



STATE OF CONNECTICUT
DEPARTMENT OF REVENUE SERVICES

PS 2006(8)

25 Sigourney Street
Hartford CT 06106-5032

POLICY STATEMENT

Sales and Use Taxes on Computer-Related Services
and Sales of Tangible Personal Property

Purpose: This Policy Statement:

- Describes the application of sales and use taxes to purchases of computer and data processing services, other enumerated services, and sales of tangible personal property;
- Clarifies the definitions of computer and data processing services and computer software; **and**
- Provides clarification on differentiating between persons rendering computer and data processing services and those providing personnel services, and differentiating between employees and independent contractors.

Effective Date: This Policy Statement applies to all open tax periods.

Statutory Authority: Conn. Gen. Stat. §12-407(a)(2)(A); §12-407(a)(2)(I); §12-407(a)(8) and (9); §12-407(a)(35); §12-407(a)(36); §12-407(a)(37)(A); §12-407(a)(37)(C); §12-407(a)(37)(H); §12-407(a)(37)(J); §12-407(a)(37)(Q); §12-407(a)(37)(C); §12-408(1)(C); §12-411(1)(D); and Conn. Agencies Regs. §12-407(2)(i)(J)-1; §12-426-25; and §12-426-27.

Definitions: As used in this Policy Statement:

Computer and data processing services, as described in Conn. Gen. Stat. §12-407(a)(37)(A), include programming, code writing, modification of existing programs, feasibility studies, and installation and implementation of software programs and systems even where these services are rendered in connection with the development, creation, or production of canned or custom software, or the license of custom software.

Computer and data processing services, as defined in Conn. Agencies Regs. §12-426-27(b)(1), include

providing computer time, storing and filing information, retrieving or providing access to information, and providing consulting services.

The list of services in the regulation does not exclude other services from the scope of computer and data processing services. (See Conn. Agencies Regs. §12-426-27(k).) Data scanning, creating custom software, computer training, and online access to information are within the scope of taxable computer and data processing services. Computer and data processing services are subject to tax in Connecticut if the benefit of the services is received in this state.

Canned or prewritten software, as defined in Conn. Gen. Stat. §12-407(a)(35), means all software, other than custom software, that is held or existing for general or repeated sale, license, or lease, including software initially developed as custom software for in-house use and subsequently sold, licensed, or leased to unrelated third parties.

Custom software, as defined in Conn. Gen. Stat. §12-407(a)(36), means a computer program prepared to the special order of a single customer.

Tax Rate Reduced for Computer and Data Processing Services:

The sales and use tax rate for computer and data processing services **other than** Internet access services was reduced in annual increments and became taxable at 1% effective July 1, 2001. (Internet access services became nontaxable on that date.) Charges for computer and data processing services are reported on Line 74 of **Form OS-114, Sales and Use Tax Return**. See **Form O-88, Instructions for Form OS-114**, for details on reporting these charges.

Creation and Maintenance of Web Sites:

Under Conn. Gen. Stat. §12-407(a)(37)(A), taxable computer and data processing services **do not include** services rendered in connection with the creation, development, hosting, or maintenance of all or part of a website which is part of the graphical, hypertext portion of the Internet, commonly referred to as the World Wide Web.

This exclusion applies to all computer and data processing services (such as programming, data entry, scanning, computerized graphic design, software installation, software maintenance, and hosting fees), when the services are provided to a service recipient in connection with the service recipient's website. The exclusion does not apply to charges for access to websites maintained by others. These charges are taxable at 1%.

The sale of prewritten software necessary to create a website is taxable at the 6% rate when tangible personal property is provided to the purchaser by the retailer, but is excluded from tax when the software is delivered electronically and the retailer provides no tangible personal property to the purchaser.

Charges to Be Separately Stated: Charges for computer hardware and prewritten computer software, as well as charges for enumerated services such as business management consulting and job-related personnel training (taxable at 6%), may sometimes be combined in a single contract price with charges for computer and data processing services (taxable at 1%). The Department of Revenue Services (DRS) presumes the higher applicable rate of tax applies to an entire contract unless the charges for each component of the contract are separately stated and are reasonably allocated.

Retailers of items and services such as computer hardware, computer software, software installation, maintenance, support, upgrades, computer training, and other enumerated services must separately state the charges for tangible personal property, computer and data processing services, other enumerated services, and nontaxable charges, and collect and remit the correct amount of tax on these charges.

Purchasers that self-assess use tax must be prepared to show, through receipts or other written records, that they have remitted the correct amount of tax on the charges.

Sale, Installation, Maintenance, and Repair of Computer Hardware:

The sale or lease of computer hardware, including but not limited to mainframes, personal computers, hard drives, monitors, printers, and scanners, is the sale of tangible personal property and is subject to sales and use taxes at the 6% rate.

Charges for installation of computer hardware sold, as opposed to leased, are subject to sales and use taxes at the 6% rate if the installation services are not separately stated. If installation charges are separately stated, they are not subject to tax under Conn. Gen. Stat. §12-407(a)(8)(B)(iv) and §12-407(a)(9)(B)(iv). However, charges for installation of leased computer hardware are subject to tax at the 6% rate under Conn. Agencies Regs. §12-426-25(c), whether or not the amounts are separately stated. Installation of computer hardware normally includes unpacking, setup, wiring, and initial testing of the equipment, but does not include installation of software.

The repair and maintenance of computer hardware is the repair and maintenance of tangible personal property, enumerated in Conn. Gen. Stat. §12-407(a)(37)(CC) (or the repair of electrical or electronic devices enumerated in Conn. Gen. Stat. §12-407(a)(37)(Q)), and is subject to tax at the 6% rate. Maintenance, repair, or warranty contracts for computer hardware are also taxable at 6%. (See Conn. Agencies Regs. §12-407(2)(i)(DD)-1 for details.)

Sales of Computer Software: The tax rate for sales of computer software depends on whether the software is prewritten or custom.

Canned or prewritten software. Canned or prewritten computer software is tangible personal property. The sale, leasing, or licensing of the software (including upgrades) is taxable at 6%.

Custom software. The processes of designing, creating, and developing custom software, or adapting or modifying existing software to the particular needs of a customer, are computer and data processing services taxable at the 1% rate.

Custom software prepared to the special order of a single customer may sometimes be prepared from prewritten software that has had substantial modifications to its functions or the purpose of its program. The software may have been changed to

such a degree that it bears little resemblance to any but the most basic functions of the prewritten software on which it was based. Charges for upgrades of custom software are charges for computer and data processing services.

Because custom software is not tangible personal property, any charges (such as license fees) for the mere use and possession of the software, stated separately from charges for taxable computer and data processing services or prewritten software, are not subject to sales and use taxes.

For more information on computer software purchased in connection with exempt machinery, see **Policy Statement 98(8)**, *Exemption From Sales and Use Taxes for Items Used Directly in the Biotechnology Industry*; **Special Notice 93(1.1)**, *The Manufacturing Recovery Act of 1992 Exemption for Purchases of Property Used in Manufacturing, Processing and Fabricating*; and **Policy Statement 2001(7)**, *Purchases of Machinery, Equipment, Tools, Materials, and Supplies by Commercial Printers and Publishers*.

Example 1: A company purchases prewritten software and provides it to a customer, then makes minor modifications to the software so it will run on the customer's system. The modifications are not substantial enough to result in custom software. The company charges separate monthly license fees to the customer for the software. The company separately states the initial charge for the prewritten software program, the charges for the modifications, and the license fees. The initial charge for the prewritten software is taxable at 6%, the charges for the modifications are taxable at the 1% rate, and the license fees are taxable at the 6% rate because the license is for prewritten, not custom, software. The company may purchase the prewritten software on resale.

Example 2: A company purchases prewritten software and provides it to a customer, then makes sufficiently substantial modifications to the functions or the purpose of the software program so that it is considered to be custom software. The company charges separate monthly license fees to the customer for the software. The company separately states the initial charge for the prewritten software program, the charges for the modifications, and the license fees. The initial charge for the prewritten software is taxable at 6%, the charges for the modifications are taxable at the 1% rate, and the license fees are not

taxable because they are for custom software. (If the license fees for the custom software were not separately stated, they would be taxable at the 1% rate.) The company may purchase the prewritten software on resale.

Example 3: A company contracts with a customer to create and deliver a custom software product to the customer. The company purchases prewritten software, which it uses as the base for the custom software. When the company delivers the custom software to the customer, it makes an initial charge for the custom software and charges separate monthly license fees to the customer. The company does not make a separate charge for the prewritten software on which the custom software was based. The charge for the custom software is subject to tax at the 1% rate, and the license fees are not taxable because they are for custom software. (If the license fees for the custom software were not separately stated, they would be taxable at the 1% rate.) The company may not purchase the prewritten software on resale and must pay 6% tax on its purchase price because it is the consumer of the prewritten software it used to create the custom software.

Example 4: Company A provides prewritten software to a customer for an initial charge and charges the customer a monthly license fee for the prewritten software. The customer hires Company B to perform modifications to the software so it will run on the customer's system. All the charges from Company A are subject to tax at the 6% rate, regardless of whether Company B's modifications result in custom software, because the customer is paying Company A for prewritten software. The charges from Company B for the modifications are subject to tax at the 1% rate. Company A may purchase the prewritten software on resale.

Software Installation, Maintenance, Support, and Upgrades: Software installation is a computer and data processing service taxable at the 1% rate, whether the installation is of prewritten or custom software.

Maintenance of computer software is a computer and data processing service taxable at the 1% rate, whether the software is prewritten or custom. Maintenance of computer software typically includes consulting with the service recipient in the form of technical support, software support, user support, or

telephone support. Software warranty contracts for providing services in connection with software are similarly subject to tax as computer and data processing services.

Charges for upgrades of prewritten software involving the replacement of software with upgraded software are subject to tax as the sale of tangible personal property, at the 6% rate, when the retailer provides tangible personal property to the purchaser. When the software is delivered electronically and the retailer provides no tangible personal property to the purchaser, charges for software upgrades are taxable at the 1% rate for computer and data processing services.

Software maintenance contracts or warranty contracts that provide for computer and data processing services, such as telephone support and other services, and include upgrades of prewritten software where tangible personal property is provided to the purchaser, are presumed to be contracts for the sale of tangible personal property taxable at 6% unless the charges for services are separately stated from the charges for software upgrades.

Computer Training: In some cases, computer training and software training may be taxable at the 6% rate as business management consulting services (personnel training) under Conn. Agencies Regs. §12-407(2)(i)(J)-1(i)(1) and Conn. Gen. Stat. §12-407(a)(37)(J). Computer training and software training are taxable as personnel training services when the service provider is engaged and paid by an employer to provide job-related training to personnel whose primary workplace is located in Connecticut.

Job related training means training directly related to teaching, maintaining, upgrading, or improving the specific skills required in the employee's day-to-day job performance. (Training provided by most accredited institutions of higher education is not taxable whether or not the training is open to the general public and regardless of who pays for the training.) See **Policy Statement 2000(4)**, *Sales and Use Taxes on Charges for Personnel Training Services*.

When computer training and software training are not job-related, or are not contracted and paid for by an employer, they are computer and data processing services, taxable at the 1% rate, whether or not the training is rendered in connection with the sale or lease of software.

Example 1: A law firm engages and pays a service provider (other than an accredited institution of higher education) to train its clerical personnel in a word processing software product the personnel will

use in their jobs. Charges for this training are taxable at 6%, because the training is directly related to maintaining, upgrading, or improving the specific job skills of the clerical employees.

Example 2: A law firm engages and pays a service provider (other than an accredited institution of higher education) to conduct a class for its attorneys on the use of email to facilitate interoffice communications. Charges for this training are taxable at the 1% rate because the training is not directly related to the specific job skills of the attorneys.

Personnel Services: Sometimes employees who perform computer and data processing functions are provided to a service recipient by a provider of personnel services enumerated in Conn. Gen. Stat. §12-407(a)(37)(C). The charges for the personnel services are taxable at the 6% rate rather than at the 1% rate for computer and data processing services.

Two elements are necessary for a service to be a personnel service rather than a computer and data processing service: (1) a service provider must provide its own employees to a service recipient to perform temporary or part-time computer and data processing work; **and** (2) while the employees are with the service recipient, the service recipient must have control over the work the employee does and how the work is done.

For more details on personnel services, see **Policy Statement 2006(7)**, *Taxation of Services by Employment Agencies and Agencies Providing Personnel Services*.

The criteria for determining whether staff are employees or independent contractors for federal tax purposes also apply for Connecticut tax purposes. Whether a Form W-2 or a Form 1099 is supplied to an individual therefore does not control. Internal Revenue Service Publication 15-A, *Employer's Supplemental Tax Guide*, summarizes the criteria for determining whether an individual is an employee as defined under the common law, and these criteria apply when reviewing an individual's status for purposes of the Connecticut sales and use taxes on personnel services. The existence of an employer-employee relationship is determined by the substance of the relationship, not the label, and all information that provides evidence of the degree of control and the degree of independence must be considered.

To determine whether a service involving an employee who performs computer and data processing functions is a personnel service or a computer and data processing service, it is necessary to examine how much control the service recipient has over what the employee does and how it is done.

Although there are no invariable guidelines in this area, the more control the service recipient has over the service provider's employee's duties while the employee is with the service recipient, and the less that employee's duties are related to a predetermined task or project, the more likely the services are personnel services. Conversely, the more the duties performed by the employee fulfill a project or task predetermined by the service provider and the service recipient, and the more control the service provider has over the employee's duties while the employee is with the service recipient, the more likely the service is a computer and data processing service. (However, the fact that a service recipient has control over superficial aspects of the employee's work, such as days or hours of attendance and other rules of general conduct in the work place, is not the deciding factor of the issue.)

Example 1: A bank hires a service provider to provide temporary personnel to fill in for absent employees or to supplement the workforce in its data processing department. The bank has control over the work the employees do and how they do it. The service provider is rendering personnel services taxable at 6%.

Example 2: A bank contracts with a service provider for the provider to perform a project. The project consists of the service provider merging two computer software systems by converting all the files of an old system into files of the new system. The bank and the service provider have predetermined the scope of this project. The service provider places several of its employees at the bank to perform the conversion project. The employees have special skills that enable them to perform systems conversion. These employees work alongside bank employees, work the same hours as bank employees, and often take their breaks and lunch periods with bank employees, although the bank and the agency have prearranged their duties. The service provider is rendering computer and data processing services taxable at the 1% rate.

Example 3: A bank contracts with a service provider to provide several individuals to do routine data processing functions in the bank's data processing department. Although the individuals describe themselves as "independent contractors" and are issued 1099's instead of W-2's by the service provider, the substance of the relationship between them and the service provider meets the criteria in IRS Publication 15-A for the individuals to be considered employees of the service provider. The service provider is rendering taxable personnel services because the bank has control over the work

the employees provided by the service provider do and how they do it.

Business Management Consulting: Some service providers may provide consulting relating to computers and computer systems as part of multifaceted business management consulting contracts. Business management consulting services, enumerated in Conn. Gen. Stat. §12-407(a)(37)(J), are taxable at the 6% rate.

Business management consulting includes only services directly related to the core business activities or human resource management activities of the service recipient. Depending on the service recipient's business and the use to which the service recipient's computers are put, computer consulting may not be directly related to the core business or human resource management of the service recipient. (Conn. Agencies Regs. §12-407(2)(i)(J)-1(h).)

The service provider must separately state charges for computer consulting and show the charges are not related to the recipient's core business or human resource management. Charges for computer consulting services not stated separately from charges for business management consulting services are taxable at 6%.

Stenographic Services: Some service providers who perform typing and data entry on word processing equipment may be providing stenographic services, enumerated in Conn. Gen. Stat. §12-407(a)(37)(H) and taxable at the 6% rate.

Conn. Agencies Regs. §12-426-27(b)(9) defines stenographic services to include typing, taking shorthand, and taking and transcribing dictation for others for a consideration. If a service provider's duties are confined to typing or transcription of text, even if the typing and transcription are performed on word processing equipment, and even though the typing may be referred as data entry, the services are stenographic services and not computer and data processing services.

Effect on Other Documents: This Policy Statement modifies and supersedes **Policy Statement 2004(3), Sales and Use Taxes on Computer-Related Services and Sales of Tangible Personal Property.**

Effect of This Document: A Policy Statement explains in depth a current Department of Revenue Services (DRS) position, policy, or practice affecting the tax liability of taxpayers.

For Further Information: Call DRS during business hours, Monday through Friday:

- **1-800-382-9463** (Connecticut calls outside the Greater Hartford calling area only); **or**
- **860-297-5962** (from anywhere)

TTY, TDD, and Text Telephone users only may transmit inquiries anytime by calling 860-297-4911.

Forms and Publications: Forms and publications are available anytime by:

- **Internet:** Visit the DRS website at **www.ct.gov/DRS** to download and print Connecticut tax forms; **or**
- **Telephone:** Call **1-800-382-9463** (Connecticut calls outside the Greater Hartford calling area only), and select **Option 2** from a touch-tone phone **or** call **860-297-4753** (from anywhere).

Paperless Filing/Payment Methods (fast, easy, free, and confidential):

- **For business returns:** Use **Fast-File** to file sales and use taxes, business use tax, room occupancy tax, estimated corporation business tax, business entity tax, attorney occupational tax, nursing home provider fee, admissions and dues tax, or withholding tax returns over the Internet. Visit the DRS website at **www.ct.gov/DRS** and click on **File/Register OnLine**.
 - **For payment of business taxes other than those listed above:** Use **Fast-File** to pay your business taxes over the Internet or by phone. Visit the DRS website at **www.ct.gov/DRS** and click on **Electronic Services** for a list of eligible taxes. The ACH debit method is used to make the transfer. No pre-registration is required.
 - **For resident income tax returns:** Use **WebFile** to file personal income tax returns over the Internet. Visit the DRS website at **www.ct.gov/DRS** and click on **File/Register OnLine**.
 - **For electronic filing of income tax extensions, estimated payments, and for electronic bill payments:** Use **WebFile** to electronically file personal income tax returns over the Internet. You can also use **WebFile** to make an electronic income tax payment for a prior year. Visit the DRS website at **www.ct.gov/DRS** and click on **File/Register OnLine**.
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