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*"We Dream Big and Deliver"*

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## **SOFTWARE PROGRAMS AND HARDWARE DEVICES**

The *Arvada Tax Code* imposes sales or use tax on the sale or purchase of pre-written software programs and hardware devices.

### **HARDWARE DEVICES**

Hardware devices (computers, tablets, smart phones), peripheral equipment, parts, and accessories are taxable tangible personal property and are subject to sales / use tax.

### **SOFTWARE PROGRAM**

The sale or purchase of software programs may be taxable or exempt as circumstances indicate. Software programs may be broadly classified into two categories.

**Pre-written software program** – This category includes “canned”, “shrink-wrapped”, “off-the-shelf” or any other software that is developed by a software company for sale or license to multiple users. Pre-written software may also include software modules or components that are designed to be integrated into a larger software program package. A software program that is in existence before that software is sold or licensed to the user is taxable on its retail sale. Software programs that are already loaded on a device when the device is sold are taxable.

Charges for software as a service for pre-written software programs that is rented, leased or subscribed to from a provider and used at the consumer’s location, including but not limited to applications, systems or programs are taxable.

Pre-written software that is accessed by a user via modem or other telecommunications means (Internet) is taxable if the provider is selling a right to use through purchase, lease, rental or grant of a license.

If there are significant modifications to prewritten software to customize it to a specific user, charges for the labor which are included in the modification are not taxable if they are separately stated on the invoice.

**Custom software program** – This category of software is a non-taxable service. This software is written or designed to meet the needs of a specific user, and its value lies in the creation or development of the program.

Factors indicating a taxable transaction for the sale or purchase of software include the presence of a buyer and seller of the program and a transfer (by sales, lease, rental or a grant of license) of ownership or a right to use the program. A sale of personal service is indicated when the service provider does not own the work in progress.

Subsequent sales of customer software will be treated as prewritten (canned) software and taxed accordingly.

## **SOFTWARE MAINTENANCE AGREEMENT**

Software programs are sometimes sold or licensed for use with a maintenance agreement. The agreement may either be mandatory or optional.

A mandatory maintenance agreement that accompanies the license or sale of taxable software is part of the selling price of the software and is also taxable.

An optional maintenance agreement to maintain software programs may be taxable or exempt depending on what the maintenance agreement provides. If an optional agreement entitles the customer to program enhancements, improvements, modifications, revision, discounts on additional software purchases, etc., the agreement is taxable. If the agreement also includes technical support, fixes, or other services, the service portion of the agreement is not taxable provided that it is stated separately from the taxable portion.

An agreement that provides only technical support, fixes or other service is non taxable. Any tangible personal property that changes hands as an incidental part of the service such as disks and/or CDs is taxable to the vendor/service provider.

## **COMPUTER SERVICES**

Charges for manipulation of client owned data, such as payroll services, computer accounting services, etc., are data processing services and are not taxable.

### **EXAMPLES**

1. ABC Co. is expanding its Arvada operation and purchased 25 personal computers and 25 software program packages. In addition, ABC purchased 25 maintenance agreements that entitle the company to all future revisions and technical support. The personal computers, the software program packages and the maintenance agreements are all taxable if the technical support portion of the maintenance contract is not separately stated.
2. ABC Co. contracts to have Bob's Programming Services to provide and install a prewritten program to network the 25 personal computers. John will also provide technical support and trouble shooting on an "as needed" basis. The prewritten networking program is taxable, but John's service labor is non-taxable, if separately stated.
3. EEZY Manufacturing has outgrown their current accounting and payroll package, and they needed to purchase a whole new software system. They signed a contract with Computer Consultants to design and install a new system. Computer Consultants purchases a data base and applications modules, but the substantial portion of the contract is for the services of Computer Consultants to implement the new system. The service labor would not be taxable, if it is separately stated in the software contract, however, the purchase of the prewritten software components to install in EEZY Manufacturing's system are taxable.

## **ARVADA MUNICIPAL CODE – Chapter 98 – Taxation**

### *Sec. 98-61. - Definitions.*

**Software program** means a sequence of instructions that can be measured, interpreted and executed by an electronic device (e.g. computer, tablets, smart phones) regardless of the means by which it is accessed or the medium of conveyance. Software program includes:

- (1) Custom software program, which is a software program prepared to the special order or specifications of a single customer;
- (2) Pre-written software program, which is a software program prepared for sale or license to multiple users, and not to the special order or specifications of a single customer. Pre-written software is commonly referred to as "canned," "off-the-shelf" ("COTS"), "mass produced" or "standardized";
- (3) Modified software, which means pre-written software that is altered or enhanced by someone other than the purchaser to create a program for a particular user; and
- (4) The generic term "software," "software application," as well as "updates," "upgrades," "patches," "user exits," and any items which add or extend functionality to existing software programs.

**Software as a service** means software that is rented, leased or subscribed to from a provider and used at the consumer's location, including but not limited to applications, systems or programs.

**Software license fee** means a fee charged for the right to use, access, or maintain software programs.

**Software maintenance agreement** means an agreement, typically with a software provider, that may include

- (1) Provisions to maintain the right to use the software;
- (2) Provisions for software upgrades including code updates, version updates, code fix modifications, enhancements, and added or new functional capabilities loaded into existing software, or
- (3) Technical support.

### **Sec. 98-66. Property and service taxed.**

There is hereby levied and there shall be collected and paid a tax in the amount stated in section 98-66 as follows:

- (1) On all sales and services taxable, including, but not limited to the following:

*m. Software program. On the price paid or charged for software programs, software as a service, software license fees, and software maintenance agreements. Prewritten (canned) software programs are taxable. If there are significant modifications to prewritten software to customize it to a specific user, charges for labor which are included in the modification are not taxable, but only if such charges are separately billed on the invoice. Custom software programs written specifically for the user and billed on an hourly labor basis are not taxable. Subsequent sales of customized software will be treated as prewritten (canned) software and taxed accordingly.*

**Sec. 98-70. Exempt sales.** There shall be exempt from taxation under the provision of this article the items of sales and services including, but not limited to the following:

- (9) Additional provisions of exemption from the tax under this article:

*w. Custom software programs written specifically for the user and billed on an hourly labor basis are not taxable.*

THE ABOVE INFORMATION IS A SUMMARY IN LAYMAN'S TERMS OF THE RELEVANT ARVADA TAX LAW FOR THIS SUBJECT, INDUSTRY OR BUSINESS SEGMENT. IT IS NOT INTENDED FOR LEGAL PURPOSES TO BE SUBSTITUTED FOR THE FULL TEXT OF THE ARVADA MUNICIPAL CODE. HOWEVER, THE TAX GUIDE SHALL BE USED IN CONJUNCTION WITH THE ARVADA MUNICIPAL CODE (CHAPTER 98) IN DETERMINING TAX LIABILITY.