

State of Rhode Island and Providence Plantations

Rhode Island Department of Revenue
Division of Taxation

Public Notice of Proposed Rule-Making

Pursuant to the provisions of Rhode Island General Law §42-35-3(a)(1) and in accordance with the Administrative Procedures Act (Chapter 42-35 of the General Laws), the Division of Taxation hereby gives notice of its intent to amend regulation SU 09-25, "Computers and Related Systems."

The purpose of this rule making process is to implement Chapters 44-18 and 44-19 of the Rhode Island General Laws, which imposes sales and use tax on computers, software and related systems. This regulation amends and supercedes regulation SU 09-25 promulgated January 1, 2010. This regulation shall take effect October 1, 2011.

The proposed rule to be amended and concise summary of non-technical requirements and proposed new rules are available for public inspection at www.tax.ri.gov or in person at the Rhode Island Division of Taxation, or can be requested by e-mail: mcanole@tax.ri.gov or by calling Michael Canole at (401) 574-8729.

In the development of the proposed regulation, consideration was given to: (1) alternative approaches; (2) overlap or duplication with other statutory and regulatory provisions; and (3) significant economic impact on small business. No alternative approach, duplication, or overlap, or significant economic impact on small business was identified based upon available information.

All interested parties are invited to submit written or oral comments concerning the proposed regulations by Friday, August 26, 2011 to Michael Canole, Rhode Island Division of Taxation, One Capitol Hill, Providence, RI – telephone number (401) 574-8729 or via e-mail: mcanole@tax.ri.gov. A public hearing to consider the proposed regulation will be held on Friday, August 26, 2011, at 1p.m., at the Rhode Island Division of Taxation, One Capitol Hill, Providence, RI, at which time and place all persons interested therein will be heard. The room is accessible to the disabled and interpreter services for the hearing impaired will be provided if requested 48 hours prior to the hearing. Requests for this service can be made in writing to Michael Canole at Rhode Island Division of Taxation, One Capitol Hill, Providence, RI 02908 or by calling (401) 574-8729.

Rhode Island Department of Revenue

Division of Taxation

Concise Summary of ALL Non-technical requirements pursuant to RIGL Section 42-35-3(a)(1) regarding rules and regulations on computers, software and related systems - Amended

The purpose of this rule making process is to implement Chapters 44-18 and 44-19 of the Rhode Island General Laws, which imposes sales and use tax on certain computers, software and related systems. This regulation amends and supercedes regulation SU 09-25 promulgated January 1, 2010. This amendment shall take effect October 1, 2011

State of Rhode Island - Division of Taxation

Sales and Use Tax

Regulation SU ~~1109~~-25

Computers, [Software](#), and Related Systems

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RULE 1. PURPOSE

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

RULE 2. AUTHORITY

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

RULE 3. APPLICATION

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

RULE 4. SEVERABILITY

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

RULE 5. DEFINITIONS

“Application software” means computer software designed to help the user to perform singular or multiple related specific tasks. Application software may be bundled with the computer and its system software, or may be published separately. Application software is contrasted with system software which manages and integrates a computer's capabilities, but typically does not directly apply them in the performance of tasks that benefit the user. The system software serves the application, which in turn serves the user.

“Canned software” – See Prewritten computer software.

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

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

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

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

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

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

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

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

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

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

“Specified digital products” means electronically transferred:

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

RULE 6. COMPUTER HARDWARE

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

RULE 7. COMPUTER SOFTWARE

- (1) Prewritten computer software - The sale of prewritten computer software (“canned”) delivered in tangible form is taxable *including any services (training, maintenance*

consultation etc) pertaining to the sale. However, installation labor separately stated is not subject to tax.

- (2) Effective October 1, 2011, the sale of prewritten computer software, including application software, delivered electronically or by load and leave, is subject to tax, including any services pertaining to the sale.
- (3) Modifications to prewritten computer software that are designed to make the software conform to a purchaser's specifications are not subject to tax, provided the charges are separately stated.

~~Prewritten computer software delivered electronically or by load and leave is not subject to tax because it is not considered a sale of tangible personal property.~~

- ~~(4)~~(2) Custom Software – The sale of custom software as defined above is not subject to tax. This includes any services incidental thereto and any modifications.

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

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

RULE 8. MAINTENANCE AGREEMENTS

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

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

- (2) Effective October 1, 2011, all prewritten computer software maintenance agreements or contracts delivered electronically are subject to tax regardless of whether the related prewritten computer software was purchased in tangible format or received electronically.

The following examples are effective October 1, 2011.

Example #1

A software company has the following charges to a customer:

Prewritten computer software (tangible)	\$5,000
Software maintenance agreement (\$100 per year for five years, paid upfront as part of purchase agreement included with software)	500
Sales Tax	385
Total	\$5,885

Example #2

A software company has the following charges to a customer:

Prewritten computer software (tangible)	\$5,000
Software maintenance agreement (\$100 paid at time of software purchase, and \$100 per year for next 4 years per purchase agreement)	100
Sales Tax	357
Total	\$5,457

Remaining annual payments of \$100 per the computer software maintenance contract delivered electronically or in tangible format are subject to tax. ~~as these charges are related to prewritten computer software received in tangible format and purchased as part of the original purchase agreement.~~

Example #3

A software company has the following charges to a customer:

Prewritten computer software (tangible <u>format or delivered electronically</u>)	\$5,000
Sales Tax	350
Total	\$5,350
<u>Software maintenance agreement (purchased after the original software purchase and received electronically)</u>	<u>\$ 500</u>
<u>Sales Tax</u>	<u>35</u>
<u>Total</u>	<u>\$ 535</u>

Note: A computer software maintenance ~~contract~~ agreement purchased on or after October 1, 2011 delivered electronically or in tangible format and purchased after the original purchase agreement for software — (\$500 for 5 years) is subject to tax.

~~Since delivered electronically and is a separate charge for a computer software maintenance contract purchased after the original purchase of software, it is not subject to tax.~~

Example #4

A software company has the following charges to a customer:

Custom computer software (tangible)	\$5,000
Computer software maintenance contract (\$100 per year for five years, paid upfront as part of purchase agreement included with software)	500
Sales Tax	-0-
Total	\$5,500

Custom software and related services are not subject to tax.

Example #5

An individual purchases the following:

<u>Prewritten computer software package delivered electronically</u>	<u>\$200 *</u>
<u>E-book delivered via digital download</u>	<u>50</u>
<u>Music delivered via digital download</u>	<u>75</u>
<u>Ringtone delivered via digital download</u>	<u>5</u>
<u>Wireless (cellular) phone application</u>	<u>100 *</u>
<u>Computer game delivered via digital download</u>	<u>50 *</u>
<u>Sales Tax (* items subject to tax)</u>	<u>24.50</u>
<u>Total</u>	<u>\$504.50</u>

RULE 9. SOURCING TRANSACTIONS

Rhode Island will use the same method for prewritten computer software delivered electronically as is used for the taxation of cellular telecommunication services. The transaction is sourced to the customer's place of primary use as defined by Section 124 of Title 4 of the United States Code.

Example:

An individual from New York while in Rhode Island purchases an App and downloads it to his cell phone (or similar device) from a server hosted in Florida. In this example, the transaction would be subject to New York tax.

RULE ~~10~~9. EFFECTIVE DATE This regulation ~~shall~~ takes effect ~~October 1, 2011~~ ~~on~~ ~~January 1, 2010~~ and shall amend and supercede regulation SU 09 ~~94~~-25 promulgated January 1, ~~2010~~~~1994~~.

RULE ~~11~~10. CROSS REFERENCES

CROSS REFERENCE: SU 00-126 "Optional Service, Maintenance and Extended Warranty Contracts"

DAVID SULLIVAN
TAX ADMINISTRATOR