

SENATE BILL REPORT

ESSB 6470

As Passed Senate, March 12, 1998

Title: An act relating to the tax treatment of canned and custom software.

Brief Description: Specifying the tax treatment of canned and custom software.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators West, Anderson, Kohl, Snyder, Loveland, Fairley, T. Sheldon and Jacobsen; by request of Governor Locke).

Brief History:

Committee Activity: Ways & Means: 1/21/98, 2/5/98 [DPS].
Passed Senate, 3/12/98.

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 6470 be substituted therefor, and the substitute bill do pass.

Signed by Senators West, Chair; Deccio, Vice Chair; Strannigan, Vice Chair; Bauer, Brown, Hochstatter, Kohl, Long, McDonald, Rossi, Schow, B. Sheldon, Snyder, Swecker, Winsley and Zarelli.

Staff: Terry Wilson (786-7433)

Background: The sales tax is imposed on each retail sale of most articles of tangible personal property and certain services. Taxable services include construction, repair, telephone, lodging of less than 30 days, physical fitness, and some recreation and amusement services. The use tax is imposed on the use of articles of tangible personal property when the sale or acquisition has not been subject to the sales tax. The use tax commonly applies to purchases made from out-of-state firms.

The business and occupation tax (B&O) is levied for the privilege of doing business in Washington. The tax is levied on the gross receipts of all business activities conducted within the state. There are no deductions for the costs of doing business. Currently, the rate imposed on retail sales is 0.471 percent and on general services is 1.75 percent through June 30, 1998, and 1.5 percent thereafter.

Computer software designed for use by many people without modification is known as canned software. Canned software is considered tangible personal property and the sale is subject to sales tax. The retailer pays B&O tax under the retailing classification. Custom software is software designed for use by a single consumer. The creation of custom software is considered a service. It is not subject to retail sales tax and the seller pays B&O tax under the service classification. The customization of canned software is considered a retail sale. As such, the sale is subject to sales tax and the seller pays B&O tax under the retailing classification.

Summary of Bill: The customization of canned software is considered a service. Therefore, the sale is not subject to sales tax and the seller pays B&O tax under the service classification.

A B&O tax credit is authorized for persons engaged in the business of the creation, distribution, wholesaling, or warehousing of canned or custom software if the principal place of business of the person is located in a distressed county. The credit is 100 percent of the tax otherwise due for the first 36 months in which the person is engaged in business in the distressed county. After this, the credit is reduced to 90 percent for persons engaged in the business of the creation or distribution of canned or custom software and 70 percent for persons engaged in the business of the wholesaling or warehousing of canned or custom software. A distressed county is defined as any county in which the average level of unemployment for the previous three years exceeds the average state unemployment for those years by 20 percent.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect on July 1, 1998.

Testimony For: This bill is the result of a task force. Software is not addressed in the statutes. The bill follows current practice, except for the customization of canned software. This is a disputed area. Sometimes a few hundred dollars of canned software is used as a starting point and hundreds of thousands of dollars of service is put into modifying it. That should not be treated as the sale of tangible personal property. The rule was written when the software industry was in its infancy and it was not well understood at that time.

Testimony Against: Sales tax exemptions erode the tax base for local governments more than the state because the state can spread the losses across the entire state.

Testified: PRO: Charles Osenbaugh, Timeline, Inc.; Claire Hesselholt, Department of Revenue; Ron Rosenblum, Association. of Washington Cities (with concerns).