Massachusetts provides guidance on the new computer services sales tax

July 31, 2013

In brief

UPADTE: On September 27, 2013, Governor Patrick signed H.B. 3662, which retroactively repeals the imposition of Massachusetts sales and use tax on computer system design services. The tax had been in place since July 31, 2013. Vendors that collected but did not remit the tax must use reasonable efforts to return any tax collected. Vendors that remitted any collected tax are able to file for an abatement. Because vendors were not required to report and remit their first collections of the tax on computer system design services until October 20, 2013, the Massachusetts Department of Revenue does not anticipate many abatement claims.

UPDATE: The Department has issued Frequently Asked Questions in response to questions it has received about the new tax. The Department intends to update these answers as additional inquiries are received.

Overriding the governor's veto, the Massachusetts legislature enacted H.B. 3535, which imposes sales tax on computer system design services, effective for transactions occurring on or after July 31, 2013.

On July 25, 2013, the Department issued Technical Information Release 13-10: *Sales and use tax on computer and software services law changes effective July 31, 2013*. The Release provides initial guidance regarding the statutory changes, the applicable sourcing rules, transition rules for existing contracts, and electronic filing requirements.

Given the very short time allowed to prepare for the sales tax change, service providers should be aware of the state's guidance to help them quickly determine whether their services are subject to tax, how transactions are sourced to the state, and how to establish collection and remittance procedures.

In detail

Sales and use tax on computer and software services

The TIR describes the law change as effectively subjecting to sales and use tax the following two services starting July 31, 2013:

- **Computer system design services**, defined 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."

- **Software modification services.** Also described as 'customizing prewritten

software,' sales and use tax is imposed on modification, integration, enhancement,

- installation, or configuration of standardized software.

Please click here for our summary of H.B. 3535 and the new sales tax on computer and software services.

Non-taxable personal and professional services

Professional services not subject to sales and use tax are those that: (1) do not constitute computer systems design services or software modification services and (2) do not directly relate to a particular systems integration project involving the sale of computer hardware or software. Examples of such non taxable services include: (1) consulting and evaluation services with respect to existing computer systems to identify deficiencies and needs and (2) services to prepare a business to use modified software, such as training.

Sourcing rules

A vendor must collect and remit Massachusetts tax on transactions sourced to the state under the rules set forth below in the order of the priority listed:

- If the purchaser receives the service at a business location of the vendor, the retail sale is sourced to that business location of the vendor.

- If the vendor knows the location where the service is received by the purchaser based on instructions for delivery as provided by the purchaser, tax is due based on that location, when use of this address does not constitute bad faith.

- If the purchaser does not specify a location for the service to be delivered, the vendor must collect

tax based on the purchaser's address that is known to the vendor as provided by the purchaser or based on information known to the vendor (e.g., as collected to complete the sale), such as address information from a payment instrument or credit card, when use of this address does not constitute bad faith.

- If neither the delivery location nor the purchaser's address can be determined, then the vendor must collect tax based on the address of the vendor from which the sale was made.

Multiple points of use certificate – Purchaser's use tax remittance

A purchaser may provide a vendor with a **multiple points of use certificate** (MPU) if the purchased services will be concurrently available for use in more than one jurisdiction. Acceptance of a certificate relieves the vendor of collecting tax and requires the purchaser to remit use tax on the services, which includes the need to source the purchase across several states.

Sales of *software modification services* generally should be sourced in the same manner as the software being modified. The purchaser may 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. Such a reasonable method could be based on the number of computer terminals or licensed readers in each jurisdiction where software will be used, but **not** based on the location of the servers where the software is installed.

Sales of *computer design services* should be sourced to reflect the location of use of the computer system

design work by the purchaser. Generally the location of use is considered to be where the business will utilize the computer system and is not limited to the business headquarters or the location where the services were performed.

Transition rules for existing contracts

Contracts for taxable computer and software services entered into before July 31, 2013 are not taxable except to the extent a payment under such a contract is invoiced, or billed (or if not invoiced or billed, due under the terms of the contract) on or after July 31, 2013, and only to the extent that the payment relates to services performed on or after July 31, 2013.

Electronic filing requirements

Sales or use tax on computer and software services must be separately reported and paid electronically through Webfile for Business on Form ST-9. Transactions occurring on July 31, 2013, shall be reported with a taxpayer's August 2013 transactions.

The takeaway

While the TIR is a first step in providing taxpayers with guidance on the new law, the term 'computer system design services' needs a practical definition with examples that lays out what types of services are taxable. Moreover, if taxable services are provided along with non-taxable services (e.g., consulting and evaluation services with respect to existing computer systems to identify deficiencies and needs) what rules will apply in determining the taxable portion of the transaction?

In addition, in the multiple points of use (MPU) section of the TIR the Department observes that the sourcing methods for sales of software modification and sales of computer system design services may be

different. Examples of when this might be the case would be instructive.

Finally, for sales in which no MPU certificate is provided, the Department provides a set of rules that are to be applied in the order in which they are set forth. Until vendors provide the Department with feedback on how these rules might be refined in light of real life situations, there will likely be questions regarding the sourcing of some services.

Let's talk

If you have questions about the TIR, please contact:

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