



SC REVENUE RULING #93-4

SUBJECT: Charges for Maintenance or Support of Computer Software
(Sales and Use Tax)

TAX ANALYST: Steve C. Hallman

EFFECTIVE DATE: April 1, 1993

REFERENCE: S.C. Code Ann. Section 12-36-90 (Supp. 1992)
S.C. Code Ann. Section 12-36-130 (Supp. 1992)
S.C. Code Ann. Section 12-36-910(A) (Supp. 1992)
S.C. Code Ann. Section 12-36-1310(A) (Supp. 1992)
Regulation 117-174.48
Regulation 117-174.262

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1992)
SC Revenue Procedure #87-3

SCOPE: A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Question:

Are charges for maintenance or support of computer software subject to the sales or use taxes?

Facts:

Frequently, when computer software is purchased or a license to use software is granted, the purchasers or licensees enter into agreements for the maintenance or support of the software. These agreements generally entitle the purchasers or licensees to one or more of the following benefits:

1. Telephone assistance on standby or during certain hours.
2. Updated or new versions of the software as they become available.

3. Coding or modifications to fit specific hardware needs.
4. Debugging of programs or correction of errors.
5. Training concerning use of the software.
6. Installation of the software.

In addition to the various benefits that may be available through software maintenance or support agreements, diverse conditions exist in conjunction with the terms of these agreements. For instance, some agreements are entered into when the software is purchased or a license to use is granted and others are entered into some later time; some agreements are optional while other agreements are mandatory; etc.

As a result of the diversity of benefits, conditions and terms associated with computer software maintenance or support agreements, there is some confusion as to whether the charges for these agreements are subject to the sales or use taxes.

Discussion:

Before we can discuss whether computer software maintenance contracts are subject to tax, we need to understand why sales of computer software are subject to tax.

Computer Software

Code Section 12-36-910(A) states:

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail. (Emphasis added.)

Code Section 12-36-1310(A) reads:

A use 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 the property, regardless of whether the retailer is or is not engaged in business in this State. (Emphasis added.)

In Citizens and Southern Systems, Inc. v. South Carolina Tax Commission, 280 S.C. 138, 311 S.E.2d 717 (1984), the Supreme Court of South Carolina determined that computer software sold and delivered to the purchaser by means of magnetic tape was tangible personal property and subject to the State's sales and use taxes.

Regulation 117-174.262, "Automatic Data Processing Equipment and Programs" states, in part:

* * * *

Prewritten Programs - The tax applies to total charges for coding, punching or otherwise reproducing prewritten programs including charges for the tapes or other properties when furnished by the seller or producer.

The temporary transfer of possession of a program for a consideration for the purpose of direct use by the customer or to be reproduced by the customer on or into tapes or other properties is a lease of tangible personal property subject to the tax on the total amount paid even though the consideration may be labeled a license fee or royalty payment; and even though royalty payments or payments for a license to use may be paid long after the original programs are returned to the seller.

Custom Programs - Custom programs are programs prepared to the special order of a customer, the gross proceeds therefrom being subject to the tax. Also considered to be custom programs are sales of programs developed through modification of existing prewritten programs to meet a customer's specific needs. Charges to modify and adapt these programs to a customer's equipment (including testing) or translating a program to a language compatible with a customer's equipment are services that are a part of the sale price of tangible personal property and likewise subject to the tax.

In summary, computer software sold and delivered to a purchaser in a tangible form, such as by magnetic tape or on a disk, is a sale subject to the sales or use tax.

Charges for Maintenance Contracts Made in Conjunction
With the Sale of Computer Software

Having established that the sale or purchase of computer software is subject to the sales or use tax, we must next examine whether charges associated with the acquisition of software are taxable (i.e. maintenance agreements).

The sales tax is imposed upon a retailer's "gross proceeds of sales" which is defined at Code Section 12-36-90, in part, as:

...the value proceeding or accruing from the sale, lease, or rental of tangible personal property... without any deduction for... the cost of materials, labor, or service... [or] any other expenses....

The use tax is based upon the "sales price" of tangible personal property. The term "sales price" is defined at Code Section 12-36-130, in part, as:

...the total amount for which tangible personal property is sold, without any deduction for the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses, or any other expenses.

(1) The term includes:

- (a) any services or transportation costs that are a part of the sale, whether paid in money or otherwise;...

In Meyers Arnold, Inc. v. South Carolina Tax Commission, 285 S.C. 303, 328 S.E.2d 920, 923 (1985), the Court of Appeals of South Carolina held the element of service involved in a lay away sale was subject to tax as being part of the sale of tangible personal property. The test used by the court was as follows:

...But for the lay away sales, Meyers Arnold would not receive the lay away fees. The fees are obviously charged for the service rendered in making lay away sales. For these reasons, this court holds the lay away fees are part of the gross proceeds and subject to the sales tax. Accordingly, the total amount charged in conjunction with the sale or purchase of tangible personal property is subject to the tax....(Emphasis added.)

A similar conclusion was reached in Regency Towers Association, Inc. v. South Carolina Tax Commission, 88-CP-26-1109 (1989), where the Horry County Court of Common Pleas held charges for maid service were not deductible from gross proceeds derived from charges for accommodations. More recently, in Commission Decision #92-37, the Commission held that charges for maid services, which were optional, were a part of the accommodations furnished to transients and therefore subject to the accommodations tax.

In Commission Decision #90-38, the Commission held that charges for engraving services, even though optional, were a part of the sale of plaques and trophies by the retailer and includible in gross proceeds of sales. The decision states, in part:

...We find and conclude that here the "engraving charges" are part of the sale of tangible personal property since the customer is not seeking a professional service but is seeking an engraved trophy or plaque....

* * * *

...The Courts have held that although the amount of materials used may be inconsequential with respect to the labor involved where the customer seeks to purchase custom made or designed tangible personal property, the artistic skill of the craftsman is a part of the sales price of the product and is inextricably linked....

In addition, Regulation 117-174.48, entitled "Warranties", provides further guidance and reads, in part:

On all sales of tangible personal property which include a charge for warranty which is a part of the sales price of the property, such warranty charges are to be included in the measure of the tax, even though said warranty charges may be billed separately from the price of the merchandise.

Warranty contracts entered into subsequent to the sale of tangible personal property and which are separate and distinct from the sale, and for which a separate and distinct charge is made are not to be included in the measure of the tax....

In summary, charges for maintenance agreements (whether optional or mandatory) that are made in conjunction with, or as part of the sale of, computer software are includable in "gross proceeds of sales" or "sales price", and, therefore, subject to the tax.

Maintenance Contracts Not Sold in Conjunction with Computer Software

The above discussion concerns maintenance contracts that are sold in conjunction with the sale of software. However, we must also consider sales of maintenance contracts that are not made in conjunction with the sale of software (e.g. contracts sold by a third party and contracts sold at a later date). In such cases the question often arises as to whether one is selling a service or tangible personal property. Typically, such contracts provide software updates, technical support, on-site modifications, etc.

In Commission Decision 89-1, the Commission considered whether charges for a digital data tape, which when applied to the appropriate computer system would produce maps, were subject to use tax. In reaching its conclusion that the charges were subject to tax, the Commission stated:

...Here the facts demonstrate that the true object of the subject transaction was to obtain the digital data tape and base maps both of which are tangible personal property....

In Richland County v. South Carolina Tax Commission, 82-CP-40-2143 (1983), the Richland County Court of Common Pleas held that tax map sheets made and delivered by a third party did not represent a personal service transaction, but were the "saleable product" of the third party's skill and therefore subject to the use tax.

In summary, if the true object of a particular transaction is to acquire or to use tangible personal property, the transaction is subject to tax. The measure of the tax being the entire amount charged for the contract. If the true object of a particular transaction is to acquire a service, as opposed to tangible personal property, the transaction is not subject to tax.

Conclusions:

CONTRACTS SOLD IN CONJUNCTION WITH THE SALE OF SOFTWARE

Maintenance contracts (whether optional or mandatory) sold in conjunction with the sale of computer software are includable in the measure of the sales or use tax. It is irrelevant whether the maintenance contract is for tangible personal property, services, or both.

CONTRACTS THAT ARE NOT SOLD IN CONJUNCTION
WITH THE SALE OF SOFTWARE

Maintenance contracts that are not sold in conjunction with the sale of computer software may or may not be subject to the sales or use tax.

In determining whether or not a contract is taxable, the true object of the contract must be established. If the true object of a contract is to acquire tangible personal property (e.g. software updates), the total charges for the contract are taxable, even though certain services are also provided. If the true object is to acquire services (e.g. telephone assistance), then the total charges are not taxable, even though certain tangible personal property is also provided.

An Example of When the True Object of a Contract is the Sale of Tangible Personal Property:

The true object of a particular contract is to sell software, and the transaction is subject to tax, where:

1. the contract provides for the purchaser to receive software updates;
2. there is no additional charge to the customer for the updates; and
3. the original software is obsolete without the updates (e.g. an income tax preparation program).

While a contract is taxable if all the above are met, absence of one or more of the criteria does not establish that a contract is for the sale of services, as opposed to software. In such cases, all the facts and circumstances should be considered before concluding that a particular contract is not taxable.

SOUTH CAROLINA TAX COMMISSION

s/A. Crawford Clarkson Jr.

A. Crawford Clarkson, Jr., Chairman

s/T. R. McConnell

T. R. McConnell, Commissioner

s/James M. Waddell

James M. Waddell, Commissioner

Columbia, South Carolina
February 23, 1993