December 8, 2005

FOLLOW UP – TAXPAYER (The Taxpayer)

We have reviewed the Letter Ruling dated December 2, 2005 written in response to our initial ruling request dated March 31, 2004. The initial ruling request was based on my understanding of the facts 21 months ago. On September 21, 2004, I submitted additional documentation which expanded, clarified and essentially corrected the facts represented in the original letter. The purpose of this letter is to correct the facts and issues, to propose a draft legal conclusion that appears to be consistent with the legal conclusion in your recent letter ruling. We respectfully request that the Tax Commission reconsider these clarifications and reissue the letter ruling.

Proposed Corrected Facts

TAXPAYER (the "Taxpayer") licenses its principal information systems software from DEVELOPER, a software developer located outside the State. In accordance with the original contract ("Licensing Agreement") executed on October 14, 2003, the Taxpayer pays an annual licensing/maintenance fee to DEVELOPER for continued use of the "DEVELOPER software." The initial license fee covered all maintenance costs through the first 12 months. Thereafter, the Taxpayer pays an annual maintenance fee equal to 20 percent of the original license fee. These fees under the Licensing Agreement entitle the Taxpayer to software upgrades, when available, and error corrections, and the use of the software. DEVELOPER has historically treated its Licensing Agreement software as canned software, and continues to presume that this treatment is correct. Accordingly, DEVELOPER has collected sales tax on all license fees from the Taxpayer.

In addition, the Taxpayer has entered into a separate and distinct consultation agreements entitled Premier Platinum Services agreement (the "Platinum Agreement") wherein employees of DEVELOPER perform additional consultation services on behalf of the Taxpayer. The Platinum Agreement entitles the Taxpayer to the following bundle of services enumerated on the face of the Platinum Agreement:

1. a Dedicated Business Development Coordinator assigned to Taxpayer's organization
2. 20 days of on-site professional services by DEVELOPER employees
3. $6,000 credit towards educational services;
4. on-site DEVELOPER Product strategy session;
5. two on-site Business Development Services planning sessions;
6. a CEO Technology Update on the DEVELOPER campus;
7. two fully paid executive registrations for the DEVELOPER National Client Conference;

8. use of DEVELOPER software for evaluating live environment functionality;
9. priority registration of on-site Professional Services dates;
10. access to Professional Services staff for unique integration projects;
11. advance DEVELOPER software releases to which it may be entitled under Licensing Agreement
12. no charge, overnight shipping; and
13. one complimentary copy of the current SAS70 audit report.

While these are the stated benefits to the Taxpayer, the core reason for enrolling in the Platinum Agreement is to participate in the "best practices" group with other participating DEVELOPER customers. Under this arrangement, all participants shared their results and best practices with DEVELOPER. Under the service, DEVELOPER employees travel to the Taxpayer's premises to meet with Taxpayer employees, compare the Taxpayer's practices with the best practices of other participants, and assist the Taxpayer in implementing certain best practices, not in implementing software installations per se. The essence of this service was education and consultation, and did not entail any modification, implementation or customization of the DEVELOPER software resident on the Taxpayer's information systems.

In addition to these two contracts, it is conceivable that Taxpayer may engage DEVELOPER to perform separate software related to implementing or customizing DEVELOPER software on the Taxpayer's computer systems. These services, if any, would be separately negotiated, performed and invoiced aside from the two contracts listed above.

Proposed Corrected Issue:

Are the charges for the Platinum Agreement subject to Utah sales tax?

What standards should be used when considering the taxability of other software services that may be purchased aside from the original license/maintenance and the Platinum Agreement?

Proposed Corrected Conclusion:

The Platinum Agreement

To determine if the services included within the scope of the Platinum Agreement are taxable, we first look to see whether the sale of the Platinum Agreement is connected to the sale in the original software license. Second, we look to see if the Platinum Agreement includes any taxable activities.

If the Platinum Agreement is an arms-length agreement negotiated separately from the

original contract, and the services provided under it could be obtained from other providers, the Platinum Agreement may be viewed as not connected to the sale or lease. Other factors, we would consider are the timing of the Platinum Agreement and the degree to which the services provided are interconnected with the original contract and sale of the software.

For example, if the Platinum Agreement was negotiated at roughly the same time as the original software license contract, it is possible that the Platinum Agreement be connected to the sale or lease of the software. More specifically, if the purchaser signing the original contract would not do so without the services provided under the Platinum Agreement, the services provided under the Platinum Agreement could be taxable. Also, if DEVELOPER would not sign not original contract without the Taxpayer's agreement to enter into the Platinum Agreement would be taxable.

You represented that the Platinum Agreement was negotiated and executed two and one half months after the original agreement, and only after the software license had been fully installed and implemented on the Taxpayer's computers. Under this factual assumption, the purchase of the Platinum Agreement would be non-taxable assuming that all of the following were found to be true:

- the decision to purchase the Platinum Agreement occurred after the original contract was negotiated and completed.
- the Taxpayer's use of the original software did not rely on the subsequent purchase of the Platinum Agreement; AND
- the bundle of services acquired under the Platinum Agreement does not include to any products or services that would be taxable if purchased separately.

Based on the specific services listed in the Platinum Agreement, it appears that none of the services would be subject to tax as they are primarily intended to educate the Taxpayer on how to achieve the best use of the software, as you indicated in your letter From your description, this appears to be a separate and distinct agreement from the original contract.

Other customization and Implementation Services. If the Taxpayer purchases any implementation and customization services from DEVELOPER in relation to the DEVELOPER software, the Taxpayer must distinguish the nature and type of work to be done. For any such services to be non taxable, it must be clear that the work done (i.e. implementing and customizing the software) is work done to solely to modify or adapt the software to the customer's needs and equipment. Neither modification nor adaptation to a customer's needs or equipment is subject to sales tax. This must be identified as separate from the purchase of the software. However, if what is done is "maintenance, consultation in connection with a sale or lease, enhancements, or upgrading of canned or prewritten software," or an "implementation" of the original software, charges for the

"consultation" would be subject to sales tax.

If any such services were rendered, DEVELOPER must determine whether "non-taxable" customization services were separately negotiated and invoiced from "taxable" implementation services . .
"Implementation" of the software appears to be a taxable transaction. Specific customization services may be non-taxable if they separately stated and identified on the invoice. Otherwise they would be subject to tax as part of the entire transaction.

Conclusion

We respectfully request that the Tax Commission reissue its original letter ruling to reflect the factual enhancements. Please do not hesitate to call me with any questions.

Sincerely,

NAME

April 28, 2006

NAME
ADDRESS

Re: Resubmission of Private Letter Ruling Request for Consultation Charges related to Computer Software

Dear NAME,

We received your request to reconsider and reissue our private letter ruling of December 2, 2005, regarding sales tax issues related to software sold and serviced by your client, the TAXPAYER. You submitted proposed changes for our consideration.

As we read your request, you are requesting changes with regard to the Premier Platinum Services Agreement. We find the Platinum Services Agreement is connected to the sale of the original software license and that it includes taxable activities.

The Platinum Services Agreement allows the purchaser to receive advance releases of DEVELOPER software to which it may be entitled under the Licensing Agreement. This links it to the original purchase of the DEVELOPER software. The 20

days of professional services, which includes installation, appears to be taxable. DEVELOPER'S website also lists one of the benefits of the agreement as a $$$$$$ licensing credit toward the purchase of DEVELOPER software. At the very least, the licensing credit applicable to DEVELOPER software, assuming it is "canned," is taxable.

The information states, "This popular strategic services package boasts a 100 percent subscription renewal rate." This suggests the notion that similar packages and services are acquired from other providers is theoretical only. It reinforces the conclusion that the purchase of the Platinum Services Agreement is linked to the sale of the Licensing Agreement, which you concede is taxable.

The term "best practices group" does not appear in the information regarding the Platinum Services Agreement. You explained in a telephone conversation that this is a term used to describe the interaction between persons providing service and various customers. For example, one customer might report something to a person providing service under the agreement. That information would then be passed on to other customers who have also purchased the agreement. In light of the things specifically set forth as benefits of purchasing the Platinum Services Agreement, it does not appear that being included in the "best practices group" is the object of the transaction.

Based on the foregoing, we conclude the Platinum Services Agreement is subject to sales tax. Unless any non-taxable work is separately stated, the agreement would be taxable in full.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/SR
04-008