

Computer Software

Sales Tax Fact Sheet 134

What's New in 2018

We clarified when sellers are required to collect local sales taxes. See Local Sales and Use Taxes on page 3.

Prewritten computer software

The sale, lease or license to use a canned or prewritten computer software program is taxable. The software may be delivered to the customer by any means, including:

- electronically
- Internet download
- load and leave
- discs
- CD ROM
- tape

All payments for prewritten computer software are taxable, including those billed on a periodic basis (i.e., weekly, monthly, yearly), or on a per use or per hit basis.

A multiple-use license for prewritten computer software is taxable.

Custom computer software

A custom computer software program is not taxable. A custom program is one that is prepared to the special order of the customer. It generally requires consultation and an analysis of the customer's requirements.

The program may be transferred in the form of written procedures or contained or recorded on tapes, discs, cards or another device. It also may include documentation or manuals designed to facilitate the use of the custom computer program.

It does not include:

- a *canned* or *prewritten* computer program held or existing for general or repeated sale or lease, even if the prewritten or canned program was initially developed on a custom basis for in-house use,
- CD's, disks, or other items developed for the purpose of training, speaker support, sales aides, etc., even when designed for a particular customer.

The vendor of the custom computer software program must pay sales or use tax on the cost of all materials used to produce the custom software.

Prewritten computer software with modifications

A prewritten computer software program that is modified to meet one specific customer's needs is a custom software program only to the extent of the modifications. The price for the prewritten program is taxable. The price for modifying or adapting the program is not taxable if separately stated on the bill.

Other charges

Installation or set up of a computer system, or installation of hardware or prewritten software upgrades, is taxable. This is true when the installation charges are billed by the seller of the system and when billed by a third party hired only to do the installation. Amounts paid to reimburse the expenses of the installer for travel, lodging, meals, etc., are part of the installation charge and are also taxable.

Reinstallation charges are not taxable. For example, if a system crashes and software has to be reinstalled, no tax applies to the charge for reinstallation. Tax is only due on the initial installation of an item.

Delivery charges for taxable products, such as computer hardware or prewritten software, are taxable. Delivery charges include charges such as shipping, postage, handling, crating and packing. Delivery charges for nontaxable products or services are not taxable. For more information, see Fact Sheet 155, *Delivery Charges*.

Free software. Installation or delivery charges for free software are taxable. Since installation and delivery charges are included in the definition of sales price, these charges become the sales price of the free software and are taxable.

Converting data from one physical form to another is taxable. For example, converting a floppy disk to CD, tape, or paper report is taxable.

Converting data from one electronic format to another is not taxable. For example, converting electronic data in order to run the data on a new computer system is not taxable.

Compressing or zipping files is not taxable.

Charges to access data from a database at a remote location are not taxable.

Training services are not taxable. If training materials, such as books, videos, or discs, are furnished with training services, the service provider must pay sales or use tax on the cost of the materials. If a separate amount is charged for the materials, the service provider should buy the materials exempt for resale and charge tax to the customer.

Disaster recovery services are not taxable. Disaster recovery services are charges for maintaining copies of computer files and databases at a remote site for use in the event of a disaster. The service provider must pay sales or use tax on the cost of all taxable items used to provide the service.

Capital equipment

Computers and software purchased for use in a production process may qualify for the capital equipment exemption.

To qualify, the computers or software must be used primarily for manufacturing, fabricating, mining, or refining a product to be sold ultimately at retail, or for electronically transmitting results retrieved by a customer from an on-line computerized data retrieval system.

Beginning July 1, 2015, the capital equipment exemption is allowed at the time of purchase. To purchase exempt, give the seller a completed Form ST3, *Certificate of Exemption*.

Before July 1, 2015, you had to pay the tax and apply for the refund.

For more information, see Fact Sheet 103, *Capital Equipment*.

Exemption certificates

To buy items exempt, give the seller a completed Form ST3, *Certificate of Exemption*, indicating the proper exemption code.

Multiple points of use (MPU)

Beginning July 1, 2013, a purchaser of digital products, computer software delivered electronically, or a taxable service may source the sale to multiple locations if the purchaser knows at the time of purchase that these items will be used concurrently in more than one taxing jurisdiction.

For purposes of this exemption, “concurrently available for use” means that employees or other agents of the

buyer may use the digital products, computer software delivered electronically, or services simultaneously from one or more locations within this state and one or more locations outside this state.

A digital code is concurrently available for use within and outside this state if employees or other agents of the buyer may use the digital products to be obtained by the code simultaneously at one or more locations within this state and one or more locations outside this state.

The purchaser must provide the seller a completed Form ST3, *Certificate of Exemption*. Specify the MPU exemption. Purchaser is responsible for apportioning and remitting the tax due to each taxing jurisdiction. The apportionment method can be based on any reasonable method, as long as it is applied in a consistent and uniform manner, and the method can be justified through supporting records.

Sales to nonprofit organizations

Qualifying nonprofit organizations must give the seller a completed Form ST3, *Certificate of Exemption*, including their exempt status number (if they have one) to claim exemption.

Maintenance agreements

Prewritten computer software

If the maintenance agreement for a prewritten software program is *required* by the vendor as a condition of the sale, lease, or license to use the prewritten software, the price of the maintenance agreement is taxable.

If the maintenance agreement for prewritten software is *optional*, separately stated charges are taxed as follows:

- **Upgrades or enhancements.** Information and directions, received in any format, that provide new or significantly improved function to a computer program are taxable. This includes information and directions that dictate the function performed by the computer. It also includes updated tables, such as employee withholding tables, and postage rates.
- **Support services.** Corrections received in any format, consultation services, or technical or telephone support for computer programs are not taxable.

Combination charges. If there is only one charge for both upgrades or enhancements and support services, tax applies to 20% of the entire price of the optional maintenance agreement.

Custom software

A maintenance agreement for custom software is not taxable.

Equipment

Optional maintenance contracts are taxable if they include any taxable items, unless the cost of those items is insignificant. These contracts provide:

- repair and replacement parts; and
- consumable items at no cost to the customer.

Optional warranty contracts (extended warranties) that cover future unexpected repair costs are not taxable. However, sales or use tax does apply to the parts used for contracted repairs.

The following examples help show when tax is due and who pays it.

If the customer:	Then you must:
Does not pay for parts	Pay sales or use tax on your cost for the parts
Pays a percentage of parts and labor	Charge sales tax only on the amount they pay for the parts
Pays a deductible for parts or labor	Pay sales or use tax on your cost for the parts (the deductible payment is not taxable)

Repair or replacement parts are not taxable when covered by a manufacturer's warranty or recall. These repair or replacement parts are exchanges of inventory.

For more information, see Revenue Notice 16-03, *Optional Warranty and Maintenance Contracts on Equipment*.

Equipment sales

If you sell equipment or other items that were used in your business, the sale may be subject to sales tax. For more information, see Fact Sheet 132, *Isolated and Occasional Sales*.

Local Sales and Use Taxes

If you are located in or makes sales into an area with a local tax, you may owe local sales or use tax. For more information, see Fact Sheet 164, *Local Sales and Use Taxes*.

Legal References

Minnesota Statutes 297A.61

subd. 17, Prewritten computer software

subd. 17a, Delivered electronically

subd. 17b, Load and leave

subd. 3(f)

subd. 4(c)

subd. 10 (a)

Minnesota Rules 8130.9910, Computer software

Revenue Notices

02-15, Copies of Scanned Documents

16-03, Optional Warranty and Maintenance Contracts on Equipment

Other Fact Sheets

103, *Capital Equipment*

132, *Isolated and Occasional Sales*

142, *Sales to Government*

146, *Use Tax for Businesses*

152, *Labor – Installation, Fabrication, Construction, and Repair*

155, *Delivery Charges*

164, *Local Sales and Use Taxes*