

# City and County of Denver, Colorado

## TAX GUIDE

### *Topic No. 18*

## SOFTWARE

The Denver Revised Municipal Code (DRMC) imposes sales or use tax on the purchase price for software programs, software as a service, software license fees, and software maintenance agreements (collectively referred to in this tax guide as “software”). Taxability depends on whether the transactions meet conditions of Sections B [Note: Section B is the only section that addresses taxability. The other sections address other things, including non-taxability, etc.] in the following guide. *See* DRMC §§ 53-54(7) and 53-104(7).

### A. Definitions

**The following definitions are intended to aid in understanding the subject matter. They are in simple and straightforward language. They are not binding on the Manager of Finance, nor do they replace, alter, or supplant the definitions in Chapter 53 of the D.R.M.C.**

1. Software Program: A software program means a sequence of instructions that can be measured, interpreted and executed by an electronic device (e.g. a computer). Software program includes:
  - a. Custom software program, which is a software program prepared to the special order or specifications of a single customer;
  - b. Pre-written software program, which is a data processing program prepared for sale or license to multiple users, and not to the special order or specifications of a single customer. Pre-written software is commonly referred to as “canned,” “shrink-wrapped,” “off-the-shelf (“COTS”),” “mass produced” or “standardized;”
  - c. Modified software, which is pre-written software that is altered or enhanced by someone other than the purchaser to create a program for a specific user; and
  - d. The generic term “software,” “software application,” as well as “updates,” “upgrades,” “patches,” “user exits,” and any items which add or extend functionality to existing software programs.
2. Software as a Service: Software that is rented, leased, or subscribed to from a provider and used at the consumer’ location, including but not limited to applications, systems, or programs.
3. Software License Fee: A fee charged for the right to use, access or maintain software programs.
4. Software Maintenance Agreement: An agreement, typically with a software provider, that may include provisions to maintain the right to use the software; provisions for software upgrades including code updates, version updates, code fix modifications, enhancements and added or new functional capabilities loaded into existing software; or technical support.
5. Purchase Price: The consideration paid to acquire title (ownership) or possession (license/usage fee/right to use) of software.

6. Retailer: Any person making a retail sale of software.
7. Retail Purchaser: Any person making a retail purchase of software. A retail purchaser is generally the end user or consumer of the software.
8. Retail Sale or Retail Purchase: The transfer of title (ownership) or possession (license/usage fee/right to use) of software, conditionally or absolutely, for consideration (measured in currency). The term does not include sales of personal services, including “work for hire” as described herein.
9. Wholesaler: Any person who sells software to a licensed retailer or other wholesaler, for the purpose of resale.
10. Wholesale Sale: A sale of software to a licensed retailer or wholesaler, for the purpose of resale. This includes the sale of software that will be incorporated into other software that will be resold.

## **B. When Denver’s Sales or Use Taxes Apply**

**Note: As a general matter, items B.1 and B.2 must exist for a purchase of software to be taxable in Denver. Each purchase of software must be examined on a case-by-case basis to determine whether Denver’s sales or use taxes apply. Examination may include the review of documentation such as contracts, invoices, or other transaction documents.**

1. **The sale, storage, use distribution or consumption must occur in Denver.** The sale, storage, use, distribution or consumption of the software must occur in Denver for the transaction to be subject to Denver’s sales or use taxes. Software that is used in Denver is subject to Denver’s sales or use tax, regardless of where the software resides (inside or outside of Denver). If a retail purchaser uses software both inside and outside of Denver, Denver’s tax is due only on the portion of the purchase price attributable to the software used in Denver. If the software resides on a server outside Denver and one or more users located in Denver access the software, only those charges attributable to the use of the software in Denver are subject to Denver’s taxes.
2. **The transaction must be a retail sale.** For Denver’s sales or use tax to be due, the transaction must meet the definition of a retail sale. In other words, there must be:
  - a. a retailer and retail purchaser;
  - b. a transfer of title or possession of the software; and
  - c. consideration must be given for the transfer of title or possession.
3. **Mandatory service charges to acquire software programs.** All mandatory service charges that must be paid by the retail purchaser to acquire title or possession of software are subject to sales or use tax, even if the mandatory service charges are separately stated in a contract, invoice, or other transaction document. A service charge is mandatory if the retail purchaser cannot acquire title or possession of the software program from the retailer without also paying the additional charge. Note: If the retail purchaser may forego the charge, or pay the charge without also purchasing the software the charge is not mandatory

## **C. When Denver’s Sales or Use Tax Does Not Apply**

1. **The sale, storage, use, distribution or consumption does not occur in Denver.** If the software is not sold, stored, used, distributed, or consumed in Denver, there is no Denver sales or use tax due.

1. **The sale is not a retail sale.** A transaction will not meet the definition of a retail sale, and therefore will not be subject to Denver's sales or use tax, if any of the following are true:
  - a. The transaction lacks either a retailer or a retail purchaser;
  - b. The transaction does not involve a transfer of title or possession of the software; or
  - c. no consideration is given for the transfer of title or possession.
  
2. **The sale is a wholesale sale.** When software is sold to a retailer or wholesaler for resale or for incorporating the software into other software for resale, the sale is a wholesale sale and is not subject to Denver's sales or use taxes. Note: If the software is not resold, but is instead used by the retailer or wholesaler in Denver, then Denver use tax is due.
  
3. **Non-mandatory service charges to acquire software.** Charges for services that are not mandatory to acquire title or possession of software are not subject to Denver's sales or use taxes, if they are separately stated and identified in a contract, invoice, or other transaction document. A charge is not mandatory if the retail purchaser can forego the charge or can acquire title or possession of the software from the retailer without also paying the additional charge for the service.
  
4. **Sale of Personal Services.** The sale of personal services is not subject to Denver's sales or use taxes. A distinction exists between the retail sale of a software and the sale of personal services. A retail sale must contain the elements listed in B.1 and B.2 above. As an example, a sale of personal services exists when the service provider does not have any rights in the work in progress, own the work in progress at any time, or have the right to reuse or resell the work in progress or the completed work product. This is commonly referred to as "work for hire." Examples of non-taxable personal services may include the following:
  - a. Installing software;
  - b. Writing code;
  - c. Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized);
  - d. Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required);
  - e. Consulting services (e.g., study of all or part of a software system);
  - f. Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated);
  - g. Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial);
  - h. Providing technical help, analysts and programmers, usually on an hourly basis;
  - i. Training services;
  - j. Maintenance of equipment (See Denver Tax Guide Topic No. 54 for application of the tax to Maintenance Agreements); and

k. Consultation as to use of equipment.

**D. Other Important Information: Who is Responsible for Paying the Tax; Delivery Method for Acquiring and Using Software.**

If the purchase of software meets the criteria detailed above in B.1 and B.2 then:

5. The retail purchaser is responsible for paying the tax, either as a sales tax (to a licensed Denver retailer) or as use tax (if the purchaser did not pay sales tax).
6. If a Denver retailer makes a retail sale and fails to appropriately charge, collect and remit sales tax, then under the Denver Revised Municipal Code, the retailer can be held liable for the sales tax. As noted above in D.1, the purchaser is also liable to pay use tax (Denver would only collect the tax once, either as sales tax from the retailer who failed to appropriately charge, collect and remit the tax or as use tax from the purchaser).
7. The delivery method for acquiring or using software does not affect its taxability. The software can be acquired through a tangible medium (disk, flash drive, etc.), by electronic delivery (download from the Internet), by load and leave, or used/accessed through any medium, such as accessing software via the Cloud.

**EXAMPLES**

1. Company A, located in Denver, purchases pre-written software from Software Retailer, a licensed Denver retailer. Software Retailer requires that Company A also purchase its software implementation service in order to acquire the pre-written software. Company A must pay sales tax to Software Retailer on the purchase price paid for the pre-written software and the implementation service. Because Company A's purchase of the implementation service is mandatory, the stated charge for the service is considered part of the taxable purchase price for the software.
2. Company A hires Company B, a consulting firm, to modify software already owned by Company A. Company B supplies software programmers to perform the modifications (including writing new lines of code), for which Company B charges an hourly rate for each programmer or a fixed rate for the entire project. Throughout the course of the modifications, Company A owns all work for hire or work in progress. These charges are not taxable because there is not a transfer of title or possession of software.
3. Company Z, a Denver based business, hires Company Y, a software development firm located in Denver to create a new accounts receivable software application for them. The lump-sum purchase price stated in the contract is \$510,000, payable in three equal payments, one at the end of conceptualization and design, the next at the beginning of user acceptance testing, and the final payment when the application is completed and rolled out in production. The contract also specifies that Company Z has title to the software at all times, during all work in progress and when completed. The contract specifies that Company Y has no rights, or title to the software, nor can they reuse or resell it. This is a work for hire and not subject to Denver sales or use tax, since there was no transfer of title or possession, and since Company Z had constructive possession of the software at all times. Note: A person has constructive possession of property (software in this case) if he has power to control such item.
4. Company A, a Denver based software company, is hired by another Denver-based software company, Company B. Company A creates a portion of new software, which will be incorporated into the finished

software that Company B will sell to consumers. The transaction between Company A and Company B is a wholesale sale, and thus non-taxable. Any retail sales of the finished software by Company B, to Denver purchasers, are subject to sales or use tax.

5. Company A, located in Denver, enters into an agreement with Software4U to develop custom software. Software 4U is a software development firm located in Boulder that is not licensed in Denver. Software 4U owns the work in progress throughout the development of the software, and transfers ownership or a license to use the software to Company A after it has been completed. Software 4U also sells Company A an installation service for a separately stated charge. Company A was not required to purchase the installation service as a condition to acquire the software. Company A must pay use tax to Denver on the price paid for the custom software. However, the charge paid by Company A for the separately stated installation service is non-taxable.
6. Deluxe Accommodations, which operates a hotel in Denver, is a franchisee of a national hotel chain. As part of its franchise agreement, Deluxe pays for licenses to use the franchisor's internet-based reservation software. Deluxe's reservation system automatically uploads and downloads information pertaining to room availability, reservations, price information, and reports to and from the franchisor's reservation system. The full amount paid by Deluxe for the right to access the franchisor's reservation software is taxable.
7. Company A, located in Denver, purchased several licenses to use software from Company B, located in Florida. Company A's employees access the software, located on Company B's server in Florida, via the Internet. In addition to their monthly license fee, Company B also charges Company A a mandatory monthly CPU usage charge. In this example, both the monthly license fee and the CPU usage charge to use the software are taxable.
8. Graphic Design/Advertising Company A, located in Denver, hires Company B, a software consulting firm, to implement a web or application design for software that will be owned by Company A or a client of Company A. Company B supplies software programmers to perform the development (including writing new lines of code), for which Company B charges an hourly rate for each programmer or a fixed rate for the entire project. Throughout the course of the development, Company A owns all work for hire or work in progress. Company B's charges are not taxable because there is no transfer of title or possession to use the software.
9. Company A, located in Denver, hires Company B, also located in Denver, to develop a custom software program. Pursuant to the contract (work-for-hire), Company A maintains title to all work in progress, as well as the finished product. The contract calls for two equal payments, one when the software program is submitted for user acceptance testing and the other when the program is ready to go into production. Company A makes the first payment as agreed. However, when the program is ready to go into production, Company A informs Company B that they cannot make the second payment. Company B, then refuses to turn over the software program to Company A, since Company A has defaulted on the contract. The two decide to end their contract and relationship, and Company B retains the first payment and the program they created. In this example, there is no tax due, because there was not a retail sale. However, if Company B ends up reselling the program they developed, then that sale (if it meets the requirements detailed in B.1 and B.2) would be subject to sales or use tax.
10. Company X provides technical support for software issues for Company A. Company A may call Company X to help resolve software issues or it may allow Company A to remotely log into their computers to navigate and resolve the issues directly. If the technical support charge is separately stated from any maintenance agreement charges that allows for software updates and upgrades to be sent to the customer, the technical support charges are nontaxable.

11. Company AB Cloud is a provider of cloud computing services. They host the infrastructure components usually found in a data center, including server storage and networking hardware. They provide infrastructure as a service (IaaS) on a pay-per-use basis to charge customers for the amount of virtual space they need to run their own software or systems. The separately stated charge for the virtual space is non-taxable to the customer. The IaaS provider will owe sales/use tax on the hardware they purchase to provide their services if they are located in Denver.

#### RELATED TAX GUIDE TOPICS

Information Services  
Maintenance Agreements

#### REFERENCES

- \* DRMC Section 53-53(14) Definitions – Gross Sales
- \* DRMC Section 53-53(21) Definitions – Purchase Price
- \* DRMC Section 53-53(28) Definitions – Software Program
- \* DRMC Section 53-53(29) Definitions – Software as a Service
- \* DRMC Section 53-53(30) Definitions – Software License Fee
- \* DRMC Section 53-53(31) Definitions – Software Maintenance Agreement
- \* DRMC Section 53-54(1) Imposition of tax.
- \* DRMC Section 53-54(7) Imposition of tax.
- \* DRMC Section 53-103(15) Definitions – Gross Sales
- \* DRMC Section 53-103(23) Definitions – Purchase Price
- \* DRMC Section 53-103(34) Definitions – Software Program
- \* DRMC Section 53-103(31) Definitions – Software as a Service
- \* DRMC Section 53-103(32) Definitions – Software License Fee
- \* DRMC Section 53-103(33) Definitions – Software Maintenance Agreement
- \* DRMC Section 53-104(1) Imposition of tax
- \* DRMC Section 53-104(7) Imposition of tax.

*The complete Denver Tax Guide, the Denver Revised Municipal Code (DRMC), tax forms, and other related information and forms are available on-line at [www.denvergov.org/treasury](http://www.denvergov.org/treasury).*

THE ABOVE INFORMATION IS A SUMMARY IN LAYMAN'S TERMS OF THE RELEVANT DENVER TAX LAW FOR THIS INDUSTRY OR BUSINESS SEGMENT. IT IS NOT INTENDED FOR LEGAL PURPOSES TO BE SUBSTITUTED FOR THE FULL TEXT OF THE DRMC AND APPLICABLE RULES AND REGULATIONS.