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## Letter Ruling 00-14: Database Service - Sales and Use Tax Issues

September 21, 2000

You request a letter ruling on behalf of \*\*\*\*\* (the "Company"), a World Wide Web based business that provides researched information to customers through the Internet. You ask whether the information service, which includes access to the Company's database and the transmission of information through the Internet, is a taxable service. You also ask whether sales of software to support the information service are taxable sales.

### I. Facts

The following is your representation of the facts upon which we base this letter ruling. The Company is a World Wide Web based business that provides researched information to customers through the Internet. Customers have access to the Company's database through the Internet, and the Company sends updates of information to its customers through the Internet. The Company provides its customers with a suite of canned software necessary to access the researched information. The software is transferred to the customers either through the Internet or on a tangible medium. Part of the software suite is canned software manufactured by another corporation, enhanced by the Company, and sold to customers. The Company itself develops the rest of the software suite. The Company separately states charges for the portion of the software suite that is manufactured by the other corporation and enhanced by the Company, and collects a sales tax on that price. The Company does not charge its customers, and does not collect or pay a sales or use tax on the software developed exclusively by the Company. Access to the database provided by the Company and the information update service is sold to customers in a twelve-month subscription format. The Company uses a GAAP standard of deferring the revenue over a twelve-month period.

### II. Issues

1. Whether access by the Company's customers to its database through the Internet is a taxable sale or service.
2. Whether the provision of periodic updates of information by the Company to its customers through the Internet is a taxable sale or service.
3. Whether the sale of software by the Company to its customers either through the Internet or on a tangible medium is a taxable sale, and what is the sales price of the canned software.
4. Whether the provision without charge of canned software that is used to access the Company's

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database to its customers is a taxable sale.

### III. Rulings

1. Access by the Company's customers to its database is not a taxable sale or service.
2. The transmission of software and of periodic updates of information by the Company to its customers through the Internet is not a taxable sale or service.
3. The sale of canned software by the Company to its customers through the Internet is not a taxable sale. The sale of canned software by the Company to its customers on a tangible medium is a taxable sale. The sales price of canned software on which tax is due is the separately stated price of the software.
4. The provision without charge of canned software that is used to access the Company's database to its customers is not a taxable sale. The Company is considered the user of the software and must pay a use tax thereon. The value of the software on which a use tax is due is the cost of the computer disks to the company.

### IV. Discussion

Massachusetts imposes a five percent excise on all sales of tangible personal property and telecommunications services within the Commonwealth. G.L. c. 64H, §§ 1, 2. A complementary five percent use tax is imposed on tangible personal property and telecommunications services purchased for storage, use, or other consumption within the Commonwealth. G.L. c. 64I, §§ 1, 2. A "sale" includes any transfer of title or possession, or both, of tangible personal property and of taxable telecommunications services. G.L. c. 64H, § 1. Taxable telecommunications services are defined as "any transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiberoptics, laser, microwave, radio, satellite or similar facilities but not including cable television. G.L. c. 64H, § 1 (effective July 1, 1999). The definition formerly excluded Internet access services, electronic mail services, electronic bulletin board services, web hosting services or similar on-line computer services. St. 1997, c. 88, § 23 (effective September 1, 1990 through June 30, 1999). Despite the change in statutory definition, federal law prohibits Massachusetts from imposing a tax on Internet access and electronic commerce for a three-year period beginning October 21, 1998. See H.R. 4328, Laws 1998. See also TIR 99-2.

Generally, charges for access by telephone or other means to databases stored in computer equipment not on the premises of the customer are not taxable. 830 CMR 64H.1.3(13). Charges for the Company's database access service are therefore not a taxable sale. Charges for transmitting computer software or reports of any type by telephone lines, microwaves, or other electronic modes of transmission are not taxable, unless the Company transfers an otherwise taxable storage medium imprinted with the programs or reports as part of the same transaction. 830 CMR 64H.1.3(12). The Company's transmission of computer software and of reports of information to its customers through the Internet, when unaccompanied by a medium imprinted with the programs or reports, is therefore not a taxable sale.

A sale of canned computer software on a tangible medium is a sale of tangible personal property subject to tax. See 830 CMR 64H.1.3(4), (2). If the Company combines a taxable sale of software with a tax-exempt contract for its database access service, the company should separately state the price of the software. See, e.g., DD 94-3, "Sales Tax on Taxable Tangible Personal Property when combined with Tax Exempt Tangible Personal Property." The sales tax is imposed on the separately stated price of the software. See G.L. c. 64H, § 2; Cf. 830 CMR 64H.1.3(13)(d).

The Company also transfers canned software that it develops itself on a tangible medium to the customers without separately stating the cost of the software. The software at issue is part of the suite of software that is necessary for customers to access the database service. The Supreme Judicial Court has reviewed transactions that comprise both sales of tangible personal property and a tax-exempt service. The Court has concluded that "where the services and the property are inseparable, because of the integrated nature of the transaction, the character of the transaction

must be analyzed to ascertain whether the buyer's basic purpose was to acquire the property which was sold to it, or to obtain the services." *Houghton Mifflin Co. v. State Tax Commission*, 373 Mass. 772, 774 (1977), *quoted in Commissioner of Revenue v. Houghton Mifflin Co.*, 396 Mass. 666, 670 (1986). In this case, the buyer's basic purpose is the purchase of the non-taxable service, and the transfer of software without a separate charge is not a taxable sale.

Because the transfer of tangible property is not a taxable sale in this case, the Company is considered to be the consumer of the software and is liable for a use tax thereon if no sales tax has been paid. See G.L. c. 64I, §§ 2-6, G.L. c. 64H, §§ 1-5. The use tax is imposed on the cost of the tangible property to the Company, namely, the cost of the computer disks. G.L. c. 64I, § 2.

#### V. Conclusion

The Company only needs to charge its customers sales tax when it sells tangible personal property or taxable services to its customers. Database access services and sales of information or software over the Internet are not taxable sales or services. The sales of canned software on a tangible medium are taxable, and the sales price subject to tax is the separately stated price of the software. The Company is considered the user of the canned software it develops and transfers to its customers on a tangible medium without charge. It must pay a use tax on the cost of the computer disks it uses.

Very truly yours,

/s/Frederick A. Laskey

Frederick A. Laskey  
Commissioner of Revenue

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