The New Massachusetts Sales and Use Tax on Computer System Design and Software Modification Services

August 6, 2013

By Attorney Morris N. Robinson, CPA, LL.M.
and Attorney Matthew A. Morris, LL.M.[1]

I. Introduction

On July 24, 2013, the Massachusetts General Court overrode a veto by Governor Deval Patrick and enacted an $800 million transportation bill entitled An Act Relative to Transportation Finance (the "Act").[2] The Act became effective one week later on July 31, 2013.[3] This Act contains new taxes on computer system design services and software modification services.[4]

On July 24, 2013, the Massachusetts Department of Revenue ("MDOR") issued Technical Information Release 13-10: Sales and Use Tax on Computer and Software Services Law Changes Effective July 31, 2013 ("TIR 13-10").[5] This TIR (1) sets forth the new statutory language, (2) provides a broad overview of the type of services that might be subject to the new tax, and (3) introduces some administrative relief for computer service providers subject to the new tax. TIR 13-10 is authoritative. It "states the official position of the Department of Revenue, has the status of precedent in the disposition of cases unless revoked or modified, and may be

[1] Morris N. Robinson is Managing Director of M. Robinson & Company, a boutique tax law firm located at the Landmark Building on Federal Street in Boston's financial district. M. Robinson & Company is a recognized leader in Massachusetts tax law, offering tax planning and controversy resolution services for both businesses and individuals. M. Robinson & Company has particular expertise in Massachusetts sales and use tax laws and recently tried a seven-figure use tax case on federal and Massachusetts constitutional grounds before the Appellate Tax Board. Matthew A. Morris, a Tax Associate at M. Robinson & Company, P.C., participated as "second chair" at the use tax trial. See www.mrobinson.com for further details about the authors and their practice areas.

[2] An Act Relative to Transportation Finance, St. 2013, c. 46, available at https://www.irstaxforum.com/scheduleDay1

[3] TIR 13-10, Part I; Frequently Asked Questions: The New Computer and Software Services Tax Effective 7/31/13 [hereafter FAQ] at FAQ 5, available at http://www.mass.gov/dor/docs/dor/law-changes/faqss-computer-software-2013.pdf (last visited August 5, 2013).

[4] See **Section IV**, below.

[5] Available at http://www.mass.gov/dor/businesses/help-and-resources/legal-library/tirs/tirs-by-years/2013-releases/tir-13-10.html (last visited July 31, 2013).

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

relied upon by taxpayers in situations where the facts, circumstances and issues presented are substantially similar to those in the TIR."[6]

On August 2, 2013, the MDOR issued Frequently Asked Questions: The New Computer and Software Services Tax Effective 7/31/13 ("FAQ").[7] The FAQ is intended to be informational only and is not authoritative—even, perhaps, to the taxpayers to whom the responses were originally given.[8]

The purpose of this article is to summarize the main points of TIR 13-10 and the FAQ and to discuss some of the ambiguities that must be addressed by the MDOR in a revised sales and use tax regulation for the computer-services industry.[9]

II. Background: The Massachusetts Sales and Use Taxation of Computer Services Prior to July 31, 2013

Computer Hardware and Related Services. Under the sales and use tax regime in effect before July 31, 2013, vendors were responsible for collecting sales tax on the sales of computer hardware and equipment. No sales tax, however, was imposed on any service component connected with that hardware or equipment unless that service component was a "mandatory service."[10] If a service component connected with the hardware was an optional service and was a separately-stated charge on the invoice, then the optional service component was generally

[6] Available at http://www.mass.gov/dor/businesses/help-and-resources/legal-library/tirs/ (last visited August 5, 2013).
[7] Available at http://www.mass.gov/dor/docs/dor/law-changes/faqss-computer-software-2013.pdf (last visited August 5, 2013).
[8] The FAQ cites 830 CMR 62C.3.2(10)(c), a citation that does not exist, as authority for the MDOR to issue the FAQ. The intended citation appears to be 830 CMR 62C.3.2(8)(c), a portion of the Letter Ruling regulations. The Letter Ruling regulations provide, in pertinent part, that "a ruling issued to a taxpayer with respect to a particular transaction represents a holding of the Department on that transaction only." (emphasis added). Moreover, 830 CMR 62C.3.2(8)(a) provides that "[a] taxpayer may not rely on a ruling issued to another taxpayer."
[9] 830 CMR 64H.1.3: Computer Industry Services and Products, available at: http://www.mass.gov/dor/businesses/help-and-resources/legal-library/regulations/64h-00-sales-and-use-tax/830-cmr-64h13-computer-industry-services-and.html (last visited August 5, 2013).
[10] See id. at 64H.1.3(4)(h)(1) ("If computer hardware cannot be purchased without services such as training, maintenance, developing custom software, and testing, charges for the services are considered part of the sales price and are generally taxable even if separately stated.").

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

treated as exempt from Massachusetts sales and use tax. Under the new sales tax regime (statutory language provided in **Section IV.A**, below), both the computer hardware and the optional service component will generally be subject to sales or use tax.

Computer Software. Under the sales and use tax regime in effect before July 31, 2013, the sale of prewritten software was subject to sales tax "regardless of the method of delivery."[11] The sale of any modification services to prewritten software, however, was generally exempt.[12] Under the new sales tax regime (statutory language provided in **Section IV.B**, below), both the sale of prewritten software and any modification services in connection with that software will be subject to Massachusetts sales or use tax.

Multiple Use Certificates. Under the sales and use tax regime in effect before July 31, 2013, if a purchaser of prewritten software provided the vendor with a Multiple Points of Use (MPU) certificate—a certificate which apportions use to Massachusetts—the vendor was relieved of its responsibility for collecting and remitting a sales tax. By providing the vendor with the MPU, the purchaser accepted the responsibility to remit an apportioned use tax to Massachusetts.[13] This same process will also apply under the new regime to both the purchaser's use of computer system design services and software modification services.[14]

---

[11] 830 CMR 64H.1.3(3)(a).

[12] See id. at 64H.1.3(6)(d) (definition of "Custom modifications to prewritten software"); MDOR Working Draft Directive 13-XX: Criteria for Determining Whether a Transaction Is a Taxable Sale of Pre-written Software or a Non-taxable Service (offering draft guidance on the various factors that will indicate whether a transaction should be treated as a taxable transfer of prewritten software rather than a non-taxable service).

[13] 830 CMR 64H.1.3(15). See **Section VIII**, below, for a detailed discussion of MPU certificates and their role in shifting the responsibility from the vendor to the purchaser to remit use taxes to the Commonwealth of Massachusetts.

[14] See **Section VIII.B**, below, for further discussion regarding the sourcing rules for computer and software services.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

III. Background: Exemptions and Definitions of Taxable Services That Remain Unchanged by the Act

A. Sales Tax Exemptions: In General

Certain services were subject to the sales and use tax before the Act became effective. The taxation of these services was subject to the normal sales and use tax exemptions. These exemptions will also apply to the new tax on computer services. For example, exempt sales of taxable services continue to include the sale of computer services (1) to the United States, the Commonwealth of Massachusetts or any political subdivision thereof and (2) to Section 501(c) organizations.[15] It is important, however, that the seller receive a sales-tax exemption certificate from the customer which claims to be exempt. Similarly, a subcontractor who provides taxable services to a general contractor does not have to collect a sales tax on its service fees provided the subcontractor obtains a resale certificate from the general contractor.[16]

These points are clarified in FAQ 16, which provides in its entirety as follows:

> **Suppose prewritten or customized software is written for the ultimate use of a nonprofit organization, but it is sold to a for-profit organization that intends to license or sell the software to the nonprofit. Is it subject to sales tax at any stage?**
>
> No, provided that the only retail sale is to the non-profit entity. The for-profit intermediary could purchase the taxable software and taxable services with a resale certificate (ST-4) and then take an exemption certificate (ST-5) from its non-profit customer. The sale to the for-profit entity would be exempt as a "sale for resale" under G.L. c. 64H, § 8.

B. Taxable Services: In General

Certain types of services will continue to be exempt from sales and use tax under the new statute. Chapter 64H, Section 1 of the Massachusetts General Laws defines "services" subject to the sales tax as:

---

[15] FAQ 28; MGL c. 64H §§ 6(d) & 6(e).
[16] FAQ 14.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

> [a] commodity consisting of activities engaged in by a person for another person for a consideration; provided, however, that the term "services" shall not include activities performed by a person who is not in a regular trade or business offering his services to the public, and shall not include services rendered to a member of an affiliated group, as defined by section 1504 of the Internal Revenue Code, by another member of the same affiliated group that does not sell to the public the type of services provided to its affiliate. . . .[17]

This portion of the statute remains unchanged under the new law.[18]

Based on the above definition, a partial summary of the different types of taxable and tax-exempt services follows. Taxable "services" include:

a. Services performed by a college student who has a part-time computer service business;[19]

b. Services performed by a corporate affiliate that performs similar services to the general public;[20] and

c. Services performed on behalf of an affiliated company that does not meet the 80 percent ownership test of Section 1504, IRC, even if the company providing that service does not sell the service to the general public.

Similarly, based on the above definition, taxable "services" exclude:

a. Services performed gratis, such as neighbors helping neighbors without charging a fee;[21] and

b. Services performed for a consideration where the performer is not in the trade or business of offering services to the public, such as a "tech-savvy" 14-year old who performs computer-related services to a select group of family and friends.[22]

IV. Summary of the New Sales and Use Tax Law Effective July 31, 2013

The new sales and use tax is implemented through two major statutory changes:

A. Adding a New Definition for "Computer System Design Services."

---

[17] MGL c. 64H, § 1 (definition of "services").
[18] TIR 13-10, Part II (providing the new statutory definition of "services" in italics).
[19] See MGL c. 64H, § 1 (definition of services). The college student in this example is in the "regular trade or business of offering his services to the public." Id.
[20] See id.
[21] See id. (the services must be performed for a "consideration").
[22] See id. ("The term 'services' shall not include activities performed by a person who is not in a regular trade or business offering his services to the public.").

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

The Act defines "computer system design services" as "the planning, consulting or designing of computer systems that integrate computer hardware, software or communication technologies and are provided by a vendor or a third party."[23] "Computer system design services" is included in the amended definition of "services" subject to Massachusetts sales and use tax.[24]

B. Amending the Definition of "Services" To Include Software Modification Services.

The Act also includes in the definition of "services" the "modification, integration, enhancement, installation or configuration of standardized software." [25] TIR 13-10 refers to these services as "software modification services." TIR 13-10 suggests a reasonably precise definition: "the new provisions serve as overlapping descriptions generally intending to tax software services that modify, enable, or adapt prewritten software to meet the business or technical requirements of a particular purchaser and to operate on the purchaser's computer systems, regardless of how those services are described or billed to the customer."[26]

V. What are "Computer Design Services?"

What are "computer design services?" As noted above, the Act defines "computer system design services" as "the planning, consulting or designing of computer systems that integrate computer hardware, software or communication technologies and are provided by a vendor or a third party."[27]

---

[23] M.G.L. c. 64H, § 1 (effective July 31, 2013) (emphasis added).
[24] Id. ("[S]ervices [subject to sales and use tax]. . . shall be limited to the following items: telecommunications services, computer system design services and the modification, integration, enhancement, installation or configuration of standardized software.") (new statutory text underlined).
[25] M.G.L. c. 64H, § 1 (effective July 31, 2013).
[26] TIR 13-10, Part II.
[27] M.G.L. c. 64H, § 1 (effective July 31, 2013) (emphasis added).

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

A. Statutory Requirements for "Computer Design Services"

In order for the new sales and use tax to apply to "computer design services," the following requirements must be met:

1. *There must be a purchase of services from a vendor or a third-party.*

The Act provides that computer design services must be "provided by a vendor or a third party."[28] Thus, if a business uses its own employee(s) or—in the case of larger companies—an in-house IT department to design a new computer system, purchase the hardware and software for that system, and implement the hardware and software based on its design, then the in-house design services are not subject to sales tax.[29]

This provision of the new law has the potential to discriminate in favor of larger companies that can afford to staff their own in-house IT departments. Smaller companies that cannot afford to staff their own in-house IT departments and are forced to outsource this work to third-party vendors will be subject to sales tax on the same services from which larger companies are exempt. Since the "outside vendor" requirement is statutory, it might not be possible to correct the discrimination against smaller companies through the regulatory process. Therefore, corrective legislation may be necessary.

2. *There must be a purchase of computer system design services in connection with a purchase of computer hardware or software.*

TIR 13-10 excludes from computer system design services those services "that are not directly related to a particular systems integration project involving the sale of computer hardware or software."[30] Thus, if a project is abandoned before hardware or software is

[28] MGL ch. 64H, § 1 (definition of "computer system design services").
[29] Caution must be used, however, where a member of an affiliated group of companies provides IT services to an affiliate that does not meet the 80 percent ownership rules of Section 1504, IRC. See **Section III.B**, above.
[30] TIR 13-10, Part II (emphasis added).

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

purchased, all of the consulting and evaluation services are exempt from tax.[31] Apparently, TIR 13-10 reads the statutory phrase "and are provided by a vendor or a third party" to refer to the purchase from a third party of (1) computer system design services and (2) hardware, software, or a combination of both. Since this is a reasonable interpretation of the Act and since TIR 13-10 is authoritative, the courts should honor the services exclusion if the project is abandoned before hardware, software, and/or communications technologies are purchased.

3. *The computer system design services must integrate hardware, software, and/or communications technologies.*

One of the key terms in the new statutory definition of computer system design services is "integrate": the new tax will not apply unless the services "integrate"—or "form, coordinate, or blend into a functioning or unified whole"[32]—computer hardware, software, or communication technologies. The classic example of a computer system that integrates computer hardware, software, or communication technologies is a "local area network" (LAN), in which an outside vendor attaches computers to a server and router and configures the server's operating system to allow for file sharing and print sharing. Thus, FAQ 23 opines that when a vendor installs a local area network, all "services either fall within the definition of taxable computer system design services or are taxable sales of prewritten software."

B. Ambiguities Associated with the Statutory Requirements for "Computer System Design Services"

There are a number of ambiguities associated with the statutory definition of "computer system design services." Suppose the computer system design services result in a design fee of $1,000,000. Suppose, however, that the purchase price of the hardware and/or software is inconsequential, involving merely the installation of single computer cable valued at $20. Does

[31] FAQ 15.

[32] Definition of "Integrate," MERRIAM-WEBSTER DICTIONARY, available at http://www.merriam-webster.com/dictionary/integrate (last visited July 31, 2013).

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

the purchase of the $20 cable render the entire design fee taxable?[33] Does it matter if the vendor chooses not to charge the customer for the $20 cable?

In addition, when do the computer system design fees become taxable? Do the design services become taxable when the bill is rendered? If so, is the customer entitled to a refund if the customer later abandons the project?[34] In the alternative, is the project exempt from tax until the customer purchases the first item of hardware or software? Suppose the project was designed to be built in stages and the customer abandoned the project after beginning the first stage: Is the customer still subject to sales tax on the design services? What if the project was only designed to identify weaknesses in the current system and suggest possible changes: Would the customer be subject to a sales tax on the purchase of the consulting services if the customer outsources the purchase and installation of hardware and software to a different company?[35] The new "Computer Industry Services and Products" regulation—830 CMR 64H.1.3—must address these questions in order to clarify the scope of the new tax.

C. Exclusions from the Tax on Computer System Design Services

If the computer system design service in question meets the statutory requirements above, that does not necessarily mean that the service is subject to sales or use tax. The specific exclusions from the statutory definitions for both "computer system design services" and "software modification services" are discussed in detail in **Section VII**, below.[36] For other

[33] See, e.g., Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992) (a de minimis sale of a few hundred dollars triggered an income tax liability of several hundred thousand dollars).
[34] See FAQ 15.
[35] See FAQ 33 (a company that designs and installs, but does not purchase, hardware and software from an unrelated third party is subject to the sales price on the computer system design service). It is unclear whether the MDOR would reach the same result if the third-party vendor—instead of the computer system design company—sold and installed the hardware and software.
[36] See TIR 13-10, Part II, which explicitly combines "computer system design services" with "software modification services" for purposes of determining the exclusion of certain services from the new sales/use tax.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

transactions and activities that do not reach the threshold definition of "services" under both the prior and current sales tax statutes (M.G.L. c. 64H, § 1), see **Section III**, above.

VI. What Are "Software Modification Services"?

What are "software modification services?" The new statutory language tells us that the "modification, integration, enhancement, installation or configuration of standardized software" will be subject to sales and use tax.[37]

A. Statutory Requirements for "Software Modification Services"

In order for the new sales and use tax to apply to "software modification services," the following requirements must be met:

1. The services purchased or licensed must be associated with "standardized software."

Under the new sales and use tax regime, both the sale of prewritten software and the sale of custom software modification services are subject to tax.[38] It makes no difference if the fee-based taxable modifications are made to "open source" software that is available free on the Internet.[39] Finally, it makes no difference if the software is sold or licensed.[40]

What is "standardized software"? To answer this question, FAQ 1 falls back on MDOR's existing "Computer Industry Services and Products" regulation, which provides a detailed definition of "standardized software" (referred to in the regulation interchangeably as "prewritten," "canned," or "standardized" software):

> [C]omputer 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

[37] M.G.L. c. 64H, § 1 (effective July 31, 2013).
[38] Id. (emphasis added). Under the prior sales and use tax regime, only the sale of prewritten software was subject to tax. See FAQ 4.
[39] FAQ 9.
[40] FAQ 3 ("[L]icensing software is treated as a sale for purposes of the sales and use tax.").

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

> 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. …"[41]

Thus, the above definition provides that:

- Software wholly "designed and developed to the specifications of a specific purchaser" is not prewritten software; and
- Prewritten software that has been modified to the specifications of a specific purchaser is only considered prewritten software with respect to the standardized, non-modified, or non-enhanced portion of the software.

Both of these conclusions based on the existing definition of "standardized software" helps taxpayers to understand what constitutes a taxable "modification or enhancement" of standardized software under the new statute (discussed immediately below).

2. *The services must be rendered in connection with the modification, integration, enhancement, installation or configuration of standardized software.*

"Modification, integration, and enhancement" of standardized software. A taxable modification, integration, or enhancement may be made by the original or third-party vendor of the modified software.[42] As explained above, software that is wholly designed to the specifications of an individual purchaser is not prewritten software; therefore, any services rendered in connection with this type of purely customized software (not involving any "third party programs or packages") are not subject to sales or use tax.[43]

"Installation and configuration" of standardized software. The "installation and configuration" of standardized software is clearly part of "software modification services" subject to sales and use tax. This is clarified in FAQ 7, which provides in its entirety:

---

[41] FAQ 1; 830 CMR 64H.1.3.
[42] FAQ 2.
[43] See FAQ 36 (an independent software contractor that writes new custom software that does not integrate any "third party programs or packages" is not subject to the new sales tax).

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

We are a computer service and IT support company located in Massachusetts. We occasionally install Microsoft Office and operating system software into computers for our customers. We purchase the software and tax the end user but do not tax the labor for installing the software into the computer. Are you saying with this new law, we charge tax on the software and labor as well?

Yes, that is correct, both the taxable prewritten software and installation charges are subject to tax on and after July 31, 2013.

Similarly, FAQs 21 and 22 provide for taxing the installation of prewritten software, regardless of whether those services are sold in conjunction with computer system design and/or the customization of prewritten software.

B. Exclusions from the Tax on Software Modification Services

If the software modification service in question meets the statutory requirements above, that does not necessarily mean that the service is subject to sales or use tax. The specific exclusions from the statutory definitions for both "computer system design services" and "software modification services" are discussed in detail in **Section VII**, immediately below.[44] For other transactions and activities that do not reach the threshold definition of "services" under both the prior and current sales tax statutes (M.G.L. c. 64H, § 1), see **Section III**, above.

VII. Specific Exclusions in TIR 13-10 and the FAQs from the Definitions for Computer Systems Design and Software Modification Services

The following is a list of the specific exclusions from the definitions for "computer system design services" and "software modification services" set forth in TIR 13-10 and the FAQ.

A. The Exclusion for Consulting and Evaluation Services Relating to Existing Computer Systems

TIR 13-10 exempts "[c]onsulting and evaluation services relating to existing computer

[44] See TIR 13-10, Part II, which explicitly combines "computer system design services" with "software modification services" for purposes of determining the exclusion of certain services from the new sales/use tax.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

systems to identify deficiencies and needs" from the scope of the new tax, [45] unless those consulting and evaluation services also involve the purchase of hardware and/or software. FAQ 15 clarifies that the tax "does not apply to design or consulting services that do not result in a sale of a computer system that integrates computer hardware, software or communication technologies," such as a computer system "designed but not actually built."[46]

B. The Exclusion for "Troubleshooting Services"

FAQ 6 provides guidance for excludable troubleshooting services:

> **Are troubleshooting computer services generally provided at the customer's home or place of business taxable?**
>
> Generally, service technician charges for determining why a customer's hardware or software is not working properly are not taxable. This may include reinstallation of software that was already on the customer's computer. If additional hardware or software is provided to the customer during the service call, the rules in 830 CMR 64H.1.1, Service Enterprises, apply. If the service technician sells the customer a subscription to prewritten software, such as antivirus protection, those charges would be subject to the tax on prewritten software.

C. The Exclusion for "Training Services"

There is a "training exclusion" for training employees on both modified[47] and prewritten[48] software. FAQ 8 provides in its entirety:

> **Am I correct in interpreting the law change as meaning that technical support and training are not part of the above definition of taxable services?**
>
> Yes, technical support and training that do not otherwise involve the transfer of taxable prewritten software or tangible personal property to the customer remain nontaxable under the new law.[49]

---

[45] Id., Part II.
[46] But see FAQ 33 (a company that designs and installs, but does not purchase, hardware and software from an unrelated third party is subject to the sales price on the computer system design service).
[47] TIR 13-10, Part II, provides that "[s]ervices to prepare a business to use modified software, such as training" are not taxable.
[48] FAQ 8.
[49] Id. (emphasis added).

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

Thus, the training exclusion assumes that the computer hardware and/or software can be purchased without training. However, if computer hardware and/or software cannot be purchased without also purchasing training services, these services are considered part of the sales price and are generally taxable even if separately stated.[50]

D. The Exclusion for Purely Customized Software or Hosting Services

If a software developer or website designer is configuring or modifying Open Source (free) code or other prewritten software for the needs of a customer, the designer's charges to that customer are subject to tax. If, however, a software developer or website designer creates purely custom software for its customer that is not based on other prewritten software ("third party programs or packages"[51]), then the charges are not taxable.[52] It makes no difference whether the hosting server is located within the geographical boundaries of the Commonwealth of Massachusetts.[53]

E. The Exclusion for "Professional Services That Do Not Themselves Constitute Computer System Design Services or Software Modification Design Services"

TIR 13-10 provides an exclusion for "professional services that do not themselves constitute computer system design services or software modification design services." FAQ 20 clarifies this exclusion and provides in its entirely:

> **An attorney or accountant uses prewritten software to prepare a document or a tax return. How does the sales tax apply?**
>
> The attorney or accountant must pay sales or use tax on any prewritten software used in their practices in Massachusetts, including custom modifications. The attorney's and accountant's work product to clients is not subject to sales or use tax.

[50] See note 10, above.
[51] FAQ 36.
[52] FAQ 10.
[53] FAQ 11; see also DD 13-XX, note 12, above.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

F. The Exclusion for "Data Conversion Services"

Data conversion services include conversion and/or migration of the customer's data from the customer's legacy software to the new system. The work can also include formatting data, loading data and monitoring data during the conversion process. FAQ 26 provides that these services "are considered exempt data processing services and remain non-taxable under the new law so long as the charges are separately stated and set in good faith."[54]

G. The Exclusion for "Data Storage and Disaster Recovery Services"

FAQ 13 provides that data storage and disaster recovery and backup services remain non-taxable services.

VIII. How Are Companies that Purchase Software Modification and Computer Design Services for Use in Multiple Jurisdictions Supposed To Determine Their Massachusetts Sales or Use Tax Liabilities?

TIR 13-10 provides guidance on the sourcing rules for taxpayers that offer computer design and software services that will be available for use in multiple jurisdictions (including Massachusetts). The general rule for imposing Massachusetts sales tax on vendors that provide computer design and software services in multiple jurisdictions is that vendors are not responsible for collecting and remitting the sales tax on the services if the purchaser provides the vendor with a Multiple Points of Use (MPU) certificate (Form ST-12).

An MPU certificate relieves the vendor of the liability for collecting sales tax and shifts the responsibility to the purchaser to remit an apportioned use tax to MDOR in accordance with the rules set forth in 830 CMR 64H.1.3.(15). This provision of the existing "Computer Industry Services and Products" regulation will be amended to encompass MPU certificates for computer design and software modification services. However, the basic premise of the existing regulation

[54] See also TIR 13-10, note 1 ("The taxability of data access, data processing or information services is unchanged by the Act; these services are not subject to sales/use tax.").

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

should remain the same even after the regulation is amended: If the purchaser of computer design or software modification services knows that the end product will be available for use in multiple jurisdictions and provides the vendor of these services with an MPU certificate, then it is the purchaser of services rather than the vendor that will ultimately be responsible for remitting a use tax to MDOR on an apportioned basis.

A. When the Purchaser Provides an MPU Certificate to the Vendor of Computer Design or Software Modification Services: The Purchaser's Use Tax Responsibilities.

Assuming that the end product of the computer design or software modification project will be available for use in multiple jurisdictions (including Massachusetts), how is the purchaser of these services supposed to determine a "fair apportionment" of use to Massachusetts in preparing an MPU certificate?[55] TIR 13-10—in conjunction with the MPU provisions of the current computer industry services and products regulation, 830 CMR 64H.1.3(15)—provides some guidance on the methods that the MDOR will accept in determining what constitutes a "fair apportionment" of use tax:

- For computer software modification services, can the purchaser rely on the same apportionment reflected in its MPU certificates for prewritten computer software to which the modification services relate? The answer to this question is **yes**: "Sales of software modification services relating to prewritten software generally should be sourced in the same manner as the software to which the services relate."[56]

- For computer system design services, can the purchaser rely on the location of its servers to determine allocation or apportionment of use to other jurisdictions? The answer to this question is **no**: the current MPU regulation (although in reference to use of prewritten software) states that a "purchaser delivering an exemption certificate claiming multiple points of use may use any reasonable, but consistent and uniform, method of apportionment that is supported by the purchaser's books and records as they exist at the time the transaction is reported for sales and use tax purposes," but also states that a

[55] "Fair apportionment" is one of the requirements of the four-part test set forth in Complete Auto Transit v. Brady, which requires that a state tax must meet the following requirements to pass scrutiny under the Commerce Clause of the United States Constitution. See 430 U.S. 274, 279 (1977).
[56] TIR 13-10, Part III.B.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

consistent and uniform method of apportionment "may not be based on the location of the servers where the software is installed." [57]

- For computer system design services, can the purchaser rely on the location of its business headquarters or another location where the design or modification services were performed in order to determine allocation or apportionment to other jurisdictions? The answer to this question is **no**: TIR 13-10 states that use of computer system design services "will not be limited to the business headquarters or other location where the design services may have been performed."[58]

- For computer system design services, can the purchaser rely on the number and geographic location of its company-wide computers that will be affected by the new design? The answer to this question seems to be **yes**. TIR 13-10 states that a purchaser of computer system design services may, similar to its use of software modification services, "use a method of apportionment reasonably designed to reflect the location of use of the modified software by the purchaser, where such method is consistent and uniform and is supported by the purchaser's books and records."[59]

B. When the Purchaser Does Not Provide an MPU Certificate to the Vendor: The Vendor's Sales Tax Collection Responsibilities.

If the purchaser does not provide the vendor with an MPU certificate, then the vendor will be held responsible for collecting and remitting sales tax to Massachusetts in accordance with the following sourcing rules, in order of priority:

1. If the purchaser receives the service at the vendor's business location, then the retail sale is sourced to the jurisdiction of the vendor's business location.

2. If the vendor knows the location where the service will be provided based on the purchaser's delivery instructions, then the retail sale is sourced to the jurisdiction of the purchaser's delivery location, unless use of this address constitutes bad faith.

3. If the purchaser does not specify a location for the service to be delivered, then the vendor must collect sales tax based on the purchaser's address as provided by the purchaser or known to the vendor (e.g. collected to complete the sale) such as address information from a payment instrument or credit card, unless use of this address constitutes bad faith.

---

[57] 830 CMR 64H.1.3(15)(a)(3). See, also, FAQ 11 ("The location where the website is hosted and the ownership of that server do not determine taxability.")
[58] TIR 13-10, Part III.B.
[59] Id., Part III.B.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

4. If neither the purchaser's delivery location nor address can be determined, then the vendor must collect use tax based on the vendor's business location.[60]

Under the above sourcing rules, a multistate purchaser of computer system design services might be tempted to supply as little information as possible regarding its Massachusetts computers to an out-of-state vendor of computer design services. Thus, if the vendor knows only that the corporate headquarters are located in New Hampshire, the sale may be sourced to New Hampshire and a Massachusetts sales tax will not be collected.

A more serious problem with the sourcing rules is that they conflict with the Supreme Judicial Court's holding in Town Fair Tire Centers, Inc. v. Commissioner of Revenue, 454 Mass. 601 (2009). In Town Fair Tire, the Massachusetts Supreme Judicial Court clarified that the Massachusetts use tax statute, MGL c. 64I, § 4, "imposes no obligation on a vendor to collect use tax unless and until the 'storage, use or consumption of tangible personal property occurs in Massachusetts,' either at the time of sale or at some later point."[61] The Supreme Judicial Court in Town Fair Tire made it abundantly clear that "[t]here is no Massachusetts statutory presumption of use in the Commonwealth where personal property is sold to a Massachusetts resident outside the Commonwealth."[62] Although the new sales tax statute applies to computer design and software modification services rather than tangible personal property, the principle is identical. The sourcing rules of TIR 13-10 appear to be an attempt by the MDOR to reestablish a "presumption of use" in Massachusetts based on the purchaser's address or the address of final delivery for the design or modification services.

[60] TIR 13-10, Part III.C. These sourcing rules track the language of the Marketplace Fairness Act. Marketplace Fairness Act, S. 336, S. 743, H.R. 684, 113th Cong. § 4, ¶ 7 (2013) (as passed by the Senate on May 6, 2013), available at http://www.marketplacefairness.org/bill-text/ (last visited August 2, 2013).
[61] Id. at 607 (quoting the use tax statute).
[62] Id. at 608.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

The sourcing rules above track the sourcing rules from the Marketplace Fairness Act.[63] The Marketplace Fairness Act—in conjunction with the Streamlined Sales and Use Tax Agreement (SSUTA)—may eventually trump Town Fair Tire and require out-of-state retailers to collect Massachusetts sales tax. The Marketplace Fairness Act, however, will only compel out-of-state retailers to collect and remit sales tax to Massachusetts after the Massachusetts legislature simplifies its sales and use tax laws and either becomes a member state of the SSUTA or adopts and implements the minimum simplification requirements set forth in the Marketplace Fairness Act.[64] Because Massachusetts has not yet simplified its sales and use tax laws, become a member state of the SSUTA, or enacted the minimum simplification requirements set forth in the Marketplace Fairness Act, it is unlikely that the MDOR can currently enforce out-of-state sellers to remit and collect sales tax under the sourcing rules of TIR 13-10 without conflicting with the holding of Town Fair Tire.[65] Indeed, FAQ 32 acknowledges the inherent limitations of the sourcing rules for out-of-state vendors with no physical presence in Massachusetts: "[W]hether or not a vendor is required to collect Massachusetts sales tax depends on whether the vendor has or exercises some form of physical presence in Massachusetts . . . . If [the vendor] does not have physical presence in Massachusetts, its Massachusetts customers will be required to self-report and pay use tax on their purchases of taxable goods and services."

The response to both concerns, of course, is that the Massachusetts Department of Revenue conducts business use tax audits on a regular basis and will likely identify the

---

[63] See note 60, above.

[64] Marketplace Fairness Act § 2, note 60, above.

[65] The Massachusetts State Legislature is currently considering joining the SSUTA. A bill sponsored by the Joint Committee on Revenue and (filed by Representative Jay Kaufman) and recently referred to the House Committee on Ways and Means would enable the Commissioner of the MDOR to "take such administrative actions as are necessary to comply with any law enacted by the Congress of the United States that requires states to simplify the collection of sales and use taxes for remote sellers." See Bill H.3526: An Act to Ensure Compliance with Federal Marketplace Fairness (2013), available at https://malegislature.gov/Bills/188/House/H3526 (last visited August 2, 2013).

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

underpayment of the use tax by the computer or software service purchaser if the vendor has no presence in Massachusetts or is otherwise not required to collect the tax. If the MDOR conducts a use tax audit of the computer or software service purchaser, the purchaser will be subject to a use tax, plus penalties and interest, regardless of the vendor's responsibilities to collect sales tax at the point of sale. See also **Section VIII.C**, below.

C. When the Vendor Is Not Required, or Is Required but Fails, to Collect the Sales Tax: The Purchaser's Use Tax Responsibilities.

If the vendor is required to collect the sales tax on the purchase of computer design or software modification services but fails to do so, the purchaser will ultimately be responsible for remitting an apportioned use tax on the software or services, subject to a credit for sales or use taxes paid to other jurisdictions provided by MGL c. 64I, §7(c).[66] As is the case with the purchaser's allocation of use tax to Massachusetts in its MPU certificates, the purchaser may use any "reasonable, but consistent and uniform" method of apportionment that is designed to reflect the location and use of the modified software or computer design services.[67]

IX. Transitional Relief for Vendors and Purchasers

The following administrative guidelines set forth in TIR 13-10 provide some transitional relief for taxpayers that might be liable for sales and/or use tax under the new law:

A. Transition Rule for Existing Contracts

The new tax on computer and software services will not affect contracts entered into before July 31, 2013, if (1) payment is either invoiced or due under the terms of the contract prior to July 31, 2013, and (2) the payment relates to services performed prior to July 31, 2013.[68]

[66] The statute cited provides an exemption for sales taxes paid to another jurisdiction; TIR 03-1 provides an exemption for use taxes paid to another jurisdiction.
[67] TIR 13-10, Part III.B.
[68] Id., Part IV.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

FAQ 18 makes clear that "services performed before the effective date of the new legislation [i.e., July 31, 2013] are not taxable even if paid after July 31, 2013."[69]

B. Filing Deadlines

Taxpayers subject to the new sales and/or use tax on computer design and software modification services must report the July 31, 2013, transactions along with the August 2013 transactions by the September 20, 2013, deadline for August 2013 transactions.[70]

C. Tax Forms

Vendors and purchasers of computer design and/or software modification services are required to file and submit a Form ST-9: Monthly Sales and Use Tax Return online using the MDOR Webfile for Business online filing system. TIR 13-10 states that a revised Form ST-9—which will include additional lines for the reporting of tax on computer design and software modification services—will be available "on or about July 31, 2013."[71] The revised online Form ST-10 (annual Business Use Tax Return) will be available "later in 2013."[72]

X. The "Cruel Dilemma" Facing Vendors of Computer and Software Services

The inherent ambiguities in portions of the new law[73] jeopardize those who sell computer system design and/or software modification services, placing these vendors in a cruel dilemma. Vendors who mistakenly collect a sales tax on computer design or software modification services will find themselves at a significant competitive disadvantage with respect to those vendors who do not collect the tax. On the opposite end of the spectrum, vendors who fail to collect a valid sales tax at the point of sale may find themselves in an even worse situation.

---

[69] FAQ 18 (emphasis added).
[70] TIR 13-10, Part V.
[71] Id.
[72] Id.
[73] See, in particular, **Sections V** and **VI**, above.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

Vendors are required, by law, to include sales taxes on their invoices and to collect and remit sales taxes in a timely fashion, whether or not the tax is collected at the point of sale from the purchaser (unless the purchaser provides the vendor with an MPU Certificate). As a practical matter, vendors who do not collect the sales tax "up front" (i.e., at the point of sale) may find it impossible to collect the tax at a later time. Meanwhile, the president, board of directors, and chief financial officers might find themselves personally responsible for any unpaid sales taxes on services including penalties and interest on the unpaid tax and penalties. These unpaid taxes, penalties and interest add up quickly. Computer design sales of $1.6 million translate into $100,000 in sales taxes without considering penalties and interest. Indeed, proponents of the tax expect the tax to bring in about $161 million in new tax revenue on an annual basis.[74]

Therefore, vendors and purchasers facing significant ambiguity may want to consider the following options:

1. Send Informal Comments and Suggestions to the Massachusetts Department of Revenue. TIR 13-10 encourages taxpayers to submit "comments or suggestions regarding the application of sales and use taxes to . . . computer/software services."[75] The Department of Revenue also anticipates that there will be "opportunity for public comment on a working draft of the regulation amendment before it is formally proposed."[76]

2. Come Together as an Industry and Present The Massachusetts Department of Revenue ("MDOR") with a Proposed Regulation. The MDOR will likely welcome a proposed draft regulation that is acceptable to the entire industry. The problem with this approach is that it takes time to negotiate the political shoals and there is no guarantee that the computer design industry will be able to coalesce around an agreed-upon regulation.

3. Request Individual Letter Rulings from the MDOR. Vendors and customers may choose—with the assistance of general or outside counsel—to request a private letter ruling from the Massachusetts Department of Revenue based on the facts and circumstances of their individual cases.

---

[74] See Statements of Senate Ways and Means Committee Chairman Senator Stephen Brewer (D-Barre), available at http://massachusettschamberofcommerce.com/transportation-finance-bill-mass-senate/ (last visited July 29, 2013).
[75] TIR 13-10, ¶ 2.
[76] Id.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.

Why might a taxpayer opt for requesting a private letter ruling instead of submitting an industry-approved draft regulation to the Massachusetts Department of Revenue? First, letter rulings are tailored to the specific needs of the requesting taxpayer and do not consider the tax consequences to the requestor's competitors. Second, ruling requests (unlike draft proposed regulations) can be prepared and filed fairly quickly. Third, the professional fees associated with requesting private letter rulings are often quite reasonable when weighed against the requestor's potential competitive and financial exposure to the new tax. For all these reasons, requesting a private letter ruling may be preferable to submitting an industry-approved draft regulation to the MDOR.[77]

XI. Conclusions

TIR 13-10 and the FAQ represent an important initial step in clarifying the scope of the new tax. Although TIR 13-10 is authoritative, the FAQ, by its very terms is not authoritative. Thus, the MDOR urgently needs to promulgate a new regulation, after notice and a public hearing, that will clarify the numerous ambiguities in the new sales and use tax law. Meanwhile, affected taxpayers may wish to request private letter rulings from the Massachusetts Department of Revenue based on their unique facts and competitive positions in the marketplace.[78]

~End of Article~

Attorney Advertising Disclaimer: *The contents of this article should not be construed as legal advice on any specific fact or circumstance and creates no attorney-client relationship between its authors and readers. The attorneys' opinions are their own and do not represent the opinions of the Massachusetts Department of Revenue or any other federal, state, or local tax authority.*

---

[77] The attorneys at M. Robinson & Company, P.C., are available for complimentary 30 minute initial consultations regarding the process for requesting private letter rulings from the IRS and/or Massachusetts Department of Revenue and the likelihood of success for such a ruling according to the particular facts and circumstances of your company's case. Please see www.mrobinson.com for the attorneys' contact information.

[78] See **Section X**, above.

Copyright 2013 M. Robinson & Company, P.C. All rights reserved.