

(1) Introduction. This rule explains the business license tax treatment of activities related to computer software, and computer software-related services. Such activities include, but are not limited to, selling, leasing, manufacturing, installing, repairing, and maintaining computer software, as well as developing, duplicating, configuring, licensing, downloading, and accessing computer software.

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

(2) Definitions.

- (a) Automatic data processing equipment. "Automatic data processing equipment" includes computers used for data processing purposes and their peripheral equipment.
- (b) Computer software. "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 may be delivered either by intangible means such as electronically downloaded or by tangible means such as tangible storage media. Computer software does not include data.
- (c) Custom software. "Custom software" is computer software created for a single person. The use of library files in software development does not preclude such software from being characterized as custom software, if the software is created for a single person. For purposes of this rule, "library files" are a collection of precompiled and frequently used routines that a software developer can use in developing the software. The nature of custom software does not change when ownership is transferred to a person with no rights retained by the transferor.
- (d) Customizing prewritten computer software. "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.

(e) 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. 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.

(f) Prewritten computer software. “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. However, 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.

(g) 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.

(h) 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.

- (i) Royalties. “Royalties” are compensation for the use of intangible property including but not limited to intellectual 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.
- (j) Site license of prewritten computer software. “Site license of prewritten computer software” is a license which 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.

(3) Taxation of custom software, software training, royalties, and customizing prewritten computer software. The following activities are subject to tax under the service and other business activities classification:

- (a) Creation of custom software. Gross income received for creating custom software in Seattle is subject to tax under the service and other business activities classification.
- (b) Development of master copy. A third-party charge for development of a master copy of software is a charge for custom software development and is subject to tax under the service and other business activities classification.
- (c) Duplication of custom software. Duplication of custom software for the same person, or by the same person for its own use, does not change the character of the custom software. Duplication of custom software for the same person, or by the same person for its own use, is not subject to tax under the manufacturing classification but is considered to be part of the sale of custom software and subject to tax under the service and other business activities classification. If a person duplicates custom software for sales to, or use by, another person other than the original purchaser, the software becomes prewritten computer software as defined in subsection (2)(f) of this section.
- (d) Computer software training. Gross income received for training on the use of custom software is subject to tax under the service and other business activities classification. Gross income received for training on the use of prewritten computer software is subject to tax under the service and other business activities classification 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 sale of prewritten computer software subject to tax under the retail sales and retail services classification.

- (e) Licensing computer software - royalties. Income received from charges in the nature of royalties for the licensing of computer software is taxable under the service and other business activities classification.

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 subsections (2)(j), (4)(b)(ii) and (4)(c)(ii) of this rule for more information on site licenses.

Example 1: HG Computers Inc. an original equipment manufacturer (OEM), acquires prewritten computer software from LL Software Inc. for purposes of acquiring a license to reproduce and distribute the prewritten computer software, as part of a bundled computer hardware and software package to end users. LL retains all of its ownership rights to the software. Royalties received from granting intangible rights to reproduce and distribute prewritten computer software to HG are subject to tax under the service and other business activities classification.

- (f) Customizing prewritten computer software. Gross income received for customizing prewritten computer software is subject to tax under the service and other business activities classification. When there is a reasonable, separately stated charge for customization of prewritten computer software on an invoice or contract given to the purchaser, such customization is subject to tax under the service and other business activities classification. 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 to be a sale of prewritten computer software. See Section (4) of this rule for more information on prewritten computer software.

Customization of prewritten computer software includes custom installations but does not include routine installation.

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 tax under the retail sales and retail services classification. 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 tax under the retail sales and retail services

classification for the sale of prewritten computer software, but instead subject to tax under the service and other business activities classification.

Example 2. Golf Tee Inc. needs financial modeling software that can tie into most of its existing computer systems. Golf Tee Inc. finds an industry-wide computer software offered by PQR Computers Inc. that, when modified, meets the requirements of Golf Tee Inc. PQR provides a separately stated charge to Golf Tee Inc. for customization of prewritten computer software. PQR is subject to tax under the retail sales and retail services tax classification for the sale of prewritten computer software. PQR is also subject to tax under the service and other business activities classification for the customization of prewritten computer software.

Example 3. Same facts as Example 2, except that, in addition, PQR provides a separately stated charge to Golf Tee Inc. for routine installation of prewritten computer software. This charge represents installation of only the prewritten portion of the software. PQR is subject to tax under the retail sales and retail services classification for the routine installation of the prewritten software.

(4) Taxation of prewritten computer software. The following explains the taxation of 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 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.

Wholesale sale versus royalty. 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 (3)(f) of this rule for more information on royalties.

(b) Retail sales of prewritten computer software. Gross proceeds of sales of prewritten computer software to consumers are subject to tax under the retail sales and retail services 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 tax under the retail sales and retail services classification. 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.

- (i) *Free prewritten software.* The 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. This exception from taxation 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.
- (ii) *Retail sales of prewritten software under a site license.* Gross proceeds of sales of a site license to a consumer are subject to tax under the retail sales and retail services 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. 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.

Example 4. GH Computers Inc. sells at retail a multiple site license of its prewritten computer software to Quick Inc. GH is located outside Seattle, while Quick is located in Seattle 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 on its use by Quick. The software is delivered to Quick outside Seattle. Quick then electronically duplicates the software and distributes the software to all of its 500 employees, of which 100 employees are located in Seattle. The software is electronically downloaded onto the desktop computers of all employees and is immediately put into use. If GH has nexus with Seattle, business license tax is due under the retail sales and retail services classification on the 100 copies of prewritten computer software used in Seattle.

Example 5. Same facts as Example 4, 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 copies of the software are delivered to Quick in fulfilling

this new agreement. Quick distributes additional copies of the software to its 100 new employees, of which 50 employees are located in Seattle. If GH has nexus with Seattle, business license tax is due under the retail sales and retail services classification on the 50 additional copies of prewritten computer software used in Seattle.

(iii) Remote access by the licensee. If the prewritten software is hosted by the licensor or a third party for remote access by the licensee, then see subsection (8) of this rule.

(c) Manufacturing of prewritten computer software. Persons engaged in manufacturing prewritten computer software on tangible storage media are subject to tax under the manufacturing classification upon the value of the products. See Seattle Rule 5-044 (Value of products) and 5-111 (Manufacturing, processing for hire, fabricating). Manufacturers of prewritten computer software who sell their products at retail or wholesale in the city are also subject to tax under either the retail sales and retail services classification or wholesaling classification. In such cases the manufacturer must report under both the “production” (manufacturing) and “selling” (wholesaling or retailing) classifications and may claim a multiple activities tax credit (MATC). See SMC 5.45.070 (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 tax under the manufacturing classification.

(i) Duplication of prewritten computer software. Duplication of prewritten computer software in Seattle on tangible media for sales to, or use by, more than one person is subject to tax under the manufacturing classification upon the value of products which includes both the value of the tangible media and the software. Duplication of prewritten computer software outside Seattle on tangible media is not subject to tax under the manufacturing classification regardless of where software development takes place.

Duplication of prewritten computer software in Seattle is subject to tax under the manufacturing classification 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. (Refer to SMC 5.30.035.J.)

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 20% 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 Seattle Rule 5-111 (Manufacturing, processing for hire, fabricating) for more information.

(ii) *Duplication of prewritten computer software by a person under a site license.* The seller of a site license is subject to tax under the manufacturing classification for its own duplication of prewritten computer software in Seattle. Duplication of prewritten computer software is subject to tax under the manufacturing classification 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. A purchaser of a site license, however, is not subject to tax under the manufacturing classification for the duplication of prewritten computer software in Seattle for its own use, pursuant to a site license agreement with the seller.

(5) Key to activate computer software.

- (a) 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 purchaser. However, if the place of receipt for the software is unavailable to the vendor because the software was received by a third party, then the sale takes place where the key is delivered. 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.
- (b) See subsection (4)(b)(ii) 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 tax under the manufacturing classification, then the sale of the key required by that prewritten software is also subject to tax under the manufacturing classification. 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.

Example 6. JKL Computers Inc. an in-state business, sells at retail prewritten computer software to Customer R. JKL delivers the software to R in Seattle. The prewritten computer software, however, cannot be activated without a key. JKL subsequently delivers the key in Seattle to R for a separate price. JKL is subject to tax under the retail sales and retail services classification on the entire sale of the software including the separate charge for the key. The entire sale takes place in Seattle (where the software is delivered) when both the software and the key are delivered to R. There is no separate sale of the key, regardless of the fact that JKL delivers the key to R for a separate charge. It also makes no difference if the key was delivered outside of Seattle.

Example 7. MNO Computers Inc. is a software developer in Seattle. TKO Computers Inc., an original equipment manufacturer of computers (OEM) located outside Seattle, agrees in contract with MNO to distribute MNO's prewritten computer software on its

computers. TKO delivers MNO's inoperable software to Customer S as part of the sale of the computer system. Customer S, 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 Customer S, but MNO knows that the key is delivered to Customer S in Seattle. MNO is subject to tax under the retail sales and retail services classification. The entire sale takes place in Seattle because the key is delivered in Seattle 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 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. Sales of server licenses and client access licenses are 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.

Example 8. ZZ Computers Inc. a Seattle business, sells at retail server software to Customer Q. ZZ delivers the server software to Q in Seattle. ZZ also provides Q with client access licenses for free allowing Q the right to access the server software from Q's personal computers. The sale of server software to Q is subject to tax under the retail sales and retail services classification.

Example 9. Same facts as Example 8, except that ZZ sells at retail two types of prewritten computer software to Customer Q. One is server software, and the other one is client software (which is different from client access licenses). ZZ delivers the server software to Q in Seattle where Q's server is located. ZZ delivers the client software to Q outside Seattle where all of Q's personal computers are located. Sales of client software and server software to Q are separately charged. Only the sale of server software to Q is subject to tax under the retail sales and retail services classification .

(7) Other activities associated with computer software.

(a) Installing or uninstalling computer software. Gross income received for installing or uninstalling custom software is subject to tax under the service and other business activities classification. Gross proceeds of sales for routine installation or the uninstalling of prewritten computer software are subject to tax under the retail sales and retail services classification. Routine installation of prewritten computer software includes charges for labor and services with respect to the installation, such as travel for the routine installation of the software.

Example 10. XYZ Computers Inc. is hired by Customer D for routine installation of prewritten software onto Customer D's computers. XYZ's out-of-state employee remotely accesses Customer D's computers in Seattle to install the prewritten

software on Customer D's computers. If XYZ has nexus with Seattle, then XYZ's gross sales of prewritten computer software are subject to tax under the retail sales and retail services classification.

Example 11. 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 tax under the retail sales and retail services classification.

- (b) 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 are a sale of prewritten computer software subject to tax under the retail sales and retail services classification.

Alteration or modification of prewritten computer software performed for a specific person is subject to tax under the service and other business activities classification. Such alteration or modification of prewritten computer software for a specific person constitutes customization of prewritten computer software.

Example 12. STU Computers Inc. a Seattle service provider, is hired by Customer B to perform repairs via remote access on its prewritten computer software in Seattle. STU is performing alteration or modification of prewritten computer software for a specific person in Seattle and is subject to tax under the service and other business activities classification.

Example 13. VW Computers Inc. a Bellevue service provider, is hired by Customer C to perform alterations or modifications via remote access on its prewritten computer software located in Seattle. If VW has nexus with Seattle, VW would be subject to tax under the service and other business activities classification.

- (c) 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 agreement 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 subject to tax under the service and other business activities classification. See Seattle Rule 5-133 (Warranties and maintenance agreements) for information about extended warranties. Stand-alone sales of updates or upgrades to prewritten computer software in Seattle are retail sales of tangible personal

property subject to tax under the retail sales and retail services classification.

- (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 a retail sale subject to tax under the retail sales and retail services classification.

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 tax upon the value of products under the manufacturing classification 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 Seattle Rule 5-044 (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 tax under the manufacturing classification.

- (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 tax under the service and other business activities classification. Such services, including upgrades and updates, are rendered with respect to the custom or customized software and take on the underlying character and taxation of the custom or customized software.

Example 14. CBA Computers Inc. sells at retail a prewritten computer software maintenance agreement to Customer F 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 subject to tax under the retail sales and retail services classification.

Example 15. Same facts as Example 14 of this subsection, except that CBA delivers the software upgrades and updates on compact disks. CBA is subject to tax under the retail sales and retail services classification. In addition, CBA is subject to tax under the manufacturing classification on duplication of software upgrades and updates on the manufacturing activities in Seattle. The measure of tax is presumed to be the contract price of the maintenance agreement unless CBA can prove otherwise.

Example 16. Same facts as Example 14 of this subsection, except that CBA provides a separately stated charge for each component of the maintenance agreement. CBA is subject to tax under the retail sales and retail services classification for the charges on prewritten software upgrades and updates and on the extended warranty. CBA is subject to tax under the service and other business activities classification for the charge on telephone consulting services.

(8) 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 tax under the service and other business activities classification.
- (b) Remote access prewritten software. Sales of remote access prewritten software on the seller's (or a third party's) servers are subject to tax under the retail sales and retail services classification.

Example 17. BE Software Inc. offers a variety of prewritten software products on-line, but not for download, to its customers for a monthly subscription fee. If BE has nexus in Seattle, BE Software is subject to tax under the retail sales and retail services classification on the subscription fees received from its Seattle customers.

Effective: May 15, 2007

DIRECTOR'S CERTIFICATION

~~I, Director of the Department of Finance of the City of Seattle, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Department of Finance.~~

DIRECTOR'S CERTIFICATION

I, Jamie Carnell, _____, City of Seattle Interim City Finance Director, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Office of City Finance.

DATED this _____ day of August 2023.

CITY OF SEATTLE, a Washington municipality

Effective date: August __, 2023.

DRAFT