

FINAL PRIVATE LETTER RULING

REQUEST LETTER

09-005

February 11, 2009

TAXPAYER REPRESENTATIVE

Sales and Use Tax Division
Utah State Tax Commission
210 North 1950 West
Salt Lake City UT 84134

Subject: Taxability of Plan 2 Payroll Service Subscription

Dear TAXPAYER REPRESENTATIVE:

COMPANY, a state licensed accounting firm providing attest, tax and other professional services, represents many technology and software companies with operations in STATE and other states. Many of our high-tech clients are selling software products and services with such sales originating from their wholly owned or leased websites located on servers owned/leased by such companies.

Opinion Requested

Our client (Company) requests in advisory opinion of tax application to a payroll service monthly subscription that provides incidental licensing of software functionality imbedded in the customers previously purchased accounting software in addition to the monthly payroll services for no additional charge. The bundled functionality is not required to obtain the payroll services being provided. The Company believes that *Haroldsen, Inc. v. State Tax Commission*, UTAH, 805 P.2d 176, 148 applies to our facts in that the software tool access unlock that is included in the payroll service offering for no additional charge is not the “primary object” of the payroll service fee on \$\$\$\$\$\$ a month. Therefore, the \$\$\$\$\$\$ Payroll Service Monthly Fee is not subject to tax as a bundled transaction.

Facts/Background

Company currently offers their customers various payroll related services. Company currently offers payroll services (\$\$\$\$\$\$ per month- Plan 1) entered into with customers that provide services including the filing and depositing the customer’s federal and state payroll tax deposits from payroll data that is uploaded by the customers’ accounting software to the company’s payroll service center(s). Other services provided by Company employees include making direct deposits (transfers funds from the customer’s payroll bank account to the customer’s employee’s bank accounts), and preparing W-2, 1098 and 1099 etc. Additional service fees are imposed for

each customer payroll that is uploaded to the Company’s payroll service center(s). The additional service fees are imposed for (i) each employee in excess of X employees, (ii) each additional state payroll tax deposit prepared and filed, (iii) per employee direct deposit transaction or check fees, and (iv) each form W-2, 1098 & 1099 etc. prepared under the Plan 1 payroll service offering.

Company also offers a deluxe version of their Plan 1 payroll service (Plan 2). Plan 2 is available for \$\$\$\$\$\$ per month vs. the \$\$\$\$\$\$ for the Plan 1 payroll service. The Plan 2 payroll service also includes an access unlock to a software tool for the accounting software that customer has purchased previously. The software tool is not required to subscribe to either the Plan 1 or Plan 2 payroll service plans. The software tool is currently taxed by the Company as a software license in all taxing jurisdictions when sold depending on the method of delivery.

A one-time setup charge of \$\$\$\$\$\$ is imposed for each new payroll service customer agreement (Plan 1 or Plan 2). The \$\$\$\$\$\$ setup charge allows the customer to unlock certain features of the existing accounting software that the customer has already purchased. This additional software functionality is what allows the customer to transfer the payroll data directly to the Company’s payroll service center(s). The Company has been treating this set up charge as a taxable software license, and believes current taxability to be appropriate and is not at issue. Please note that the customer’s accounting software performs all of the payroll calculations.

“Plan 1 Payroll Services”

- Electronic Tax Rate Updates
- One-time New Customer Setup Fee
- Monthly Service Fee up to X Employees
- Additional Employee>X
- Federal & State Payroll Deposits
For a Single State of FEIN
- Direct Deposit Transmission Fee
- Per Check Fee
- W-2, 1098, 1099 Prep
- Additional State Deposits
- Monthly Inactivity Fee (No Payroll)
- W-2, 1098, 1099 Correction Fee
- Software Tool (not required for service)

Subscription Fees

- Not included paid separately
- \$\$\$\$\$\$
- \$\$\$\$\$\$\$ per month
- \$\$\$\$\$\$ per pay period
- \$\$\$\$\$\$ included
- \$\$\$\$\$\$ per employee per pay period
- \$\$\$\$\$\$ per check
- \$\$\$\$\$\$/yr + \$\$\$\$\$\$ ea.
- \$\$\$\$\$\$ per state deposit
- \$\$\$\$\$\$
- \$\$\$\$\$\$ per form
- \$\$\$\$\$\$

“Plan 2 Payroll Services”

- Electronic Tax Rate Updates
- One-time New Customer Setup Fee
- Monthly Service Fee up to X Employees
- Additional Employee> X
- Federal & State Payroll Deposits
For a single State of FEIN
- Direct Deposit Transmission Fee
- Per Check Fee
- W-2, 1098, 1099 Prep

Subscription Fees

- Not included paid separately
- \$\$\$\$\$\$
- \$\$\$\$\$\$
- \$\$\$\$\$\$ per pay period
- Included
- Included
- Included
- Included

- Additional State Deposits \$\$\$\$\$\$ per state deposit
- Monthly Inactivity Fee (No Payroll) \$\$\$\$\$\$
- W-2, 1098, 1099 Correction Fee \$\$\$\$\$\$ per form
- Software Tool (not required for service) Included
- Additional State Deposits \$\$\$\$\$\$ per state deposit
- Monthly Inactivity Fee (No Payroll) \$\$\$\$\$\$
- W-2, 1098, 1099 Correction Fee \$\$\$\$\$\$ per form
- Software Tool (not required for service) Included

As noted above, the software tool functionality sold separately under Plan 1 for \$\$\$\$\$\$ is “bundled” for no additional charge with a subscription to Plan 2. The Company believes that a Plan 1 customer’s primary motivation for upgrading to Plan 2 is the elimination of additional per payroll fees and not the ancillary “bundled” software functionality.

Discussion:

In analyzing the taxability of the Plus Payroll Services, Company believes that *Haroldsen, Inc. v. State Tax Commission*, UTAH, 805 P.2d 176, 148 applies . . . “If a transaction involves a service and a transfer of tangible personal property, the transaction is exempt if the essence of the of the transaction is a sale of nontaxable services. . .” The company believes that the “primary object” of the payroll services offering is the service per se and not the inclusion of the ancillary software tool unlock access that is also provided for no additional charge. The software tool at issue is not required to subscribe to the payroll services offered and is simply an ancillary access unlock to previously purchased accounting software.

The Company’s basis for this belief is that a Plan 1 payroll customer’s primary motivation to subscribe to the Plan 2 payroll service is not the included software tool (not required for subscription to the Plan 1 or Plan 2 payroll services), but the elimination of additional per payroll service fees.

For example, a Plan 2 payroll customer with 10 employees on Direct Deposit and processing payroll twice a month will save \$\$\$\$\$\$ per month versus the additional \$\$\$\$\$\$ per month for the Plan 2 payroll service that includes the software tool. Again, the included software tool is not required to subscribe to these payroll services. The included software tool is provided to the customer by an access unlock code to existing software that is NOT required to subscribe to either the Plan 1 or Plan 2 payroll services offered. The customer is not required to utilize the access unlock to existing software to subscribe to and receive the financial benefits of the Plan 2 payroll service. If the customer terminates the Plan 2 payroll service, access to the software tool is also terminated if it was not separately licensed by the customer. Please note that some customers may have already purchased this software tool prior to enrolling in the Plan 2 payroll service, and others may never access/use the included software tool functionally.

Conclusion:

The Company recognizes that this is a very unique issue in that the included access unlock code provided with the service to existing software used by the customer is not required to subscribe

to the Plan 2 payroll services. Therefore, the Company requests an opinion that inasmuch as the Plan 2 payroll services subscription is not an enumerated taxable service and the “true object” of the transaction is the services provided and no separate charge is made for the inconsequential software tool access unlock to previously purchased accounting software included (no transfer of property occurs), that the subscription price of \$\$\$\$\$\$ per month is not subject to tax as a bundled transaction since the included software tool access code included is not required to subscribe to the Plan 1 or Plan 2 payroll services and may never be utilized by the customer.

Thank you for your consideration of the unique issue presented by this Plan 2 payroll service offering.

Very truly yours,
COMPANY

NAME
Director

RESPONSE LETTER

August 19, 2009

NAME
COMPANY
ADDRESS

RE: Private Letter Ruling Request—Sales Tax Treatment of a Bundled Transaction Including Payroll Services and a Software Tool

Dear NAME:

You have requested a ruling for your client (“Company”) as to the taxability for sales tax of a transaction that includes the provision of both 1) payroll services and 2) a “software tool” used to unlock certain features of the customer’s accounting software to transfer data to Company’s payroll service center. You explained that “Company basically has two plans: Plan 1 has a lower monthly fee but includes the software tool, and certain other items, are purchased separately. Plan 2 has a higher monthly amount but the software tool and some other items not included in Plan 1 are included in Plan 2. It is not necessary to have the software tool to use the service.” You also explained that the customer does not continue to have use of the software tool if Plan 2 is dropped.

Your specific issue is “whether the Plan 2 transaction that includes the software tool is taxable as a bundled transaction or whether the software tool that is agreed to be tangible personal property is incidental to the transaction and that the transaction is exempt.”

Applicable Law

Utah Code Ann. § 59-12-103(1) imposes tax on: “(a) retail sales of tangible personal property made within the state” and on “(n) amounts paid or charged for a sale: (i)(A) of a product that; (I) is transferred electronically; and (II) would be subject to a tax under this chapter if the product was transferred in a manner other than electronically . . .”

Utah Code Ann. § 59-12-102(108) defines the term “tangible personal property” to include “(b)(v) prewritten computer software.”

Utah Code Ann. § 59-12-103(2)(d) prescribes how bundled transactions are taxed. Subsection (2)(d)(i) concerns food items and does not apply for this letter. The remaining subsections are as follows:

- (ii) Subject to Subsection (2)(d)(iii), for a bundled transaction other than a bundled transaction described in Subsection (2)(d)(i):
 - (A) if the sales price of the bundled transaction is attributable to tangible personal property, a product, or a service that is subject to taxation under

this chapter and tangible personal property, a product, or service that is not subject to taxation under this chapter, the entire bundled transaction is subject to taxation under this chapter unless:

- (I) the seller is able to identify by reasonable and verifiable standards the tangible personal property, product, or service that is not subject to taxation under this chapter from the books and records the seller keeps in the seller's regular course of business; or
- (II) state or federal law provides otherwise; or
- (B) [Does not apply for this letter.]

(iii) For purposes of Subsection (2)(d)(ii), books and records that a seller keeps in the seller's regular course of business includes books and records the seller keeps in the regular course of business for nontax purposes.

Utah Code Ann. § 59-12-102(15)(a) defines the term “bundled transaction” as “the sale of two or more items of tangible personal property, products, or services if the tangible personal property, products, or services are: (i) distinct and identifiable; and (ii) sold for one nonitemized price.”

Utah Code Ann. § 59-12-102(15)(d) further defines “sold for one nonitemized price” used in § 59-12-102(15)(a)(ii) as follows:

- (i) For purposes of Subsection (15)(a)(ii), property sold for one nonitemized price does not include a price that is separately identified by product on the following, regardless of whether the following is in paper format or electronic format: (A) a binding sales document; or (B) another supporting sales-related document that is available to a purchaser.
- (ii) For purposes of Subsection (15)(d)(i), a binding sales document or another supporting sales-related document that is available to a purchaser includes: (A) a bill of sale; (B) a contract; (C) an invoice; (D) a lease agreement; (E) a periodic notice of rates and services; (F) a price list; (G) a rate card; (H) a receipt; or (I) a service agreement.

Utah Code Ann. § 59-12-102(15)(b) defines certain transactions as not included in the definition of bundled transactions. Three exclusions are discussed below. First, under § 59-12-102(15)(b)(i) bundled transactions do not include:

the sale of tangible personal property if the sales price varies, or is negotiable, on the basis of the selection by the purchaser of the items of tangible personal property included in the transaction;

Second, under § 59-12-102(15)(b)(iv) bundled transactions do not include:

the retail sale of tangible personal property and a service if:
(A) the tangible personal property:

- (I) is essential to the use of the service; and
- (II) is provided exclusively in connection with the service; and
- (B) the service is the true object of the transaction

Third, under § 59-12-102(15)(b)(vi) bundled transactions do not include:

a transaction that includes tangible personal property or a product subject to taxation under this chapter and tangible personal property or a product that is not subject to taxation under this chapter if the:

- (A) seller's purchase price of the tangible personal property or product subject to taxation under this chapter is de minimis; or
- (B) seller's sales price of the tangible personal property or product subject to taxation under this chapter is de minimis . . .

For the third exception, Utah Code Ann. § 59-12-102(15)(e) further defines the terms of the de minimis exception of § 59-12-102(15)(b)(vi) as follows:

- (i) For purposes of Subsection (15)(b)(vi), the sales price of tangible personal property or a product subject to taxation under this chapter is de minimis if:
 - (A) the seller's purchase price of the tangible personal property or product is 10% or less of the seller's total purchase price of the bundled transaction; or
 - (B) the seller's sales price of the tangible personal property or product is 10% or less of the seller's total sales price of the bundled transaction.
- (ii) For purposes of Subsection (15)(b)(vi), a seller:
 - (A) shall use the seller's purchase price or the seller's sales price to determine if the purchase price or sales price of the tangible personal property or product subject to taxation under this chapter is de minimis; and
 - (B) may not use a combination of the seller's purchase price and the seller's sales price to determine if the purchase price or sales price of the tangible personal property or product subject to taxation under this chapter is de minimis.
- (iii) For purposes of Subsection (15)(b)(vi), a seller shall use the full term of a service contract to determine if the sales price of tangible personal property or a product is de minimis.

Analysis

In your issue, you stated, “the software tool . . . is agreed to be tangible personal property.” Your proposed assumption is consistent with § 59-12-102(108) which includes prewritten computer software in the definition of tangible personal property. Tangible personal property is taxable under § 59-12-103(1)(a). Alternatively, if the software tool were considered to be transferred electronically, the software tool would not be tangible personal property, but it would still be taxable under § 59-12-103(1)(n), as a product transferred electronically.

You asked whether the Plan 2 transaction is taxable as a bundled transaction. The Utah statutory definition of “bundled transaction” in § 59-12-102(15) was changed effective January 1, 2009. This change broadened the definition to include more than just specific transactions involving the sale of food and food ingredients. Because the Plan 2 transaction does not involve food and food ingredients and because definition of “bundled transaction” is now broader, the prior rulings dealing with “bundled transactions” are now of limited use. The facts of your situation must be applied to the current definition, not a prior one.

That being said, the Plan 2 transaction meets the general definition of a bundled transaction, defined in § 59-12-102(15)(a). The Plan 2 transaction is a combination of tangible personal property or a product subject to tax (the software tool) and services not subject to tax (the payroll services). Therefore, the Plan 2 transaction meets the definition in § 59-12-102(15)(a)—the transaction is “the sale of two or more items” that are “distinct and identifiable” and “sold for one nonitemized price.”

The Plan 2 transaction does not meet the exceptions set forth in § 59-12-102(15)(b). Discussed below are the three exceptions that are the most applicable.

First, under § 59-12-102(15)(b)(i) bundled transactions do not include:

the sale of tangible personal property if the sales price varies, or is negotiable, on the basis of the selection by the purchaser of the items of tangible personal property included in the transaction;

This first exception is not applicable to your situation because the \$99 monthly fee does not vary and is not negotiable based on whether or not the customer selects the software tool.

Second, under § 59-12-102(15)(b)(iv) bundled transactions do not include:

the retail sale of tangible personal property and a service if:

(A) the tangible personal property:

(I) is essential to the use of the service; and

(II) is provided exclusively in connection with the service; and

(B) the service is the true object of the transaction

This second exception does not apply to your situation because the software tool is not essential to the use of the payroll service and because it is not provided exclusively in connection with the payroll service.

Third, under § 59-12-102(15)(b)(vi) bundled transactions do not include:

a transaction that includes tangible personal property or a product subject to taxation under this chapter and tangible personal property or a product that is not subject to taxation under this chapter if the:

- (A) seller's purchase price of the tangible personal property or product subject to taxation under this chapter is de minimis; or
- (B) seller's sales price of the tangible personal property or product subject to taxation under this chapter is de minimis . . .

This third exception is close to the terms of the Plan 2 transaction. The Plan 2 transaction includes the taxable software tool and nontaxable payroll services. The pivotal issue is then whether the taxable software tool is de minimis.

Utah Code Ann. § 59-12-102(15)(e) further defines “de minimis” as follows:

- (i) For purposes of Subsection (15)(b)(vi), the sales price of tangible personal property or a product subject to taxation under this chapter is de minimis if:
 - (A) the seller's purchase price of the tangible personal property or product is 10% or less of the seller's total purchase price of the bundled transaction; or
 - (B) the seller's sales price of the tangible personal property or product is 10% or less of the seller's total sales price of the bundled transaction.

....

- (iii) For purposes of Subsection (15)(b)(vi), a seller shall use the full term of a service contract to determine if the sales price of tangible personal property or a product is de minimis.

For your situation, we lack the facts necessary to calculate under § 59-12-102(15)(e) whether or not the taxable software tool is de minimis. For subsection (A) of § 59-12-102(15)(e) (i), we do not have the software tool’s purchase price or the total purchase price of the Plan 2 transaction. For subsection (B), we have the \$149 sales price of the software tool and the \$99 monthly subscription price for the Plan 2 transaction, but we do not have the sales price of Plan 2 for the full term of the service contract.¹ Although we have limited information, because the software tool is sold to the customer for \$149.00 under Plan 1, we believe that the software tool likely has a significant value and is not de minimis.

¹However, we note that if the service contract were month-to-month or even for one full year, the selling price of the software tool would not be de minimis under § 59-12-102(15)(e)(i)(B) (based on the seller’s sale price). For a one-year contract under Plan B, the sales price would be \$1,188, which is \$99 per month for 12 months. The \$149 sales price of the software tool would be 12.5% of the \$1,188 total sales price for the one-year contract. The 12.5 percentage is greater than 10 percent; therefore, the selling price of the software tool is not de minimis under subsection (B). Additionally, we lack the information necessary to determine whether the software tool would be de minimis under § 59-12-102(15)(e)(i)(A) (based on the seller’s purchase price).

Based on the above discussion, the Plan 2 transaction is a taxable bundled transaction that likely does not meet any statutory exception found in § 59-12-102(15)(b). Section 59-12-103(2)(d) provides the tax treatment of bundled transactions. Under § 59-12-103(2)(d)(ii)(A):

the entire bundled transaction is subject to taxation under this chapter unless:

(I) the seller is able to identify by reasonable and verifiable standards the tangible personal property, product, or service that is not subject to taxation under this chapter from the books and records the seller keeps in the seller's regular course of business

Therefore, the entire sales price of the Plan 2 transaction would be subject to tax unless your client (Company) can meet the qualification of § 59-12-103(d)(ii)(A)(I) and is able to show the separate amount of the nontaxable portion of the sales price in their books and records.

Conclusion

The Plan 2 transaction is a bundled transaction under § 59-12-102(15)(a). The transaction is unlikely to meet any exception in § 59-12-102(15)(b); in particular, the software tool is unlikely to be de minimis for § 59-12-102(15)(b)(vi). Therefore, the transaction is taxable according to § 59-12-103(2)(d)(ii)(A) unless the Company meets the qualification of § 59-12-103(d)(ii)(A)(I). Basically, in direct response to your question, the software tool is not incidental to the transaction and the transaction is not exempt.

Our conclusions are based on the facts as described. Should the facts be different, a different conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, if you have additional facts that may be relevant, or if you have any other questions, please contact us.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/aln
09-005