchange for the remote access prewritten software, it is not given away

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for free.

(B) **"General public"** means all persons and is not limited or restricted to a particular class of persons, except that the general public includes:

(I) Certain classes of persons defined by their residency or ownership: The general public includes a class of persons residing or owning property within the boundaries of any state (e.g., Washington), political subdivision of a state (e.g., King County), or a municipal corporation (e.g., Seattle).

(II) Library customers. With respect to libraries, the term general public includes authorized library patrons.

(C) **Purchaser must have the legal rights to provide the remote access prewritten software to the general public:** The exemption provided in subsection (3) of this section does not apply unless the purchaser has the legal right to broadcast, rebroadcast, transmit, retransmit, license, relicense, distribute, redistribute, or exhibit the remote access prewritten software, in whole or in part, to the general public.

(11) **Multiple points of use (MPU) exemptions.**

(a) The retail sales tax does not apply to the sale of prewritten computer software or remote access prewritten software if the buyer correctly provides the seller with an exemption certificate claiming multiple points of use.

(b) If the sale of the prewritten software or the remote access prewritten software (including retail sales of licenses to prewritten software and remote access prewritten software) is sourced to Washington and the purchaser does not provide an exemption certificate, then the entire charge is subject to retail sales tax. Buyers may use the department's "Digital Products and Remote Access Software Exemption Certificate" to claim this exemption.

(i) **Requirements.** A buyer is entitled to use an exemption certificate claiming MPU only if the buyer is a business or other organization and the prewritten software or remote access prewritten software purchased will be concurrently available for use within and outside Washington. A buyer is not entitled to use an exemption certificate claiming MPU for prewritten software purchased for personal use.

(ii) **Concurrently available.** "Concurrently for use within and outside this state" means that employees or other agents of the buyer may use the prewritten software or remote access prewritten software simultaneously from one or more locations within this state and one or more locations outside this state.

(iii) **Apportionment (allocation) of use tax.** For purposes of this subsection on MPU, "allocation" and "apportionment" will have the same meaning. A business or other organization subject to use tax on prewritten software or remote access prewritten

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software that is concurrently available for use within and outside this state is entitled to apportion the amount of tax due this state based on users in this state compared to users everywhere. Additionally, the department may authorize or require an alternative method of apportionment supported by the taxpayer's records that fairly reflects the proportion of in-state to out-of-state use by the taxpayer.

(c) **Records requirement.** No allocation under this section is allowed unless the allocation method is supported by the taxpayer's records kept in the ordinary course of business.

(i) **"User"** means an employee or agent of the taxpayer who is authorized by the taxpayer to use the prewritten software or remote access prewritten software purchased in the performance of his or her duties as an employee or other agent of the taxpayer.

(ii) **Example 35.** Neymar operates an accounting firm headquartered in Seattle. Neymar purchases from Lionel prewritten software which Neymar installs on a server in Seattle. The software is accessed and used concurrently by 5 employees at his Seattle office and 5 employees at his California office. Neymar provides Lionel with a sales tax exemption certificate claiming multiple points of use. Neymar is only required to pay use tax for the value attributed to his employee's use at the Seattle office (i.e., 50%). Neymar does not pay use tax to Washington for the value of the software used in his California offices even though the software resides on servers in Seattle.

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NEW SECTION

**WAC 458-20-15503 Digital products.** This rule provides a structured approach for determining tax liability for digital products and digital codes. For purposes of this rule, a digital product includes digital goods or digital automated services, which are described in detail below. The sale or use of digital products and digital codes is generally subject to retail sales or use tax unless purchased for resale or some other exemption applies.

This rule is organized into six parts. Each part addresses a question or topic relevant to the determination of whether a person is selling or purchasing a digital product or digital code and, if so, what are the tax consequences that follow from such activity. In this respect this rule is intended to function similar to the decision tree provided in ETA 9003.2010.

1. Part 1: Are the products or services transferred electronically? If yes, go to Part 2.

2. Part 2: Does the product or service meet the general definitions of digital product or digital code? If yes, go to Part 3.

3. Part 3: Are there applicable exclusions from the general definitions of the digital product or digital code? If no, go to Part 4.

4. Part 4: Are the sales of the digital product or digital code sourced to Washington? If yes, go to Part 5.

5. Part 5: Are there applicable retail sales or use tax exemptions for the purchase or use of the digital product or digital code? If no, the transaction is likely taxable in Washington.

6. Part 6: Miscellaneous provisions.

Examples included in this rule identify a number of facts and then state a general conclusion; they should be used only as a general guide. The tax consequences of all situations must be determined after a review of all the facts and circumstances. Additionally, each fact pattern in each example is self contained (e.g., "stands on its own") unless otherwise indicated by reference to another example. Examples concluding that sales tax applies to the transaction assume that no exclusions or exemptions apply, and the sale is sourced to Washington.

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## **Part 1. Are the Products or Services Transferred Electronically?**

(101) **Introduction.** Products or services must be transferred electronically in order to be digital products. If a product is transferred by means of a tangible storage media (e.g., compact disc, magnetic tape, hard drive, etc.), it is not a digital product. Digital codes need not be transferred electronically in order to be digital codes, but may be obtained by any means, including tangible storage media.

(102) **Transferred electronically.** Means the purchaser obtains the product by means other than tangible storage media. Generally, this means the product is transferred using the public internet, a private network, or some combination. However, it is not necessary that the product be delivered to the purchaser. As long as the purchaser may access the product, it will be considered to have been electronically transferred to the purchaser. For example, whether a digital movie is downloaded by the user or streamed by the user, it is considered to be "transferred electronically." Alternatively, the same movie purchased on tangible media (e.g., DVD, etc.) is the purchase of tangible personal property and is not considered to be either the sale of a digital product or transferred electronically.

## **Part 2. Does the Product or Service Meet the General Definition of Digital Product or Digital Code?**

(201) **Introduction.** The term "digital product" means (1) digital goods and (2) digital automated services. Digital products transferred to an end user are generally subject to retail sales or use tax regardless of whether the purchaser's right of use is permanent, less than permanent (e.g., 24-hour period), or the purchaser is obligated to make continued payments as a condition of the sale (e.g., "subscriptions").

(202) **Digital goods.** Means sounds, images, data, facts, or information, or any combination thereof, transferred electronically, with certain exclusions discussed in Part 3 of this rule. The term "digital goods" includes within it the specific term "specified digital products" (as required by the Streamline Sales and Use Tax Agreement). The sale of a digital good is generally subject to retail sales tax and retailing business and occupation (B&O) tax.

(a) **Specified digital products.** Means electronically transferred digital audio-visual works, digital audio works, and digital books.

(i) **Digital audio works.** These are products that result

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from the fixation of a series of musical, spoken, or other sounds. Digital audio works include ringtones, recorded or live music, readings of books or other written materials, speeches, and other sound recordings. For example, a music file in MP3 format accessed or downloaded through the internet is a digital audio work.

(1) A "ringtone" is a digitized sound file that is downloaded onto a communication device (e.g., mobile phone) and may be used to alert the user to an incoming communication such as a call or text message.

(2) A ringtone does not include "ring-back tones" or other digital audio files that are not stored on the purchaser's communication device. In other words a ring-back tone is not a "specified digital product." A ring-back tone may be a digital automated service or a digital good depending on the facts. See analysis for digital automated services in subsection (203) of this section.

(ii) **Digital audio visual works.** These products are a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any. Digital audio visual works include movies, music videos, videos of live events, and news and entertainment programs. For example, a movie downloaded or accessed via the internet is a digital audio visual work.

(iii) **Digital books.** These are books in a digital format that are generally recognized in the ordinary and usual sense as books. A digital book does not include periodicals, magazines, newspapers, chat rooms, or weblogs. For example, a cookbook in a PDF format downloaded or accessed through the internet is a digital book.

(b) **Other digital goods.** The following list illustrates the types of products that are also digital goods in addition to the subclass of "specified digital products" discussed above. This list is merely illustrative and not exhaustive:

(1) A digital schematic of a lawnmower engine transferred electronically.

(2) A digital car history report transferred electronically.

(3) A digital picture transferred electronically.

(4) Digital periodicals or magazines transferred electronically.

(5) A digital presentation that includes still photos and accompanying audio content transferred electronically.

(c) **Digital goods prior to July 26, 2009.** The mere accessing or streaming of a digital good was not a retail sale before July 26, 2009. Instead, accessing or streaming a digital good was subject to the service and other activities B&O tax.

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The sale of a digital good to a customer who downloaded the digital good was a retail sale. See Part 6, subsection (604) of this section for a discussion of tax amnesty for past periods.

(203) **Digital automated services.** Means services transferred electronically that use one or more software applications. The sale of a digital automated service is generally subject to retail sales tax and retailing B&O tax.

(a) **Digital automated services may include.** One or more software applications either prewritten or custom, as well as components that are similar to stand-alone digital goods. For example, an online information service may contain data, facts, or information the use of which is facilitated by one or more software applications that provide search capabilities and other functionality. Thus, digital automated services will include software and may include elements similar to stand alone digital goods, which operate together in an integrated fashion to provide an electronically transferred service.

**Example 1.** BFC provides an online service that facilitates apartment building management. The online service lists and advertises apartment vacancies, screens applicants, routes maintenance requests, and accepts and processes rental payments. In this example the software based service facilitates and automates various administrative functions and coordinates third-party services for apartment renting. The service is a digital automated service the sale of which is generally subject to retail sales tax and retailing B&O tax.

**Example 2.** QPR provides a service that uses one or more software applications to "crawl the internet" in order to identify, gather, and categorize digital information according to specified criteria. In this example software facilitates the gathering, identifying and categorizing of information acquired from the internet. The service is a digital automated service the sale of which is generally subject to retail sales tax and retailing B&O tax.

(i) **Distinguishing a digital good from digital automated services.** A digital good is not a service involving one or more software applications. A digital good consists solely of images, sounds, data, facts, information or any combination thereof. Clear examples of digital goods are digital books, digital music, digital video files, and raw data.

**Example 3.** XYZ provides an online service that uses one or more software applications to facilitate the use of news and information with features such as: Research history, natural and boolean searching, industry chat forums, chart creation, document and word flagging, and information organizing folders. In this example software features facilitate the search of the news or information. XYZ's service is a digital automated

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service the sale of which is subject to retail sales tax and retailing B&O tax.

**Example 4.** Company sells digital music files (i.e., digital goods) on its web site. In order to locate specific digital music files customers may use a free software based search function that is integrated into Company's web site. Customers may also find the digital music file they are seeking by clicking on a series of links to get to the desired music file. Company's software based search function associated with the sale of the digital music file does not transform the sale of the digital music file into a digital automated service. Company is selling a digital good (i.e., music file) subject to retail sales tax and retailing B&O tax.

(ii) **Distinguishing remote access prewritten software from digital automated services.** Remote access prewritten software (defined in RCW 82.04.050 (6)(b)) is solely prewritten software that is made remotely accessible from the vendor's server or other third-party server for a customer. To the extent that components similar to digital goods and/or additional services are supplied with the prewritten software the sale may be the sale of a digital automated service (see also Part 3, subsection (303)(h) of this section).

**Example 5.** CFC provides an online gaming service that allows subscribers to play a game with other subscribers in a real time multiplayer environment using software accessed via the internet. In this example the gaming software is combined with additional capabilities that enable a real time multiplayer environment that is not otherwise available. The service is a digital automated service, the sale of which is generally subject to retail sales tax and retailing B&O tax.

**Example 6.** Company sells prewritten word processing software that is accessed by customers but hosted on Company's computers. The software includes access to clip-art image files that can be inserted into documents created with the remotely accessed prewritten word processing software. Company is selling remote access prewritten software and not a digital automated service or digital goods. The clip art made available with the software does not transform the remotely accessed prewritten software into a digital automated service or a digital good. Company is selling remote access prewritten software subject to retail sales tax and retailing B&O tax.

(b) **Digital automated service prior to July 26, 2009.** The sale of a digital automated service to consumers was not a retail sale before July 26, 2009. Generally, income earned from such sales was subject to B&O tax under the service and other activities classification.

(204) **Digital codes.** These are codes that provide a

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purchaser with the right to obtain one or more digital products, if all of the digital products to be obtained through the use of the code have the same retail sales and use tax treatment. A digital code may be obtained by any means, including e-mail or by tangible media regardless of its designation as song code, video code, book code, or some other term. For example, a digital code includes the sale of an alphanumeric code that, when entered online at a web site, provides the customer with a digital music file for download.

(a) **Products with mixed tax treatment.** Codes that provide the right to obtain one or more products that do not have the same retail sales and use tax treatment are not digital codes.

(b) **Codes that represent a stored monetary value, redeemable cards, gift cards, or gift certificates.** Codes that represent a stored monetary value that is deducted from a total as it is used by the purchaser or that represent a redeemable card, gift card, or gift certificate that entitles the holder to select digital products of an indicated cash value, are not digital codes.

**Example 7.** Calvin purchases a code at his local grocery store for use on Joe Seller's (JS) web site. At check out, Calvin tells the grocery store clerk to put \$25.00 in value on the plastic card containing the code. Calvin then goes to JS's web site and inputs the code from the card. The \$25.00 value of the card is stored in Calvin's "account" and can be used on any purchase by Calvin from JS's web site. Calvin then purchases five digital songs for \$5.00 from JS. At check-out from JS's web site, \$5.00 is deducted from Calvin's account to pay for the songs. When the transaction is complete, Calvin has a \$20.00 balance remaining in his account on JS's web site. Because the code represents a stored monetary value it is not a digital code and the sale of the code is not subject to retail sales tax or retailing B&O tax.

### **Part 3. Are There Applicable Exclusions from the General Definitions of Digital Product and Digital Code?**

(301) **Introduction.** For certain products or services transferred electronically that otherwise meet the definition of digital good or digital automated service (as discussed in Part 2) there may be a specific exclusion from the applicable definition. If an exclusion applies, then the product or service will generally not be considered a digital good or digital automated service for retail sales and use tax purposes. For example, a service that is transferred electronically and that uses one or more software applications will generally be subject to retail sales tax as a digital automated service.

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However, if the service is an advertising service, then an exclusion applies, and the service will not be a digital automated service subject to retail sales tax; however, the service may still be subject to B&O tax. An excluded service may also still be subject to retail sales tax under certain circumstances. For example, telecommunications services are excluded from the definition of digital automated services, but remain subject to retail sales tax under their own separate definition of retail sale.

(302) **Exclusions from the definition of digital good are:**

(a) **Telecommunications and ancillary services** as defined in RCW 82.04.065. These services may be used to distribute digital goods, digital automated services, and digital codes, but are not themselves any of these products.

(b) **Computer software** as defined in RCW 82.04.215 and WAC 458-20-15502. These are coded instructions designed to cause a computer or automatic data processing equipment to perform a task.

(c) **The internet and internet access** as defined in RCW 82.04.297.

(d) **Professional or personal services** represented in electronic form are not a digital good. This exclusion applies where the service primarily involves the application of human effort by the service provider, and the human effort originated after the customer requested the service. For example, an electronic engineering report created at the customer's request that reflects an engineer's professional analysis, calculations, and judgment, which is sent to the customer electronically, is considered evidence of a professional service and not a digital good.

(i) **Photography.** This exclusion for professional or personal services does not apply to photographers in respect to amounts received for the taking of digital photographs that are transferred electronically to the end user/customer as defined in RCW 82.04.190(11). See Example 39 for an example of a nonend user transaction involving photography that is subject to royalties B&O tax.

(e) **Exclusions listed directly below for digital automated services** are also exclusions from the definition of digital good.

(303) **Exclusions from the definition of digital automated service are:**

(a) **Services that require primarily human effort by the seller** and the human effort originated after the customer requested the service. In this context, "primarily" means greater than fifty percent of the effort to perform the service involved human labor. To determine whether the fifty percent or

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greater threshold is satisfied, the average of the time and cost factors is considered. The time factor is determined by dividing the time spent to perform the human effort portion for customers by the total time spent performing the service. The cost factor is determined by dividing the direct costs incurred to perform the human effort portion for customers by the total direct costs incurred to perform the service. Direct costs of the human effort component include salaries, employee benefits and similar direct costs. Direct costs of the automated component include the cost of software, computers, hosting services and other similar direct costs. If the average of the time and cost factors is greater than fifty percent then the service requires primarily human effort and is not a digital automated service in which case the service will generally be subject to service and other activities B&O tax.

**Example 8.** RepuCo.com performs a reputation monitoring service on the internet for its clients. The service utilizes software and other technology that searches the internet for web sites that allow posting of information that may be harmful to RepuCo.com's client's reputation ("the automated component"). If the automated component finds a web site that is posting erroneous or harmful information about one of RepuCo.com's clients, then a RepuCo.com employee will contact the owner of the web site by phone or e-mail and work with the owner and the client to resolve the matter to the satisfaction of the client ("the human effort component"). If the human effort time factor is 20% and the human effort direct cost factor is 60%, then the average of the two factors is 40% ( $80\%/2 = 40\%$ ). Accordingly, the service is performed using 40% human effort which is less than 50% and therefore the service does not require primarily human effort and is subject to retail sales tax as a digital automated service.

**Alternative methods.** If the time and cost factors in this rule do not fairly represent the extent to which the service is performed using primarily human effort, the taxpayer may ask in writing for, or the department may require, the employment of another reasonable method to equitably determine whether the service is performed using primarily human effort.

(b) **Loaning or transferring money or the purchase, sale, or transfer of financial instruments.** For purposes of this section, "financial instruments" include cash, accounts receivable and payable, loans and notes receivable and payable, debt securities, equity securities, as well as derivative contracts such as forward contracts, swap contracts, and options. For example, the electronic transfer of money from a savings account to a checking account, whether done for the customer by a bank teller or by an ATM machine, is excluded from

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the definition of digital automated service.

(c) **Dispensing cash or other physical items from a machine.** Includes an ATM that dispenses cash to users.

(d) **Payment processing services,** including services such as electronic credit card processing activities conducted online or in physical retail stores via electronic transmission.

(e) **Parimutuel wagering and handicapping contests** as authorized by chapter 67.16 RCW.

(f) **Telecommunications services and ancillary services** as those terms are defined in RCW 82.04.065. For additional information, refer to the discussion above concerning the comparable exclusion from the definition of digital goods (see Part 3, subsection (302)(a) of this section).

(g) **The internet and internet access** as those terms are defined in RCW 82.04.297.

(h) **Remote access prewritten software.** Remote access prewritten software (defined in RCW 82.04.050 (6)(b)) provided on a standalone basis is excluded from the definition of digital automated service. However, software that is used in connection with a service that is transferred electronically would generally be included in the definition of a digital automated service.

**Example 9.** Company sells prewritten gaming software that is identical in all substantive respects to the same software available in stores for individual use and installation on home computers except that it is hosted on Company's servers and accessed by customers. Company's sales to consumers would be treated as a sale of remote access prewritten software and therefore is excluded from the definition of digital automated services and generally subject to retail sales tax and retailing B&O tax.

**Example 10.** Same facts as Example 9 except that Company uses the remote access prewritten software to provide a monthly subscription service that provides a real item multiplayer environment. Company is selling a digital automated service. In this case the customers are not merely receiving the individual use of software, but instead an online gaming service facilitated by the software. Thus, the monthly subscription service is not excluded from the definition of digital automated service and is subject to retail sales tax and retailing B&O tax.

(i) **Online education programs** provided by the following:

(i) Public or private elementary or secondary schools; or

(ii) An institution of higher education as defined in Sections 1001 or 1002 of the federal Higher Education Act of 1965 (Title 20 U.S.C. Sections 1001 and 1002), as existing on July 1, 2009. This would include most colleges and

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universities. For the purposes of this section, an online educational program must be encompassed within the institution's accreditation.

**Example 11.** ABC University, a qualifying institution of higher education under the federal Higher Education Act of 1965, provides an accredited online Spanish course for which it charges a quarterly access and use fee to students. The course is remotely accessed by students logging into a web site and accessing a fully interactive program that includes components of video, text, and audio, as well as extensive software code. This service would generally be considered a digital automated service. However, it is specifically excluded from the definition of digital automated service as an online educational program and would generally be subject to service and other activities B&O tax.

(j) **Live presentations** such as lectures, seminars, workshops, or courses, where participants are connected to other participants and presenters via the internet or other networks, allowing the participants and the presenters to provide, receive, and discuss information together in real time.

**Example 12.** Company provides an online seminar service for Customer. Company provides a panel of live speakers that make a presentation to Customer's employees listening to and viewing the seminar through an internet connection supplied by a third-party service provider. The seminar allows Customer's employees and panelists to ask and answer questions on a real time basis. Company's online seminar service is transferred electronically and uses one or more software applications and therefore would generally be considered a digital automated service. However, this type of service allowing live interaction is specifically excluded from the definition of digital automated service and would generally be subject to service and other activities B&O tax.

**Example 13.** Same facts as Example 12 except that Company records the seminar and charges other individuals a fee for accessing the seminar from Company's web site. The recorded presentation allows these customers to watch the presentation but it does not allow them to ask questions on a real time basis. Because the presentation was prerecorded there is no live interaction contemporaneous with the presentation and therefore Company is selling a digital good generally subject to retail sales tax and retailing B&O tax.

**Example 14.** Company provides online training courses to Steve for a fee. The training courses provide key interactive elements such as study guides, knowledge testing, and automated help, all facilitated by one or more software applications. Such courses are not live presentations and do not provide human

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interaction. Accordingly, Company is selling a digital automated service generally subject to retail sales tax and retailing B&O tax.

(k) **Travel agent services**, including online travel services, and automated systems used by travel agents to book reservations.

(l) **Online marketplace related activities**, which are services that allow the person receiving the services to make online sales of products or services, digital or otherwise, using either:

(i) The service provider's web site; or

(ii) The service recipient's web site, but only when the service provider's technology is used either to:

(1) Create or host the service recipient's web site; or

(2) Process orders from customers using the service recipient's web site.

**Example 15.** Company provides an "electronic marketplace" service to Holcomb that allows Holcomb to list and sell his coffee mugs on the internet using Company's web site. This online marketplace service is excluded from the definition of digital automated services and charges for the service would generally be subject to service and other activities B&O tax.

**Example 16.** Same facts as Example 15, except that now Holcomb decides he no longer wants to be just another seller on Company's web site. Instead, Holcomb wants his own "retailing presence" on the internet so Holcomb contracts with Company to create and host Holcomb's new coffee mug web site, "HolcombsCoffeeWorld.com." This is still an online marketplace service that is excluded from the definition of digital automated services and charges for the service would generally be subject to service and other activities B&O tax.

(iii) **Exclusion limitation.** The services described in this subsection do not include the underlying sale of the products or services, digital or otherwise, by the person receiving the service. For instance, in Examples 15 and 16, the sale by Holcomb of coffee mugs would still generally be subject to retail sales tax and retailing B&O tax as the sale of tangible personal property.

(m) **Advertising services** means all services directly related to the creation, preparation, production, or the dissemination of advertisements. Advertising services include: Layout, art direction, graphic design, mechanical preparation, production supervision, placement, and rendering advice to a client concerning the best methods of advertising that client's products or services. Advertising services also include online referrals, search engine marketing and lead generation optimization, web campaign planning, the acquisition of

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advertising space in the internet media, and the monitoring and evaluation of web site traffic for purposes of determining the effectiveness of an advertising campaign. Advertising services do not include web hosting services and domain name registration.

**Example 17.** Company provides marketing services to customers wishing to promote their products using the internet. Amy sells widgets on the internet and hires Company to market her products. Company consults with Amy on her marketing needs and then creates a marketing plan for her business. Company also creates and distributes online banners, links, and targeted "e-mail blasts" that promote Amy's business. All of the services provided by Company are advertising services excluded from the definition of digital automated services and would generally be subject to service and other activities B&O tax.

**Example 18.** RVP, Inc. creates "sponsored links" on its web site that drive customer traffic to Amy's web site. RVP is paid by Amy for each click on a sponsored link on RVP's web site. The services provided by RVP are advertising services excluded from the definition of digital automated services and charges for such would generally be subject to service and other activities B&O tax.

(n) **Storage, hosting, and back-up.** The mere storage of digital products, digital codes, computer software, or master copies of software is excluded from the definition of digital automated services. This exclusion includes providing space on a server for web hosting or backing-up data or other information.

**Example 19.** Company charges Rowe a fee for 25 terabytes of storage space under its "basic storage service" offering. Company also charges Rowe an additional and optional fee for its "premium service" package offering, which involves services beyond mere storage. The "basic storage" services are mere storage services and excluded from the definition of digital automated services. These services would generally be subject to service and other activities B&O tax. However, the charges for the optional premium services are more than mere storage or hosting services. As such, the premium services are not excluded from the definition of digital automated services and would generally be subject to retail sales tax and retailing B&O tax.

(o) **Data processing services** means a primarily automated service provided to a business or other organization where the primary object of the service is the systematic performance of operations by the service provider on data supplied in whole or in part by the customer to: (1) extract the required information in an appropriate form, or (2) to convert the data

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to usable information. Data processing services include check processing, image processing, form processing, survey processing, payroll processing, claim processing, and similar activities. Data processing does not include remote access prewritten software used by the customer to process their own data.

**Example 20.** Bango Corp., in preparation for litigation, hires Company to use its automated technology to search Bango's computers and gather documents relevant to the lawsuit. Company's service also provides software tools that allow Bango to categorize, copy, store, and notate the gathered documents. Company's service is not data processing. The services performed primarily involve gathering data, and providing software tools that allow the customer to categorize, copy, store and notate documents in preparation for litigation. Accordingly, Company is selling a digital automated service generally subject to retail sales tax and retailing B&O tax.

**Example 21:** Company provides check processing services to Wallo Corp., a bank operating in Washington. Company accepts scanned checks provided by Wallo and then uses its software and technology to extract the check dollar amount, account number, and verify the check has been signed. Company then provides this extracted and reformatted data back to Wallo allowing it to reconcile its customer's accounts. Company provides data processing services which are excluded from the definition of digital automated services. These services would generally be subject to service and other activities B&O tax.

**Example 22.** Same facts as Example 21, except that Company accepts checks provided directly by Wallo's customers. Thus, check images come from both Wallo and Wallo's customers. The services provided by Company are still data processing services excluded from the definition of digital automated services even though the data does not come exclusively from Wallo. These services would generally be subject to service and other activities B&O tax.

#### **Part 4. Are the Sales of the Digital Product or Digital Code Sourced to Washington?**

(401) **Introduction.** Once it is determined that a transaction involves the sale of a digital product or digital code, the sale must be sourced to Washington in order to be subject to Washington's retail sales tax and B&O tax. If the sale is sourced outside Washington it is not subject to Washington sales tax or B&O tax. Sales of digital products are sourced using the same statute that applies to other retail sales, RCW 82.32.730 as outlined below.

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(402) **Sourcing retail sales.**

(a) **Business location.** When a digital product or digital code is received by the buyer at a business location of the seller, the sale is sourced to that business location.

**Example 23.** Frank goes to BigBox brick-and-mortar store in Washington and purchases a music file from an electronic kiosk in the store. Frank purchases and downloads the music file inside BigBox's store by connecting his digital music player to the kiosk in the store. The sale of the music file is sourced to BigBox's store location in Washington and is generally subject to retail sales tax and retailing B&O tax.

(b) **Place of receipt.** If the first sourcing rule explained above in (a) of this subsection does not apply, the sale is sourced to the location where receipt takes place.

(i) The digital product or digital code may be received by the buyer at the buyer's location or by the buyer's donee (e.g., a gift recipient) at the donee's location.

(ii) In the context of digital products and digital codes, "receive" and "receipt" means: (i) Making first use of digital automated services; or (ii) taking possession or making first use of digital goods or digital codes, whichever comes first.

**Example 24.** Drogba Inc., located in Olympia, Washington, purchases a digital automated service generally subject to retail sales tax from Company. Drogba's employees access and make first use of the service at their computer workstations located in Olympia. Company knows that the digital automated service is received in Olympia and therefore will source the sale of the digital automated service to that location.

(c) **Address in records.** If the first two sourcing rules explained above in (a) and (b) of this subsection do not apply, the sale is sourced to the location indicated by an address for the buyer that is available from the seller's business records maintained in the ordinary course of business, so long as use of this address does not constitute bad faith. For example, any address of the buyer held by the seller that reasonably estimates the receipt location will be sufficient, including an address contained in a relevant service contract or an address used for accounts receivable purpose.

**Example 25.** Nani Corp., located in California, purchases a digital automated service generally subject to retail sales tax and retailing B&O tax from Company located in Washington. The purchase contract between Nani and Company provides that Nani may have 5 users access the digital automated service. Company does not know where the digital automated service is actually received. However, Company has Nani's California address in its business records and will therefore source the sale to Nani's California address. Because the sale is sourced outside

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Washington, it is not subject to Washington's retail sales tax or retailing B&O tax. Note, to the extent that Nani Corp., receives the service at locations in Washington, it may have a use tax liability. See subsection (403) of this section for more on use tax.

(d) **Address obtained during sale.** If the first three sourcing rules explained above in (a), (b), and (c) of this subsection do not apply, the sale is sourced to the location indicated by an address for the buyer obtained during the consummation of the sale. For example, an address obtained during consummation of the sale would include the address of a buyer's payment instrument (e.g., billing address for a credit card), if no other address is available, so long as use of this address does not constitute bad faith.

(i) **Internet protocol (IP) address.** The buyer's IP address is acceptable location information obtained at the time of sale if an address cannot otherwise be obtained during consummation of the sale.

(e) **Origin.** If the first four sourcing rules explained above in (a), (b), (c), or (d) of this subsection do not apply, including the circumstance where the seller is without sufficient information to apply those provisions, then the sale must be sourced to the location determined by the address from which the digital good or digital code was first available for transmission by the seller, or from which the digital automated service was provided. Any location that merely provided the digital transfer of the product sold shall be disregarded.

(403) **Sourcing for use tax purposes.** The sales sourcing rules above in subsection (402) of this section are for sourcing sales subject to retail sales tax under RCW 82.08.020 and RCW 82.32.730. What follows below is a discussion of use tax reporting obligations with respect to digital goods, digital automated services, and digital codes. Generally, use tax applies to the use of a digital product or digital code in Washington if retail sales tax has not already been paid and no exemption otherwise applies.

(a) **Digital good or digital code.** "Use" means the first act within this state by which the taxpayer, as a consumer, views, accesses, downloads, possesses, stores, opens, manipulates, or otherwise uses or enjoys the digital good or digital code.

(b) **Digital automated service.** "Use" means the first act within this state by which the taxpayer, as a consumer, uses, enjoys, or otherwise receives the benefit of the service.

**Example 26.** Company, located in New York, sells a digital automated service generally subject to retail sales tax and retailing B&O tax to Lampard Inc., located in Washington.

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Lampard's employees in Washington use the internet to access Company's services using an internet web browser. However, Company does not have nexus with Washington and is therefore not required to charge and collect retail sales tax on the sale of its service to Lampard. Lampard has a use tax reporting obligation because it uses, enjoys, or otherwise receives the benefit of Company's digital automated service at its location in Washington.

**Part 5. Are there Applicable Retail Sales or Use Tax Exemptions for the Purchase or Use of the Digital Product or Digital Code?**

(501) **Introduction.** After determining that a digital product or digital code has been sold or used and the sale or use is sourced to Washington, exemptions from retail sales or use tax should be examined. What follows is not an exhaustive list of exemptions but instead an explanation of the most common exemptions for digital products. Some exemptions may apply only with respect to certain digital products (e.g., some exemptions apply only to digital goods, not digital automated services). Exemptions may also require an exemption certificate or reseller permit.

(502) **Resale.** The purchase of a digital product or digital code for resale with no intervening use is not subject to retail sales or use tax. Sellers should obtain from buyers a copy of the buyer's reseller permit, a properly completed "Digital Products and Remote Access Software Exemption Certificate," or otherwise comply with RCW 82.04.470 to substantiate the wholesale nature of the sale. See RCW 82.32.780.

(503) **Component of a new product.** Generally, purchasing, acquiring, owning, holding, or using any digital product or digital code for purposes of incorporating it into a new product for sale will not be subject to retail sales tax. The digital product or digital code must become a component of the new product for sale. A digital code becomes a component of a new product if the digital good or digital automated service acquired through the use of the digital code becomes incorporated into a new product. RCW 82.04.190(11). This is also discussed in subsection (602) of this section in the context of wholesale sales.

(a) **Product.** For purposes of this subsection, "product" means a digital product, an article of tangible personal property, or remote access prewritten software as defined in RCW 82.04.050 (6)(b). For example, an industrial drill manufacturer and seller combines hardware, software, and data to create a new product, a "smart drill." Software embedded in the drill uses the variance data (also embedded in the drill) to control the

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hardware during drill operations. The data is a digital good purchased for use as a component of a new product for sale (i.e., the drill). Sellers should obtain from buyers a copy of the buyer's reseller permit, a properly completed "Digital Products and Remote Access Software Exemption Certificate," or otherwise comply with RCW 82.04.470 to substantiate the wholesale nature of the sale.

(504) **Made available free to the general public.** Retail sales and use tax does not apply to the purchase or use by a business or other organization of a digital product (including a digital product acquired through the use of a digital code) in order to make that digital product (1) available free of charge for the use or enjoyment of (2) the general public. Buyers claiming this exemption must provide the seller with a properly completed "Digital Products and Remote Access Software Exemption Certificate" or other exemption certificate acceptable to the department. See RCW 82.08.02082.

(a) **Available for free.** In order to qualify, the digital product purchased must be made available for free. In this context, "free" means that the recipient of the digital product does not need to provide anything of significant value. If the purchaser requires something of significant value from the recipient in exchange for the digital product, it is not given away for free.

**Example 27.** Mauro purchases 1,000 digital music files from Company to be used for a "give away" to the first 1,000 people to visit Mauro's web site. When people visit Mauro's web site they are required to fill out a marketing survey before they may receive a digital music file. The information gathered from the marketing survey is then sold to a marketing company by Mauro. Thus, Mauro has required that recipients provide something of significant value in exchange for the digital music file. This is not a "free" transaction and therefore, Mauro's purchase of the digital music from Company does not qualify for the exemption and would be subject to retail sales tax and retailing B&O tax. (See also Example 29.)

(b) **"General public"** means all persons and is not limited or restricted to a particular class of persons, except that the general public includes:

(i) **Certain classes of persons defined by their residency or property ownership.** The general public includes a class of persons residing or owning property within the boundaries of any state (e.g., Washington), political subdivision of a state (e.g., King County), or a municipal corporation (e.g., Seattle).

**Example 28.** The City of Evergreen (a municipal corporation) makes satellite images of land parcels available for free only to persons residing in Evergreen. Residents are

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required to enter their zip code prior to accessing the images and certify that they are a resident of the City. Accordingly, the City of Evergreen can purchase the satellite images exempt from retail sales tax.

(ii) **Library customers.** With respect to libraries, the term general public includes authorized library patrons.

(c) **Buyer must have the legal rights to provide the digital product to the general public.** The exemption provided in this subsection does not apply unless the purchaser has the legal right to broadcast, rebroadcast, transmit, retransmit, license, relicense, distribute, redistribute, or exhibit the digital product, in whole or in part, to the general public.

**Example 29.** Same facts as Example 27, except this time visitors to Mauro's web site are provided free access to the digital music files and no survey information is required in exchange. Additionally, Mauro purchased the digital music files from Company with the right to distribute them to the general public. Mauro also provided the seller with an exemption certificate. Accordingly, Mauro's purchase from Company qualifies for the exemption because he has made the digital audio files available free of charge to the general public pursuant to a contract that gives him rights of distribution. Mauro only purchased 1,000 files and therefore must limit the distribution to the first 1,000 people. Most "give-aways" will have similar quantity limitations but this fact alone will not disqualify such transactions under the "general public" requirement.

(505) **Purchased solely for business purpose.**

(a) **Introduction.** Retail sales and use tax does not apply to the sale to or use by a business of digital goods and services rendered in respect to those digital goods, where the digital goods and services rendered in respect to digital goods are purchased solely for business purposes. This exemption only applies to purchases of digital goods and does not apply to the purchase of digital automated services, prewritten software, or remote access prewritten software. The exemption is only available when the buyer provides the seller with an exemption certificate. Buyers may use the department's "Digital Products and Remote Access Software Exemption Certificate" to claim this exemption. See RCW 82.08.02087.

(b) **Digital codes.** This exemption also applies to the sale to or use by a business of a digital code if all of the digital goods to be obtained through the use of the code will be used solely for business purposes. If the digital code purchased by a business for a business purpose provides access to both digital goods and digital automated services, the purchase of the digital code does not qualify for this exemption.

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(c) **"Business purposes"** means the digital good is relevant to the buyer's business needs.

(d) **Personal or household purpose.** This exemption does not apply to the purchase for personal or household purposes.

(e) **Government entities.** This exemption does not apply to purchases by a governmental entity.

(f) **Prior periods.** For the period July 26, 2009, through June 30, 2010, the "business purpose" exemption applied only to "standard digital information." Standard digital information is a subset of digital goods.

(i) **Standard digital information** is a digital good that consists primarily of data, facts, and/or information that is not generated or compiled for a specific client or customer. Standard digital information does not include a digital good that is comprised primarily of sounds or images.

(506) **Multiple points of use (MPU).** Retail sales tax does not apply to the sale of digital products or digital codes concurrently available for use within and outside this state. See RCW 82.12.02088 and 82.08.02088. Note that Washington use tax still applies to the use of the digital product or digital code used in Washington.

(a) **Requirements.** A buyer is entitled to claim the MPU exemption only if:

(i) The buyer is a business or other organization.

(ii) The digital product purchased (or obtained by using the digital code purchased) will be concurrently available for use within and outside this state (not for personal use).

(iii) The buyer provides the seller with a valid exemption certificate acceptable to the department claiming the MPU exemption. Buyers may use the department's "Digital Products and Remote Access Software Exemption Certificate" to claim this exemption.

(b) **Concurrently available.** "Concurrently available for use within and outside this state" means that employees or other agents of the buyer may use the digital product simultaneously from one or more locations within this state and one or more locations outside this state.

**Example 30.** Company sells an online patent searching service to Iniesta Corp., for simultaneous use at Iniesta's headquarters in Washington and its research and development facility in California. This service would generally be considered the sale of a digital automated service subject to retail sales tax and retailing B&O tax. In this case, the digital automated service is concurrently available for use by Iniesta's employees both within Washington and outside Washington, and therefore Iniesta may claim the MPU exemption from retail sales tax for its purchase of the digital automated

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service from Company. See (c) of this subsection directly below for an explanation of how to apportion the use tax in this example.

(c) **Apportionment (allocation) of use tax.** For purposes of this subsection on multiple points of use, "allocation" and "apportionment" have the same meaning. A business or other organization subject to use tax on digital products or digital codes that are concurrently available for use within and outside this state is entitled to apportion the amount of tax due this state based on users in this state compared to users everywhere. For example, in the case of Iniesta in Example 30, if we assume Iniesta had five employees in California and five employees in Washington using the service concurrently, Iniesta would allocate one-half of the purchase price to Washington because five of its ten users are in Washington (e.g.,  $5/10 = 50\%$ ). Thus Iniesta would pay use tax to Washington based on fifty percent of the value of the digital automated service. Additionally, the department may authorize or require an alternative method of allocation supported by the taxpayer's records that fairly reflects the proportion of in-state to out-of-state use by the taxpayer.

(i) **Records requirement.** No allocation under this section is allowed unless the allocation method is supported by the taxpayer's records kept in the ordinary course of business.

(ii) **"User"** means an employee or agent of the taxpayer who is authorized by the taxpayer to use the digital product purchased in the performance of his or her duties as an employee or other agent of the taxpayer.

(d) **Application to digital codes.** A digital code is concurrently available for use within and outside this state if users may use the digital goods or digital automated services to be obtained by the code simultaneously at one or more locations within this state and one or more locations outside this state.

(e) **Reporting.** A buyer claiming an exemption under this section must report and pay state and local use tax directly to the department. As explained above in (c) of this subsection, use tax may be reported and paid on an apportioned basis if supported by the buyer's records.

(507) **Machinery and equipment.** Generally retail sales and use tax does not apply to sales to or use by a manufacturer or processor for hire of certain machinery and equipment used directly in a manufacturing or research and development operation. This exemption is commonly referred to as the M&E exemption. (See RCW 82.08.02565 and 82.12.02565 and WAC 458-20-13601 for information regarding the M&E exemption.) Included within the definition of "machinery and equipment" for purposes of the M&E exemption are digital goods. Accordingly, digital

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goods acquired by manufacturers and processors for hire and used directly in a manufacturing or research and development operation are exempt from retail sales and use tax, provided all of the requirements for the M&E exemption are met.

(508) **Audio or video programming.** Income received from the sale of regular audio or video programming by a radio or television broadcaster is generally subject to service and other B&O tax and therefore not subject to retail sales tax. However, the sale of audio or video programming sold on a pay per program or subscription on-demand basis is generally subject to retail sales and use tax except as provided in (d) and (e) of this subsection.

(a) **"Radio and television broadcasters"** include satellite radio providers, satellite television providers, cable television providers, and providers of subscription internet television.

(b) **"Pay per program or subscription on-demand basis"** means programming that the buyer pays for on a per program basis or a service that allows the buyer to access a library of programs at any time for a specific charge.

(c) **"Regular programming"** is scheduled programming. The person watching cannot stop, pause, rewind, or otherwise control the broadcast of the scheduled programming, including the time that the scheduled program is broadcast.

(i) The fact that a customer uses a recording device, such as a VCR or DVR, does not result in the broadcaster's programming being characterized as a digital good.

(d) **Cable television providers paying franchise fees.** Cable television providers' sales of programming to consumers on a pay-per-program or subscription on-demand basis are not subject to retail sales and use tax if the cable television provider is subject to a franchise fee (under the authority of Title 47 U.S.C. Sec. 542(a)) on the gross revenue received from such sales. If the cable television provider is not subject to a franchise fee on the income from the sale of programming on a pay-per-program or subscription on-demand basis, then the exemption does not apply and the cable television provider must collect and remit retail sales tax on the retail sale of such programming.

**Example 31.** XYZ sells video programming to customers using cable technology. XYZ does not pay a franchise fee. Customers of XYZ are charged a monthly subscription fee to receive video programming. Customers are charged additional fees to view selected movies. XYZ must charge and collect retail sales tax on the additional fees charged to view the selected movies, but not on the monthly subscription fee which would generally be subject to service and other activities B&O tax.

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(e) Satellite television providers do not generally pay franchise fees and therefore do not qualify for the retail sales and use tax exemption based on payment of franchise fees as described in (d) of this subsection.

(509) **Newspapers.** Generally, retail sales and use tax does not apply to sales of newspapers transferred electronically, provided that the electronic version has a printed counterpart, and the electronic version:

(a) Shares content with the printed newspaper; and

(b) Is prominently identified by the same name as the printed newspaper or otherwise conspicuously indicates that it is a complement to the printed newspaper.

(c) "Printed newspaper" means a publication issued regularly at stated intervals at least twice a month and printed on newsprint in tabloid or broadsheet format folded loosely together without stapling, glue, or any other binding of any kind, including any supplement of a printed newspaper.

(510) **Received for free by end user.** Digital products and digital codes obtained by the end user for free are not subject to use tax.

(a) For example, a person's use of a free search engine is not subject to use tax.

(b) For example, a person reading an online article or viewing an online picture for free is not subject to use tax.

(511) **Other use tax exemptions.** Use tax does not apply to the use of digital goods that are:

(a) Noncommercial in nature, such as personal e-mail communications;

(b) Created solely for an internal audience; or

(c) Created solely for the business needs of the person who created the digital good and is not the type of digital good that is offered for sale, including business e-mail communications.

**Example 32.** Gary, an employee of Kadabbera Corp., creates a digital audio-visual presentation using presentation authoring software and his innate creative capacity. Gary distributes the presentation internally to various divisions within Kadabbera in order to train employees on changes to company policies. Gary has created and distributed an item that meets the definition of "digital good." However, the distribution and use of this digital good is not subject to use tax as long as it is used solely internally or solely for the business needs of Kadabbera.

## Part 6. Miscellaneous Provisions

(601) **Retail services.** Washington imposes retail sales and use tax on certain enumerated services under RCW 82.04.050

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("retail services"). For example, the sale of credit bureau services is subject to retail sales tax. However, when a retail service is transferred electronically and also meets the definition of digital automated service or digital good, such service will be treated as a digital product and is eligible for all applicable digital products retail sales and use tax exemptions as described above in Part 5 of this rule. Retail services that are not transferred electronically or those retail services that are excluded from the definitions of digital good or digital automated service (e.g., telecommunications services and ancillary services) continue to be taxed as retail services.

**Example 33.** ABC creates a "canned" digital report on Company X's creditworthiness prepared prior to a customer request for the report. The report may be a credit bureau service and/or a digital good (if transferred electronically). The "canned" report is listed for sale on ABC's web site. An employee of InvestCo, Inc. purchases and downloads a digital copy of the "canned" credit report from ABC's web site for InvestCo's business purpose. ABC is selling a digital good generally subject to retail sales tax. However, the "canned" report is purchased by InvestCo solely for a business purpose and therefore exempt from retail sales tax (see subsection (505) of this section for more on this exemption).

**Example 34.** Company sells credit reports and credit research services. EPD Corp., requests that Company prepare a credit report for EPD's specialized business purposes. After receiving the request, Company's employee researches, analyzes and generates information from various digital sources to prepare the credit report for EPD. Company then sends the report electronically as a digital file to EPD. Company is not selling a digital good because the digital item supplied to EPD is merely a representation of a professional service performed by EPD's employee. Therefore, Company's services are not a "digital product." However, Company is still required to charge and collect retail sales tax because Company is still providing credit bureau services, a retail service, subject to retail sales tax.

**Example 35.** Company sells an online credit reporting service. The service includes access to searchable data bases, digital data analysis, and digital data reporting tools. ManageCo investigates the credit worthiness of individuals and therefore purchases access to Company's online service. Company is selling a digital automated service to be used solely for a business purpose by ManageCo. However, the "used solely for a business purpose" exemption is limited to digital goods and is not applicable to digital automated services. As such, Company is required to charge and collect retail sales tax on its sale

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of the digital automated service to ManageCo.

(602) **Royalties and wholesaling B&O tax on digital products.** The sale of digital products to "nonend users" may be subject to royalties or wholesaling B&O tax depending on the type of transaction and the intangible rights provided to the purchaser. Transactions which provide the right to resell digital products (no copying rights) to consumers will generally be treated as wholesale sales. Additionally, transactions which allow the purchaser the right to incorporate a digital product into a new product for sale will also be treated as wholesale sales. See also subsection (503) of this section. Other nonend user transactions involving digital products or digital codes will generally be treated as royalties transactions.

**Example 36.** Media Corp., licenses to Rerun Inc., the right to further broadcast a digital movie file on Rerun's web site for a specified period of time. In this case Media Corp. provides Rerun with the right by contract to further commercially broadcast or exhibit a digital movie to its subscribers. This is a nonend user transaction subject to royalties B&O tax. Media Corp. would report its gross receipts from this transaction under the royalties B&O tax classification and not charge and collect retail sales tax on the transaction with Rerun. Rerun's charges for the subscription service provided to consumers are generally subject to retail sales tax and retailing B&O tax.

**Example 37.** Same facts as Example 36 except Rerun purchases individual digital movie files from Media Corp. with the right to resell those individual files to end users at retail instead of rebroadcasting or exhibiting to the public. In this case Media Corp. has provided Rerun with the right to resell individual digital movie files to end users. Media Corp. would report its gross receipts from this transaction under the wholesaling B&O tax classification and not charge and collect retail sales tax on the transaction with Rerun. Rerun's charges to consumers for the movie files are generally subject to retail sales tax and retailing B&O tax.

**Example 38.** Same facts as Example 37 except that Rerun purchases a single digital movie file with the right provided by contract to duplicate and sell that movie file. In this case Media Corp. has provided Rerun with the right to duplicate and sell individual digital movie files. Media Corp. would report its gross receipts from this transaction under the royalties B&O tax classification. Media Corp. would not need to charge and collect retail sales or use tax from Rerun. Rerun's charges to consumers for the movie files are generally subject to retail sales tax and retailing B&O tax.

**Example 39.** Jack is a photographer who creates a digital

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picture of Mt. Rainier. Jack licenses, by contract, to Cashman the right to duplicate and sell copies of the Mt. Rainier picture in retail stores. Cashman's payment to Jack is for the grant of an intangible right and subject to royalties B&O tax. Cashman's sale of the picture at retail to customers is subject to retail sales tax and retailing B&O tax.

(603) **Substantial nexus** is not established in Washington if a business's only contact with the state of Washington is ownership of, or rights in, computer software as defined in RCW 82.04.215, including computer software used in providing a digital automated service; master copies of software; a digital goods or digital codes residing on servers in Washington. For purposes of this section, "substantial nexus" means the requisite connection that a person must have with a state to allow the state to subject the person to the state's taxing authority, consistent with the commerce clause of the United States Constitution.

(604) **Amnesty.** Before July 26, 2009, retail sales of downloaded digital goods on a permanent or nonpermanent basis were subject to retail sales tax. This did not include accessed or streamed digital goods. However, amnesty is available to those who did not collect or pay retail sales or use tax on digital goods and digital codes during that time. Sales of digital automated services and accessed or streamed digital goods were subject to service and other B&O tax before July 26, 2009, and amnesty does not extend to these transactions because they were not subject to retail sales tax during that time period.

(a) **Refunds and credits of retail sales or use tax.** No refund or credit will be given for state and local retail sales and use taxes properly paid on the sale or use, before July 26, 2009, of digital goods or of installing, repairing, altering, or improving digital goods.

(b) **No B&O tax refund or credit unless sales tax was paid.** If a taxpayer paid B&O tax under the service and other activities classification prior to July 26, 2009, on income received from retail sales of digital products or digital codes, the taxpayer may not receive a refund or credit for the difference between the B&O tax actually paid and the B&O tax that should have been paid under the retailing classification unless the taxpayer has remitted the retail sales tax for those sales.

(605) **Bundled transactions.** A "bundled transaction" is the retail sale of two or more products, which are distinct and identifiable for one nonitemized price. Because retail sales of digital products and digital codes are subject to retail sales tax, the general rules on the taxation of bundled transactions

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may apply to certain transactions involving digital products and digital codes. See RCW 82.08.190 and 82.08.195 for more information on the tax treatment of bundled transactions.

(606) **Property tax.** The excise tax laws relating to digital products and digital codes do not have any impact in the characterization of digital goods and digital codes as tangible or intangible personal property for purposes of property taxation and may not be used in any way in construing Title 84 RCW. See section 1201, chapter 535, Laws of 2009.

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