



SC PRIVATE LETTER RULING #89-6

TO: ABC

SUBJECT: Computer Hardware, Software & Maintenance Contracts
(Sales and Use Tax)

REFERENCE: S.C. Code Ann. Section 12-35-810 (1976)
S.C. Code Ann. Section 12-35-515 (Supp. 1987)
S.C. Code Ann. Section 12-35-140 (1976)
S.C. Code Ann. Section 12-35-120 (1976)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #87-3

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request. Private Letter Rulings have no precedential value and are not intended for general distribution.

Questions:

1. Are the monthly fees for a computer hardware maintenance contract, paid by ABC, subject to the State's use tax, pursuant to Code Section 12-35-810?
2. Are the monthly fees for a computer software maintenance contract, paid by ABC, subject to the State's use tax, pursuant to Code Section 12-35-810?

Facts:

ABC is leasing a computer system, including terminals and printers, (computer hardware) from XYZ of Wisconsin. The initial term of the lease is sixty months and the monthly rental is \$771.39, plus \$38.59 use tax, for a total payment of \$809.96.

Initially, ABC determined the type of hardware needed for its business and arranged the transaction through X. X sold the computer hardware to XYZ which, in turn, executed a lease with ABC. In addition, ABC pays a monthly fee of \$510.00 to X for maintenance of the computer hardware.

The contract, which arranged these transactions, does not clearly specify what ABC receives for the payment of the hardware maintenance fees. However, it appears, and it is the understanding of ABC, that the maintenance agreement is "to keep the equipment running in its original shape and not to enhance it. Any enhancements [will be] paid for separately."

At the same time the computer hardware leasing contract was executed, ABC purchased a right or license to use "application programs" (computer software) from X for \$7,250.00. ABC also pays, by contract, a monthly fee of \$185.00 to X maintenance and support of this software.

The contract granting the license to use the software does not clearly specify what ABC receives for these fees. However, it appears, and it is the understanding of ABC, that such fees pay for phone support, training, and corrections of software problems. Any new programs are optional and would be paid for separately.

Discussion:

1. The first issue is whether or not the payment of the monthly computer hardware maintenance fee constitutes the purchase at retail of tangible personal property for storage, use or consumption in this State.

Code Section 12-35-810 reads, in part:

An excise tax is imposed on the storage, use or other consumption in this State of tangible personal property purchased at retail for storage, use or other consumption in this State, at the rate of [five] percent of the sales price of such property, regardless of whether the retailer is or is not engaged in business in this State. (emphasis added)

Code Section 12-35-140 defines "tangible personal property" and reads, in part:

The term "tangible personal property" means personal property which may be seen, weighed, measured, felt or touched or which is in any other manner perceptible to the senses, except notes, bonds, mortgages or other evidences of debt and stocks and shall include rooms, lodgings or accommodations furnished to transients for a consideration.

For the purposes of this chapter the term "tangible personal property" shall be interchangeable with and apply with equal force and effect to services, accommodations and intangibles, including communications, as are specifically provided for in this chapter.

In summary, tangible personal property must be either personal property perceptible to the senses or a service specifically provided for in the sales and use tax chapter.

The service provided by X under the maintenance contract is not specifically taxed under the sales tax law. However, we must also review the definition of "sales price" found in Code Section 12-35-120. That section reads, in part:

The term "sales price" means the total amount for which tangible personal property is sold, including any services that are a part of the sale....

In *Edisto Fleets, Inc. v. South Carolina Tax Commission*, 256 S.C. 350, 182 S.E.2d 713 (1971), the South Carolina Supreme Court held:

Although the definition of the term "sale" as found in Section 65-1360 does not specifically refer to the lease or rental of tangible personal property, the same nonetheless is included because of the definition of the term "purchase" that is provided in Section 65-1357. The terms "sale" and "purchase" are inextricably related and bound together and must be so construed and the term "purchase" specifically refers to the lease or rental of tangible personal property. This conclusion is fortified by the failure of the General Assembly in 1955 to amend the definition of the term "sale" to specifically include the words "lease or rental of tangible personal property." It would be unreasonable for this Court to conclude that the General Assembly amended the statute in 1955 to define as a retailer a person that leases or rents tangible personal property and at the same time intend that such person be exempt from the tax because the lease or rental was not a sale of tangible personal property.

In summary, a lease of tangible personal property is a sale of tangible personal property under the State's sales and use tax law.

It must now be determined whether or not the service provided under the maintenance contract is a service that is part of the sale. A review of the transaction indicates that the computer hardware (tangible personal property) is leased from XYZ, which is collecting and remitting the use tax on the lease, while the maintenance contract (service) was purchased from X Corp. In summary, the service provided under the maintenance contract is not a service that is a part of the lease of the computer hardware.

2. The second issue is whether or not the payment of the monthly computer software maintenance fee constitutes the purchase at retail of tangible personal property for storage, use or consumption in this State.

A determination, with respect to this issue, requires a review of the taxability of the sale or purchase of computer software. In *Citizens and Southern Systems, Inc. v. South Carolina Tax Commission* 280 S.C. 138, 311 S.E.2d 717 (1984), the South Carolina Supreme Court held:

We agree with the trial judge that the computer software was delivered to C & S in a form which could be seen, weighed, measured, felt and touched and was therefore tangible personal property, a sale of which is subject to the State's sales and use taxes.

Furthermore, the Commission in a finding issued on February 26, 1987 held that, where computer software is not delivered to the purchaser in a tangible form, then the seller has provided a service and has not sold tangible personal property. Therefore, the State sales tax was not applicable to the transaction.

In summary, computer software delivered in a tangible form is subject to the sales or use tax.

The opening statement of the Software License Agreement reads:

Whereas Licensor develops proprietary computer software programs which exist as written products in written and magnetically recorded form as well as user manuals and other appropriate documentation supporting such products (collectively referred to hereinafter as "Licensed Software") for Licensee...(emphasis added).

Section 11 of the Software License Agreement reads:

Licensor will ship all Licensed Software in sealed packages with specific serial numbers assigned to each package. Breaking or opening the seal without approval from Licensor will acknowledge acceptance by Licensee.

The software was, therefore, delivered in a tangible form and is subject to the use tax. It must now be determined if the software maintenance contract is part of the sale of the software.

Sections 9 and 22 of the agreement read respectively:

Software support fees will be subject to change on a 60-day written notice to Licensee. If the prices are increased, the Licensee may terminate this agreement on the effective date of the price change by a 30-day written notice prior thereto; otherwise such new prices shall become effective on the date specified. Licensor reserves the right and Licensee agrees to permit Licensor to remove all Licensed Software under this License Agreement from Licensee's premises if cancellation of software support services by either party occurs.

* * * *

If any of the terms and conditions of this agreement are broken by End User, in addition to all other legal rights and remedies, X may terminate this license. Upon termination, End User shall return to X all products and copies, thereof, whether modified, merged or included with other software and shall certify in writing to X that End User has not retained any X products or copies, thereof. The provisions of this license which protect proprietary rights of X shall continue in force after termination.

Furthermore, it was confirmed by a representative of X that ABC was required to purchase, and remit monthly payments (support fees) for, the computer software maintenance contract, when they purchased the license to use the software. In addition, if a customer terminates the monthly support payments under Section 9 of the contract, X will request the return of the software.

In summary, the computer software maintenance contract is a service that is a part of the sale of the software (tangible personal property).

Conclusions:

1. The monthly fees for the computer hardware maintenance contract, paid by ABC to X, are not subject to the State's use tax, pursuant to Code Section 12-35-810 and 12-35-120.
2. The monthly fees for the computer software maintenance contract, paid by ABC to X, are subject to the State's use tax, pursuant to Code Sections 12-35-810 and 12-35-120.

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.
S. Hunter Howard, Jr., Chairman

s/A. Crawford Clarkson Jr.
A. Crawford Clarkson, Jr., Commissioner

s/T. R. McConnell
T. R. McConnell, Commissioner

Columbia, South Carolina
April 19, 1989