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## Letter Ruling 93-2: Upgrades of Canned Computer Software

March 18, 1993

### I. Facts

You have requested a letter ruling on behalf of \*\*\*\*\* ("the Company"), a Massachusetts corporation in the business of developing and manufacturing canned computer software products. The Company sells its canned software at different prices depending on the customer's use of the program. A higher price is charged if the customer uses the program on more advanced or a greater number of computer systems. If the customer originally purchased the canned software at a lower price range and later seeks to use the program on more advanced systems or on a greater number of computers, a "license upgrade" must be purchased from the Company.

No additional software is sent to a customer purchasing a license upgrade. The customer receives an upgrade license agreement and a new password which allows them to install the original software on more or different computers. The upgrade license agreement states that the software is licensed for use only to the extent allowed and that no ownership is transferred to the customer with the Company retaining all proprietary rights and title to the software.

### II. Ruling Requested

You have asked the Department to rule that these license upgrades are not taxable sales because they do not involve the transfer of tangible personal property. We rule that these software license upgrades are taxable sales of tangible personal property.

### III. Discussion

Massachusetts imposes a five percent sales tax on all retail sales of tangible personal property in Massachusetts, unless otherwise exempt. See G.L. c. 64H, § 2. A "retail sale" is a sale of tangible personal property for any purpose other than resale in the regular course of business. G.L. c. 64H, § 1. A "sale" includes "any transfer of title or possession...lease, rental...of tangible personal property...for a consideration, in any manner or by any means whatsoever...." G.L. c. 64H, § 1.

The Company does not question that the original sale of canned software is a taxable sale of tangible personal property. Despite the Company's invoice and software license agreement documents asserting that no transfer of title occurs with the sale of the canned software, the right to use canned software is a taxable sale of computer software, "regardless of how the transfer is

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characterized by the parties." 830 CMR 64H.1.3(2). In addition, upgrades to canned software are taxable. 830 CMR 64H.1.3(7)(d). Therefore, the subsequent license upgrade which is a sale of the right to use canned software is a taxable sale of computer software.

There is also no question that the original sale of canned software transferred possession of tangible personal property from the Company to the customer and was therefore a "sale" as defined under the sales tax statute. See, G.L. c. 64H, § 1. Computer software contained on magnetic media or any other medium readable only by computer, is tangible personal property. 830 CMR 64H.1.3(2). It is the Company's assertion that the subsequent license upgrade involves no additional transfer of tangible personal property and therefore is not a "sale" of a canned software upgrade.

We do not agree that the subsequent license upgrade does not involve the transfer of tangible personal property. The new password and software license agreement allows the customer to use the canned software program contained on the medium in the possession of the customer. It is the same medium which was transferred in the original sale of the canned software. However, the original sale transferred "rightful possession" of only the lower priced use of the canned software program. The higher priced use of the program was physically transferred on the medium but the customer did not have "rightful possession" until the subsequent sale of the license upgrade including the new password was completed. A transaction which transfers "bare possession" without the "right to possession" is not a "recognizable taxable event...under our sales and use tax law." Kamataris v. Commissioner of Revenue, A.T.B. No. 139428 (June 14, 1985). Therefore, when the right to possession of the upgrade was transferred, the taxable event of the transfer of tangible personal property occurred.

#### IV. Ruling

We rule that under the facts presented by the Company, the software license upgrades are taxable retail sales of tangible personal property.

Very truly yours,

/s/Mitchell Adams

Mitchell Adams  
Commissioner of Revenue

MA:HMP:jmw

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