June 9, 2007

<name>
<address>
<city, state zip>

Formal Ruling 2007-04

Dear <name>:

You have requested a formal ruling as to the sales and use tax implications, both before and after tax law changes effective January 1, 2007, from the sale by your business of electronically downloaded computer software.

Facts:

According to the information you have provided, you operate a business out of your home in Vermont as a sole proprietor offering computer software that your customers may download for free from the internet. Some of the software features are disabled, however, and a customer who chooses to access the disabled features must purchase a license from a third party online service company that acts as your agent. Once purchased, the customer receives a confirming email with a license number that may be entered into the computer, allowing for access to the otherwise restricted features. No physical product is shipped to the customer. The third party service company does not have an office in Vermont, and most of the sales are to customers outside the state.

Sales Tax Issues and Liability:

You ask the following questions concerning your sales tax obligation to Vermont:

1. Are sales of the license that permits access to the computer software subject to the sales tax?

Prior to the tax law changes that occurred on January 1, 2007, computer software, when downloaded electronically, was not subject to the sales tax, although computer software sold as a tangible medium was subject to the tax. Beginning January 2007, the definition of "tangible personal property" was amended as follows:

(7) Tangible personal property: means personal property which may be seen, weighed, measured, felt, touched or in any other manner perceived by the senses. *"Tangible personal property" includes electricity, water, gas, steam, and prewritten computer software.*

32 V.S.A. § 9701(7) (amended language in italics).

The term "prewritten computer software" is defined by regulation (also effective January 1, 2007) and means, in pertinent part, "computer software, including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser." Reg. § 1.9701 (7) ("Tangible Personal Property"). Moreover, the regulation expressly states that prewritten computer software is taxable "even if the software is delivered electronically." *Id*.

Although you characterize the sale as one of a "license," the focus of the transaction, and the product sold to the customer, is the right to use the electronically delivered computer software. The transfer of the software from you to your customer constitutes a retail sale, as that term is used in Vermont law, and is therefore taxable. *See* Reg. § 1.9701 (5) -1 ("The term "sale" includes any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume, conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefore.").

Under this set of facts, you would be required to register for a Vermont business tax account and to collect the sales tax and remit it to the Department.

2. What if the situation is the same as above, but the online service company is the retail seller of licenses, and I am the wholesaler?

If you are the wholesale seller of computer software to an out-of-state retailer, you do not collect the sales tax because your sales are not "retail sales" as set forth in statute. 32 V.S.A. § 9771 (sales tax imposed on retail sales in this state). Note that even though you are not responsible for the tax, sales tax is nonetheless due on any software that is ultimately sold at retail in Vermont, and should be collected by the seller if the seller has nexus with the state, or if the seller chooses to register and voluntarily collect Vermont tax. If the seller does not collect the sales tax and the software is used in the state, the Vermont purchaser or user is responsible for payment of the use tax. 32 V.S.A. § 9773 ("Imposition of compensating use tax").

Assuming you had no employees, based on the limited information you have provided, you would not have to register with the Department under this scenario.

This ruling will be made public after deletion of the parties' names and any information which may identify the parties. A copy of this ruling showing the proposed deletion is attached, and you may request that within thirty (30) days the Commissioner delete any further information that might identify the interested parties. The final discretion as to deletions rests with the Commissioner.

This ruling is issued solely to your business and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.

Section 808 of Title 3 provides that this ruling will have the same status as an agency decision or an order in a contested case. You have the right to appeal this ruling within thirty days.

Sincerely,

Judith Henkin
Attorney for the Department

Approved this ____ day of _____, 2007.

_____
Tom Pelham
Commissioner of Taxes